ICSA
INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

November 13, 2009

Mr Greg Tanzer
Secretary General
IOSCO
C/Oquendo 12
28006 Madrid
Spain

Re: Public Comment on Transparency of Structured Finance Products

Dear Greg,

The International Council of Securities Associations (ICSA)[1] welcomes the opportunity to provide comments on IOSCO's Consultation Report on the *Transparency of Structured Finance Products* (the "Report"). We would like to compliment the members of the Technical Committee's Standing Committee 2 for the excellent Report that they have prepared. While views amongst ICSA members vary on some of the specific conclusions that were reached, all ICSA members acknowledge and appreciate the balanced and nuanced view taken in the Report. In particular, ICSA members appreciate the Report's acknowledgement that post-trade transparency regimes should be, "… tailored to take into account the unique nature of the market and participants in each jurisdiction, and that each member jurisdiction is best placed to judge the appropriate time, scope and manner for enhancing post-trade transparency." We think this is extremely important given the sharp differences between markets for SFPs in different jurisdictions and for different types of products within the same jurisdiction.

Reflecting the differences of opinion within the industry in general, which are referenced in the Report, there are differences of opinion among ICSA members regarding the need for and

[1] ICSA is composed of trade associations and self-regulatory organizations that collectively represent and/or regulate the vast majority of the world's financial services firms on both a national and international basis. ICSA's objectives are: (1) to encourage the sound growth of the international capital market by promoting harmonisation in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. More information about ICSA is available at: www.icsa.bz

advisability of a mandated post-trade reporting system for structured products. Nevertheless, there are a few individual issues upon which we would like to comment. Specifically, we suggest that the Report should stress, to a greater extent than it currently does, the importance of structured finance in providing credit to the real economy, the extremely low level of liquidity in many parts of the market for structured products at the current time, and the need for regulators to ensure that the introduction of post-trade transparency regimes for structured products does not further reduce market liquidity. We also think that the Report should more fully stress the complementary nature of private sector initiatives that aim to restore confidence in the market for structured products by improving the infrastructure of the securitization market. Finally, ICSA members recommend that principles for post-trade transparency of SFPs should not be developed in isolation but instead should be considered in the context of the ongoing global dialogue regarding post-trade transparency for corporate bonds as well as OTC derivatives.

1. Post-trade transparency in the context of barely liquid or non-existent markets

The Report sets out a very clear assessment of the costs and benefits of post-trade transparency for structured products. On the positive side, the Report concludes that post-trade transparency for structured products may improve: (1) the price discovery process; (2) the valuation of products and portfolios; (3) confidence in the market; and (4) the involvement of retail investors. On the negative side, the Report points out that post-trade transparency for structured products may be inappropriate because of the customized nature of SFPs and the illiquidity of markets for SFPs. The Report also notes post-trade transparency for SFPs could have a negative impact on market liquidity due to the loss of confidentiality of positions and investment strategies.

The Report then sets out a balanced set of recommendations detailing specific issues that should be examined by regulators prior to the introduction of a post-trade reporting system for structured products.

Our main concern has to do with the potential negative impact of mandated post-trade reporting on the market for structured products at the current time. At the Report notes, there were only moderate levels of secondary market trading of SFPs prior to the financial crisis. Moreover, as the Report also notes, both primary issuance and secondary market trading of SFPs have declined significantly since the onset of the financial crisis. Indeed, as is detailed in the IMF's most recent *Global Financial Stability Report*, new issuance of global private label (or non-agency) structured debt fell from a peak of nearly US$5 trillion in 2006 to an estimated US$1 trillion in 2009. The decline would have been even steeper had it not been for the surge in the issuance of mortgage backed securities in the EU, which is comprised almost entirely of issues retained by issuers as collateral for central bank financing.[2]

The decline in new issuance and the virtual disappearance of secondary market trading for most SFPs has contributed to the declining growth in commercial bank lending to businesses and households over the past two years in a number of jurisdictions. The effect of this is greatest in the U.S., where securitization during the past several years is estimated to have funded over 25% of outstanding consumer credit, including nearly 60% of outstanding home mortgages.[3] While securitization played a lesser role in Europe than in the U.S., it was still a significant source of funding in some market segments.[4]

We think that it would be extremely useful for the IOSCO Report to emphasize the critical role that securitization has played in providing liquidity to the real economy and could play in the future. Because of deteriorating bank balance sheets and the prospect of increased capital requirements, it is highly unlikely that deposit-based bank financing alone could substitute for the financing that had been provided by securitization in some jurisdictions and in some markets, most particularly home mortgages. In the absence of such financing, global economic growth could remain constrained for some time to come. This is a critical issue which we believe is not sufficiently underscored in the Report.

As a corollary, we also think that it is important for the Report to stress, to a greater extent than is currently the case, the need for regulators to take a cautious and measured approach to implementing post-trade reporting systems, particularly at the current time, in order to limit any

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[2] International Monetary Fund, *Global Financial Stability Report*, "Navigating the Financial Challenges Ahead", October 2009, page 84. See also Igno Fender and Janet Mitchell, "The future of securitisation: how to align incentives?" *BIS Quarterly Review*, September 2009, pages 27-43.

[3] Cited in George Miller, Executive Director, American Securitization Forum, testimony before the U.S. Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance and Investment, "Securitization of Assets: Problems and Solutions", October 7, 2009, page 3.

[4] Not surprisingly, the authors of the IMF's most recent *Global Financial Stability Report* stress repeatedly that the revival of non-agency securitization is critical for limiting the impact of the financial crisis on the real economy and allowing government and central bank financing to be withdrawn.

negative impact on market liquidity. In particular, as is noted in the Report, post-trade reporting regimes for SFPs must be designed carefully in order to avoid exposure of principal positions and to not discourage market-making in these products. While it is possible that post-trade transparency would contribute to increased liquidity, it is also possible that mandated post-trade transparency could end up harming rather than helping liquidity, thereby hindering the revival of the securitization market and, potentially, negatively impacting global economic growth.

Finally, we suggest that the Report should address more directly the possible accounting issues that may arise if post-trade transparency regimes are mandated for products that are essentially illiquid. As the Technical Committee is aware, markets for certain SFPs, such as agency mortgage-backed securities in the U.S., maintain a certain degree of liquidity. Specifically, SFPs in those markets are traded frequently and can be traded in large blocks with relative ease of execution and settlement. Precisely because of those market characteristics, recent trade prices for those specific products are available and generally reflect the current market valuation of those products. Markets for many other SFPs, however, are much less liquid, with trades occurring much less frequently. For a less liquid SFP, reported prices may not necessarily be a good indicator of the current market value of that specific product These prices may still be useful for investors, as they would be one element in a broader valuation exercise that would include other information such as collateral performance. We are concerned, however, that financial firms holding these illiquid assets may need to use prices derived through post-trade reporting systems for accounting purposes, despite the fact that such prices for many SFPs would not be an accurate reflection of current market valuation of those products. We suggest that this specific issue should be addressed by IOSCO in the final Report.

For all of the reasons noted above, we think it is important that the Report explicitly recommends that the introduction of post-trade transparency regimes should be gradually phased-in, focused on the most liquid instruments, and calibrated in such a way to ensure that market liquidity both overall and in individual product segments is not adversely affected.

2. Importance of industry initiatives

As the Technical Committee is aware, industry participants and their representative organizations are moving forward with important reforms to improve securitization market practices and retool key parts of the market's operational infrastructure.[5] ICSA members believe that these initiatives, which include the provision of frequently updated and standardized reporting data for the underlying assets of SFPs, independent third-party sources of valuation and open access to new data providers' portals, will be extremely important for the recovery of the structured finance market.

These market-based initiatives are referenced in the Report. However, we suggest that the final Report should give more weight to these initiatives, as they will substantially improve transparency early in the transaction chain and therefore are both extremely important on their own and complementary to any regulatory reforms in the structured finance market.

In closing, we would like to reiterate our thanks to IOSCO for the opportunity to comment on this Consultation Report. Please do not hesitate to contact René Karsenti (rene.karsenti@icmagroup.org) and/or Duncan Fairweather (dfairweather@afma.org.au) to discuss the issues contained in this letter.

Yours sincerely,

René Karsenti
Chairman
ICSA

Duncan Fairweather, Chairman
ICSA Standing Committee on
Regulatory Affairs

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5 These include the Ten Industry Initiatives to Improve Transparency in the EU Securitization Market, Project RESTART for RMBS transactions and the ASF Credit Card Disclosure Package in the U.S., and the Global Joint Initiative to Restore Confidence in the Securitization Markets.