AFME/ESF and IMN Global ABS 2012 Conference

Keynote address

12 June 2012

1. MACROECONOMIC & POLITICAL ENVIRONMENT

Ladies and gentlemen,

Europe is facing turbulent times. The economic prospects are generally not very positive. Economic activity is expected to stagnate in the coming months. Our determination and political unity are being tested right now.

The **sovereign crisis** is the immediate challenge that we have to deal with and the regulatory focus is on the safety and resilience of financial markets to ensure macro financial stability. But over the longer term, we have the equally substantial task of financial sector reform to correct the regulatory failures of the last decade.

There are voices saying that our reform program is excessive and burdensome for the industry and does not facilitate economic growth. However, the recent crisis has shown all the negative effects that mainly result from insufficient and lax regulation and supervision.

Our financial reform agenda aims to ensure that financial services play a vital role and contribute to our ultimate goal of restoring economic growth by making institutions and financial markets more stable, transparent and accountable, supported by strong infrastructure and supervision harmonised throughout Europe.

Our ambitions are shared worldwide. All major economies are engaged in the G20 reform agenda which is due to be implemented by 2013.

Europe has taken a number of substantial measures in line with the G 20 commitments:

- **We are building firewalls.** The European financial stability fund already has a lending capacity of €440 billion euros to help countries facing difficulties and, as from this summer, we will have a new bigger, stronger and better fund in place: the European Stability Mechanism;

- **We are strengthening European banks.** The European Council launched in October 2011 an extraordinary exercise implemented by the European Banking Authority (EBA) in order to ensure that the biggest European banks will all have a significant capital basis to face the risk of a potential sovereign debt crisis. The European Central Bank is providing significant amounts of short and mid-term liquidity to the EU banking sector. These two processes are bringing back stability and confidence in the market. In addition, it becomes clearer and clearer that there is political will to move towards a **banking union** including an integrated financial supervision, a European resolution fund and a single deposit guarantee scheme.

- **We are reforming European economic governance**. This is not a question of minor tweaks. Rather, it is a fundamental overhaul: all member states agree on the need for budgetary discipline and fiscal stability in the medium term and a new legally-binding Treaty (recently endorsed by Ireland in a referendum) known as the fiscal compact establishes a strict and credible process within the EU to ensure this.

- **We proposed a European resolution regime,** a key measure towards financial stability without leaving the entire burden to EU tax payers.

The upcoming EU Council end of June will discuss next steps towards deepening the economic and monetary union including progress towards a fiscal union. In addition there is broad support for a discussion on how to advance on a banking union in general.

All these measures are very important but in order to achieve a stable return to **growth** we cannot disregard the central role that the financial services sector must play in backing the recovery.

Financial services play a crucial role in our economy – matching savers to borrowers, helping to manage risk, and providing firms and individuals with the means to make and receive payments. It is therefore critical for the efficiency of the wider economy and the Single Market that the financial sector functions efficiently.

Consequences of the two existing financial crises – the financial shock in 2007-08 and the sovereign debt crisis in 2010-11 – are still on-going and financial markets have been at the heart of both. This has shown the disastrous effects stemming – amongst other reasons - from inadequate, lax and ineffective regulation and supervision of the financial sector. By making financial institutions and markets more stable, transparent and responsible, underpinned by sound infrastructure and consistent supervision across the EU, **our regulatory reform agenda is designed to prevent or mitigate the probability that future crises can take place and ensure that financial services play their essential and positive role, supporting our ultimate goal of restoring growth**.

Reform is vital to entrench stability in the financial sector and stability is itself a vital precondition of sustainable growth. Financial crises, in particular if they are global crises, have a huge impact on growth. One of the key goals of financial regulation is to prevent or mitigate future crises by making financial institutions and markets more stable and transparent. If we achieve this, regulation can help increase growth over the cycle.

Delivering on the objectives just mentioned presents the challenge of ensuring the effective implementation around the globe of financial regulation and supervision coordinated at the international level. Therefore, the reform agenda is not being pursued uniquely in the EU alone. What we are doing in the EU is part of a concerted effort at global level since all the major world economies have committed, through the G20, to reforming their financial sectors by 2013 under the close monitoring of the Financial Stability Board.

The G20, and its regulatory reform implementation body, the Financial Stability Board, have become the prime global fora for economic and regulatory policy to address macro-economic imbalances. The EU is a very active member in these discussions. Inadequate international co-operation was one of the hallmarks of the crisis, and the lesson has been learnt.

2012 is a busy year for the implementation of the G20 commitments, with FSB charged with numerous work streams, for example on assessment of vulnerabilities, work regarding SIFIS or data gaps. It is important not to lose the momentum on financial regulation in the FSB and G20 process.

We participate in the IOSCO working group dedicated to the securitisation, where the retention requirements and measures aimed at enhancing transparency and standardisation of disclosure for asset-backed securities are examined. The FSB intends to develop policy recommendations in this area by July 2012 aimed at requesting all jurisdictions to adopt comparable and compatible frameworks. The Commission will support appropriate recommendations by IOSCO to eliminate those material differences between jurisdictions that could make the rule less effective in a specific jurisdiction, creating risks to financial stability or distortions of competition and disadvantages for market participants from other jurisdictions, being specified that the alignment shall be reached on more stringent rules.

2. MAIN CHALLENGES AND WORKSTREAMS IN 2012 FOR SECURITISATION MARKETS

Securitisation markets are one of the areas where the regulatory reform at EU and global level can bring incentives to reactivate these markets to better serve the real economy. Let me try to guide you through the state of the work and debates with respect to specific regulatory initiatives, particularly in terms of those which are being considered to strengthen securitisation markets.

For this purpose, I propose first to go through initiatives which are conducted at a global level. In a second step, I will give you an overview of legislative initiatives falling directly within the remit of the Commission and which are aimed to revive the market for securitised products, mainly by ensuring suitable risk-retention and enhancing transparency.

2.1. Initiatives at a global level

Securitisation and shadow banking

As you know, regulation of the **shadow banking** system has been on the G20 agenda since the Seoul summit in 2010.

The Commission has made shadow banking one of the priorities for 2012, alongside other key topics such as the European framework for the prevention and resolution of banking crises, a discussion of the structural measures in the banking sector and measures to protect investors and users of financial services.

The Commission intends to fill the last gap in the new regulatory and supervisory framework by addressing shadow banking activity and entities. In doing so, it intends to anticipate and prepare for any potential future developments that may once again threaten the stability of our financial system.

There remains a rapidly growing area of non-bank credit activity, which is not subject to the same degree of internationally-agreed and coordinated regulation and supervision. The financial crisis has shown that this **shadow banking** can pose major threats to long-term stability. As long as this activity and entities remain less well-regulated, the tightening of banking regulations could drive many parts of banking activities towards shadow banking, heightening the risks still further. This issue is now being discussed at international level. The EU is actively contributing to this work.

Of course, it is far too early to reach any specific conclusions. **However, based on the work carried out by the FSB, we have so far identified securitisation as a main activity that does not need more regulation**

but needs to be revived subject to better regulation in order to ensure better investor protection and financial stability.

Indeed, the Commission has highlighted the need to ensure safer and sounder securitisation practices in the recently adopted Green Paper on Shadow Banking.

ECB ABS Loan-level Initiative

The ECB is also dealing with this subject by launching a data warehouse for the processing, verification and transmission of loan-level data. Of course, the Commission welcomes this initiative and totally shares the aim of standardisation of loan level reporting in order to improve transparency and helping to restore investor confidence in the European securitisation markets.

The Prime Collateralised Securities (PCS)

In addition, various market-led initiatives have been taken to increase product transparency in the securitisation market. The Commission supports such type of initiatives, but, the question remains whether they might differ from one Member State to the other since the implementation of and compliance with the self-regulatory rules is voluntary.

The most advanced one is surely the AFME led the Prime Collateralised Securities (PCS) announced today which could enhance market standards by means of an independent entity that grants a securitisation label.

The Commission considers this initiative presents a threefold advantage:

1. standardisation will help in making sure that securitisation is safer in the future and does not jeopardise the stability of the overall financial system;
2. this initiative could allow for a better comparison between the products to the benefit of investors; and
3. this initiative does not prevent incentives to innovate and respond to investor demand for bespoke complex products in justified cases.

In addition, the Commission considers that PCS has to fulfil two absolute obligations:

1. the minimum standards required for the underlying assets shall be set at a level guaranteeing their better quality; and
2. PCS labelling shall be open and inclusive vis-à-vis newcomers to avoid the risk of becoming a closed shop and act in all transparency with the way it manages any conflict of interests in its governance bodies.

Accounting matters

In addition, accounting matters are important in this field. For example, the manner in which entities account for securitized assets may differ depending on whether they use IFRS or U.S. GAAP. These differences may be significant to entities investing in ABS, which are subject to the accounting rules, and investors in entities holding ABS, which rely on such accounting disclosure.

2.2. Commission's legislative initiatives

In the EU we have not initiated any specific legislative initiative aimed at reviving the markets for securitised products. However, important measures have been introduced in specific legislative proposals that should help the reviving of sound securitisation markets:

First, **risk retention**. Regarding **risk retention** - to achieve the "skin in the game" objective – the **CRD III** Directive, in force since the end of 2010, requires that when a regulated institution wants to invest in Assets Backed Securities, it has to ensure that the originator, the originating lender or sponsor must retain an economic interest equal to at least 5% of the assets securing the issue of securities. The current proposals on **CRD IV** also significantly increases the levels of capital that banks and investment firms must hold to cover their risks. Similar and consistent requirements are provided for insurance companies (**Solvency II** Directive), alternative fund managers (**AIFM** Directive) and the UCITS funds (**UCITS IV** Directive) which invest in securitisation products. The final calibration for the capital requirements for insurance companies investing in ABS (Solvency II) has yet to be finalised.

Second, **transparency**.

- The new MiFID rules proposed by the Commission will enhance pre- and post-trading transparency for non-equity instruments. This includes further reporting by firms to regulators of transactions and positions in OTC instruments. In addition, the proposals on **MiFID 2** introduce obligations on the management bodies of investment firms to define, approve and oversee a policy as to services, activities, products and operations offered to clients, including the securitization process, and strengthen the powers of supervisory authorities to verify whether the service is provided in an appropriate manner.

- In addition, in order to reduce the overreliance of investors on **credit ratings**, the Commission proposal on CRA III requires issuers to disclose on on-going basis specific information on financial structured products, especially the major elements of the underlying assets, for investors to form their own opinion and avoid the use of external ratings. In addition, further work under delegated acts related to the **Prospectus Directive** will reassess and strengthen disclosure requirements imposed on issuers of securitized products.

3. Conclusion

Securitisation products have been at the origin of the financial turmoil in 2007. The growth of the securitisation market has stalled in the wake of the crisis and there are fears that prospects are for further decline. We need to make sure that securitisation is safer in the future and does not jeopardise the stability of the overall financial system.

The Commission considers it desirable to revive the market for securitised products provided that it can serve its function to raise capital to the benefit of the real economy and disperse risk in a safe way.

Our main interest as public authorities is to facilitate the transition away from the current "exceptional" market conditions generally and thus help ensure that credit provision to the real economy is sufficient to sustain the economic activity. Securitisation has a role to play in that process.

Europe has played a key role in driving forward the global agenda. The European Commission has risen to this challenge with a comprehensive programme of financial regulatory reform, aiming at meeting the G20 commitments. It is also key to make sure that the agenda is implemented at global level: problems are global and we need to ensure that rules are consistent so as to avoid regulatory arbitrage leading to risks building in other parts of the world.

Without pre-empting the results of the work conducted at a global level, the Commission will of course support all appropriate recommendations and initiatives to eliminate material differences between jurisdictions that could lead to a circumvention of the rule in a specific jurisdiction, creating distortion of competition and disadvantages for market participants from other jurisdictions.

To conclude, securitisation could become an important source of funding again if we manage to set the adequate framework to stimulate these markets in a sound and safe manner to restore investor confidence and to serve again to the real economy by accompanying and supporting the growth.

Thanks for your attention.

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