June 15, 2009

Mr. Greg Tanzer
Secretary General
International Organization of Securities Commissions
C/Oquendo 12
28006 Madrid
Spain

Re: Public Comment on Consultation Report on Unregulated Products and Markets

Dear Secretary General Tanzer:

On behalf of the American Securitization Forum (ASF), European Securitisation Forum (ESF), International Swaps and Derivatives Association (ISDA) and Securities Industry and Financial Markets Association (SIFMA)[1], we welcome the above-referenced IOSCO initiative and appreciate the opportunity to provide meaningful input in the consultation process. We applaud IOSCO and the Task Force on Unregulated Markets and Products (TFUMP) for their efforts at international coordination on these important topics.

I. Executive Summary

The commenting associations acknowledge that securitization and CDS markets are systemically important, have featured prominently in the ongoing financial crisis and are relevant to a restoration of function and confidence to the global financial markets. We also acknowledge that regulatory reform in certain aspects of both markets is necessary.

Regarding the securitization markets, we believe that:

- Restoration of securitization market function is essential to broader global economic recovery and growth;
- Globally consistent and harmonized approaches to regulatory oversight of securitization market activities should be undertaken, including with respect to those matters that are addressed in the TFUMP report as well as other important matters not within the scope of the TFUMP report;
- We support the policy goal of aligning incentives among securitization market participants. However, we are concerned that mandated retention of risk is unlikely to be the most

[1] A description of the associations is provided in Annex A.

effective mechanism to achieve this policy goal, and believe other alternatives, including disclosure, transparency and other market infrastructure enhancements that facilitate more effective risk identification, assessment and management, are likely to be more effective. However, to the extent that risk retention is mandated, we offer specific implementation suggestions to create workable standards and to avoid undue restrictions on lending and risk transfer activities supported by the securitization markets;

- Certain disclosure and transparency enhancements are desirable, and significant industry initiatives in this area have been implemented, with others in progress. Additional regulatory initiatives in this area—including those relating to enhanced disclosures of quality control and risk management checks and assessments performed on behalf of issuers, independence and reporting requirements for third-party experts, and risk management practices generally, should be coordinated wherever possible with industry initiatives. The industry welcomes the opportunity for further dialogue with IOSCO on these topics; in the meantime, we offer suggestions to avoid an overly broad scope of application of the recommendations set forth in the TFUMP report;

- We believe that regulatory concerns relating to the suitability of certain securitization products for some types of institutional investors, and relative levels of sophistication among those investors, would be best addressed via direct regulation and oversight of those counterparties rather than a broad revisitation of investor suitability requirements generally. Promoting and maintaining international harmony in investor suitability requirements is essential, given the global nature of investment and capital flows in the securitization market;

- We strongly support steps to improve risk management techniques and practices by all securitization market participants, including but not limited to investors; and

- We support a broader examination of the scope and structure of regulatory oversight of securitization market activities globally, and would welcome the opportunity (through an IOSCO/industry working group or otherwise) to have input into that review.

Regarding credit default swaps, we:

- Offer a number of perspectives regarding clearing resources, including those provided by CCPs as well as by individual firms and data warehouses, and their relevance in supporting CDS market functions and systemic risk oversight;

- Agree that standardization of CDS market contracts is an appropriate area of regulatory and industry focus that should continue to be pursued, but note that standardization of all facets of CDS market activity and function (e.g., contracts, settlement mechanics and protocols, post-trade procedures, etc.) should be a part of this process;

- Believe that CDS-specific standards for CCPs should take into account the key features of the CDS and the way these products interact with clearing house arrangements;

- Believe that achieving regulatory transparency—i.e., providing transparency and effective information-sharing of CDS-related activities among supervisors, taking into account the full range of exposures that a supervised firm faces across the full range of financial products in which it conducts business—should be a key area of regulatory focus; and

- Recommend that a number of operational issues should continue to be addressed through ongoing industry-supervisory dialogue and interaction, including those relating to automation of post-trade processes and trade confirmations; risk management systems; valuations; collateral management practices; dispute resolution; and trade compression initiatives.

II. General Introduction: Securitization Market Issues

We acknowledge that securitization markets need reform and broadly agree with IOSCO's assessment of where things went wrong. We also agree with the thrust of IOSCO's recommendations. Where we do have comments, in general they are either because we do not believe that the proposed recommendation is the best way to address the policy objective, or because the scope of the recommendation is unclear.

We agree with the observation that substantial industry responses to securitization market issues and deficiencies have been identified and are underway, such as ASF's Project RESTART and ESF's RMBS Issuer Principles and other EU transparency initiatives. Insofar as possible the industry is discussing and coordinating its market practice and policy responses to key securitization market issues globally.[2] We strongly welcome therefore IOSCO taking into account and, where appropriate, encouraging and supporting such initiatives.

We fully endorse IOSCO's express recognition that the absence of a well-functioning securitization market will adversely impact consumers, banks, issuers and investors, and has substantial implications for global economic recovery and growth. For these reasons it is essential for the securitization markets to recover; this produces a strong alignment of interest within public and private sector to take steps necessary to restore securitization market function and confidence over the short- and long-term.

We agree with IOSCO's recognition that securitization markets and products are not wholly "unregulated" in any jurisdiction and that some products and activities are already heavily regulated in certain jurisdictions. The appropriate focus is therefore not whether securitization should be regulated or not, but the specific nature of, and any gaps in, the current regulatory structure, and the degree to which any new regulations are needed to promote market function, transparency, efficiency, integrity and confidence, taking into account the scope and effect of industry initiatives directed at achieving the same objectives.

We note several other critically important policy topics that were intentionally excluded from scope of the TFUMP Report, but that are being addressed in other IOSCO and global regulatory responses to securitization market issues. Among others, these include valuations, accounting standards reforms, capital adequacy regulations, price transparency and transaction reporting, enterprise risk management and credit rating agency reforms. All of these initiatives are

[2] Examples include the ASF/ESF/AusSF/SIFMA Joint Global Initiative on Restoring Confidence in the Securitization Markets, and coordination of industry responses to securitization risk retention initiatives, accounting standards and regulatory capital proposals, credit rating agency reforms, and other topics having universal application to the securitization markets.

important to the future regulation and oversight of securitization market activities, and must be factored into a comprehensive and coordinated global response.

Overall, we believe that regulatory and other policy responses to perceived securitization market deficiencies should:

- Be pursued only in those areas where there is a clearly-defined need and prospective benefit;
- Reflect a high level of coordination among regulators and policymakers internationally, given global nature and linkages among markets;
- Be aimed at facilitating the return of securitization market activities as part of the exit strategy to the crisis. Securitization is one of the few ways that banks can continue to lend without increasing leverage or using scarce capital and balance sheet resources, which is an important feature for regulators and policymakers to consider, given bank deleveraging underway globally; and
- Take into account the goals, scope and efficacy of corrective/responsive industry initiatives. We strongly welcome IOSCO's consideration of further work with the industry in developing next steps relating to the implementation of certain of the recommendations contained in the TFUMP report.

Our detailed responses to the recommendations contained in the TFUMP report follow. For ease of reference, we have italicized excerpts of specific recommendations.

III. Discussion and Reaction to Section 4 of TFUMP Report—"What are the Issues with Securitisation" and Interim Recommendations

A. Incentive Structure and "Skin in the Game"

The TFUMP report concludes that "wrong incentives" were a key contributor to securitization market dislocations. In particular, the report cites weaknesses in the "originate to distribute model," and that a reconsideration of the incentive structure among securitization market participants/throughout the value chain is required. Here, the report suggests that some asset originators had insufficient incentives to perform quality underwriting or adequate due diligence, or to focus on long-term performance of those assets.

To address these perceived shortcomings, the report suggests consideration be given to *"requiring originators and/or sponsors to retain a long-term economic exposure to the securitization"*

Summary Position

We strongly support steps to support the policy objective of better aligning incentives among securitization market participants. We acknowledge that mandated retention by asset originators or securitization transaction sponsors of some amount of the economic exposure associated with those assets or transactions may provide some level of comfort that incentives of originators and sponsors are aligned with those of end investors. We further recognize that the adoption of retention in European legislation (Article 122a of the Capital Requirements Directive, which will become effective for European credit institutions as of 2011) provides some momentum for adopting a similar approach as a global standard. However, we stress that:

- mandated retention of risk is unlikely to be the most effective policy mechanism to achieve the stated policy goal;

- other mechanisms (as outlined below) are available that would more closely align interests and incentives of securitization market participants; and

- to the extent that IOSCO does recommend retention as a global standard, it should recommend that retention is (i) structured in a manner that preserves necessary flexibility (also as outlined below), in order to be workable at a practical level and to avoid imposing arbitrary and undesirable limitations on the ability to create, manage and transfer risk through responsible securitization market activities, and (ii) implemented in a manner that avoids different substantive approaches, some of which may have extraterritorial application, will produce regulatory inconsistencies, fragmentation and substantially increase compliance costs and burdens. IOSCO can play an important role in driving toward international consistency among workable retention standards, to the extent such standards are adopted.

Detailed Analysis

As confirmed by investor members of our organizations and as discussed at the May 29th industry consultation meeting, we do not believe that many investors or other parties who assume economic risk (including but not limited to credit risk) in securitized assets or transactions consider as particularly meaningful whether or not the asset originator or transaction sponsor retains some portion of that risk. Indeed, those investors, among others, have observed that significant losses have been incurred in securitization transactions where asset originators and deal sponsors retained risk, as well as in securitization transactions where they did not.

Instead, what is of paramount importance in promoting an effective alignment of incentives is the ability of investors and other parties to evaluate and price whatever risk they are assuming. For this reason, we believe that the goal of alignment of incentives among securitization transaction participants is best served by equipping all transaction participants with information necessary to assess and make informed judgments about relevant risks.

Accordingly, the industry has focused considerable energy and resources on initiatives that are designed to produce more extensive, accurate, reliable, standardized and comparable information about securitized assets and transactions. A primary emphasis of this work is the residential mortgage securitization sector, which has constituted the largest and most central securitization asset class globally. It is also the sector for which investors, in particular, have demanded more extensive and higher quality information flows to support their continued participation. While the specifics of these industry initiatives (broadly organized under the auspices of ASF's Project RESTART in the U.S., ESF's RMBS Issuer Principles in Europe, and several similar initiatives globally) differ somewhat due to national and regional differences in the organization and oversight of mortgage finance markets, at their core they are designed to:

- Enhance the scope and quality of securitization transaction information that is captured and reported to investors on an initial and ongoing basis;

- Facilitate meaningful analytical comparisons between and among securitization transactions and the performance of underlying assets upon which payments to securities holders are primarily based, by standardizing basic data definitions and calculations, as well as key securitization contractual terms and provisions;

- Establishing industry-wide due diligence, data verification and quality assurance protocols for securitized assets, thereby promoting improvements in the accuracy and reliability of data used by all parties (e.g., investors, analysts, rating agencies, data and pricing vendors);

- Promoting the creation and adoption of more robust contractual protective mechanisms commonly used in securitizations, such as representations and warranties and related repurchase obligations made by originators/sellers of securitized assets, to produce an ongoing alignment of incentives between and among asset originators, transaction sponsors and investors.

We believe that these improvements to securitization market standards and practices, coupled with effective regulation and oversight of consumer lending practices, are the most direct means of promoting a better and more effective alignment of incentives among all securitization market participants. Such measures would make it far more difficult and less likely for undesirable loan products to be made to consumers, and for unknown or unquantifiable risks relating to those products to be unwittingly assumed by investors via securitization.[3]

To the extent, however, that legislative or regulatory measures are adopted to require retention of some measure of economic or other risk by asset originators or transaction sponsors, we believe the following principles must be observed.

First, policymakers should recognize that any mandated risk retention threshold is, by definition, an arbitrary standard. Depending upon the particular asset and transaction structure, any specific retention threshold is highly unlikely to produce a close alignment of risk exposure and incentives between the parties who are involved in creating, transferring and assuming the risks inherent in a particular securitization due to the unique characteristics of each transaction and differences in relative credit risk among the various asset classes that collateralize securitizations. Progressively higher risk retention thresholds will not necessarily produce a closer alignment of incentives among securitization transaction participants. However, the higher the retention requirement, the greater the likelihood of impairing the capacity to originate the underlying assets and transfer their related risks.

Mandated risk retention requirements will require asset originators and transaction sponsors to evaluate the economic, capital, accounting and legal consequences of those requirements. Progressively higher requirements may render certain asset origination activity non-economic (for example, by requiring

[3] Additional information regarding these industry initiatives, including technical specifications and implementation plans, are available at http://www.americansecuritization.com/story.aspx?id=2655 (ASF Project RESTART) and http://europeansecuritisation.com/dynamic.aspx?id=1672 (ESF RMBS Issuer Principles for Transparency and Disclosure).

unacceptably high levels of capital), and may frustrate risk transfer (for example, by rendering it impossible to achieve accounting sale treatment or to achieve a sufficient legal isolation of transferred assets), which may be important commercial requirements for many lenders who depend in part upon the liquidity provided by securitization to fund their businesses. Especially in light of extreme balance sheet and capital constraints facing many lending institutions in the current economic environment, the systemic implications of a reduction in credit origination capacity that may be occasioned by risk retention mandates should be carefully considered.

Second, risk retention requirements should be formulated in a manner that preserves important business flexibility in the calculation and measurement of relevant risks. For this reason, we believe that a broader and more flexible formulation of "economic exposure" along the lines suggested by IOSCO is preferable. To preserve flexibility that may be necessary or desirable to sustain different business models, parties to whom any risk retention requirement is applicable should be able to comply with the requirement in a reasonably flexible manner (such as by retaining a "first loss" or "vertical slice" of tranched risks based on either nominal or risk-weighted assets, or by holding other exposures that present similar risks to those embodied in a particular securitization transaction). In addition, retention requirements and thresholds should be calibrated between and among different asset classes in a manner that recognizes their widely varying risk profiles. For example, a meaningful risk retention threshold may be far different for a subprime mortgage asset than for a prime credit card receivable.

B. Disclosure of Checks and Assessments Performed by Transaction Originators and Sponsors

The report includes a recommendation to *"enhance transparency through disclosure by issuers of all checks, assessments and duties that have been performed or risk practices that have been undertaken by the underwriter, sponsor, and/or originator."*

We support the thrust of this recommendation. As noted above, it is a key focus of industry market standards initiatives to enhance the scope and quality of various review and quality assurance practices performed with respect to securitized assets and transactions. Our principal question and concern relating to this recommendation relates to its scope.

We are unclear about the intended scope of disclosure of "all checks, assessments and duties that have been performed or risk practices that have been undertaken." In the context of securitizations, this is potentially a very broad and open-ended requirement that, without refinement, would produce significant uncertainty and excessive compliance costs, and would substantially increase the likelihood of inconsistent application in practice.

Depending upon the particular transaction, securitization underwriters, sponsors and originators currently perform numerous "checks, assessments and duties." The results and findings of these activities are often presented or summarized in public disclosures or presented to particular transaction parties (such as rating agencies). Moreover, certain practices and related disclosures are in the process of changing as a result of changes to industry practices, including via implementation of the industry initiatives outlined above. We therefore recommend that IOSCO seek to refine the specific scope of "checks, assessments and duties" that are of principal concern, and to identify further which of these are already disclosed or made available to various parties, before issuing any specific recommendations in this area. This work could be undertaken as part of the IOSCO/industry working group to develop appropriate disclosure refinements and other enhancements to the securitization market infrastructure. In the meantime, the recommendation could be amended to add “as appropriate or necessary,” or “all relevant checks,” for example, to address concerns relating to its potential scope of application.

C. Independent Experts and Reports

The report also contains recommendations that would require *“independence of experts used by issuers” and “require experts to revisit and maintain reports over the life of the product.”*

Here again we are unclear about the intended scope of “experts” that would be included within this recommendation. During the industry consultation meeting with industry representatives on May 29th it was suggested that credit rating agencies were one important area of focus. Leaving aside the question of whether credit rating agencies are appropriately identified as “experts” as that term may be applied and interpreted under various regulatory standards as well as in normal custom and usage, we believe that this recommendation also requires greater refinement and precision. The references in the report suggest that a broader range of “experts” may be contemplated—such as outside service providers used by asset originators (valuations or property appraisers), in addition to “experts” used by securities issuers (presumably including accountants, auditors, rating agencies, law firms, due diligence and other service providers). We would also recommend that the practicality of “independence” be reviewed, since many service providers are compensated by the originator, transaction sponsor/issuer, or another party related to the securitization. Depending upon the circumstances, there are likely to be other effective mechanisms to manage potential conflicts of interest without requiring “independence” of those parties.

The corollary requirement to “revisit and maintain reports over the life of the product” is potentially very broad, open-ended and could entail substantial additional transaction burdens and expense. Many “expert” reports, including inputs from various service providers, are provided at specified times for specified and limited purposes in securitization transactions (such as a property appraisal conducted in connection with a mortgage refinancing, or due diligence performed by an underwriter or issuer with respect to an asset pool prior to a securitization offering). Requiring ongoing updating and maintenance of these and all other reports and assessments would be highly impractical and contrary to historical market practice. If there are specific reports provided by specific “experts” or service providers that are of primary interest to IOSCO, these should be clearly specified. We also note that in many securitizations, periodic servicing reports are certified by a responsible party, thereby creating accountability that is important to maintaining confidence in the accuracy and integrity of data provided to the market.

D. Inadequate Risk Management Practices

The focus of this section of the report is on the quality and extent of information provided to investors, and enhancing transparency with regard to underwriting and origination processes (especially relating to residential mortgage-backed securities)

The report notes that improved information disclosure and dissemination to investors may not be effective if investors do not undertake appropriate risk assessment and management practices, and that heightened investor suitability requirements (including re-evaluating “sophisticated investors” standards) may be responsive to this concern

To address this specific concern, the report offers a recommendation to *"mandate improvements in disclosure by issuers including initial and ongoing information about underlying asset pool performance and the review practices of underwriters, sponsors and/or originators including all checks, assessments and duties that have been performed or risk practices that have been undertaken. Disclosure should also include details of the creditworthiness of the person(s) with direct or indirect liability to the issuer."*

We strongly support improvements in disclosure by issuers of initial and ongoing information about pool performance. As noted above, this is the central focus of many industry initiatives that are already underway globally.

However, we believe that technical details comprising specific recommended disclosure standards should be further discussed with IOSCO, taking into account industry disclosure and transparency reform initiatives already undertaken and other work now in progress. We strongly believe that this is an area where IOSCO and industry working together will be able to produce stronger and more effective standards and a more cost-efficient approach.

In addition, we have similar concerns as those noted above regarding the potential overbroad scope of required disclosure by issuers of "review practices of underwriters, sponsors and/or originators including all checks, assessments and duties that have been performed or risk management practices undertaken." Again, necessary calibration and refinement of this requirement could be undertaken as part of the IOSCO/industry working group referenced above, and to amend the recommendation in the meantime to indicate "as appropriate or necessary," or "all relevant checks."

Suggested requirements for disclosures to include *"details of the creditworthiness of the person(s) with direct or indirect liability to the issuer"* are also potentially overbroad and require refinement and greater precision. As written, this recommendation would appear to include a wide variety of transaction parties, including guarantors, swap counterparties, servicers, liquidity providers and even individual obligors on underlying assets. Different types and levels of disclosure regarding the "creditworthiness" of these various parties would be relevant (or not), depending upon the circumstances and the type and materiality of direct or indirect liability to the issuer presented by each. Moreover, specific disclosure requirements already apply to certain of these parties under local law and regulation. For example, in the U.S., Regulation AB sets forth detailed disclosure requirements of this type. We believe that existing regulatory models should be examined prior to issuing a refined and more narrowly targeted recommendation in this area.

E. Investor Suitability and Risk Management

The report recommends that steps be taken to *"strengthen investor suitability requirements as well as the definition of sophisticated investor in this market."*

If IOSCO's concerns relate to inadequate risk management and credit assessment practices among some investors, attempting to address those concerns by imposing broader or stronger investor suitability requirements will not necessarily address that concern. As demonstrated by the recent global credit and liquidity disruption, even some highly sophisticated investors apparently did not possess or did not effectively apply sufficient risk management/credit assessment discipline to their securitization market activities.

We believe a better approach would be to encourage or require requisite levels of risk management discipline directly with investors and others responsible for exercising it, rather than indirectly via a revision of suitability standards or investor sophistication definitions. Investor participation in the securitization market globally is overwhelmingly institutional in nature. Those investors, ranging from the largest and most sophisticated global asset managers to investment portfolios managed by local government entities, are generally subject to some form of regulatory oversight and supervision. They either possess or should be obligated to acquire relevant professional expertise in managing their investments. In addition, in many jurisdictions there are already in place investor "suitability" requirements that apply to institutional/professional investors and to parties seeking to conduct business with them.

It is important to note the practical difficulty associated with defining which specific products may be suitable (or not) for various investors. For example, are some investors equipped to purchase RMBS but not CDOs? Alternatively, how and where should lines be drawn regarding local versus international product suitability (e.g., where an investment by a UK investor in UK RMBS is suitable, whereas an investment by a UK investor in non-UK RMBS is not suitable)? This is a significant practical problem, to the extent that global consistency of suitability regulations is not achieved, the functionality of the securitization and broader financial markets (and economic recovery) may be impaired, due to the inability of product distributors to determine which securitization products may be suitable for particular investors in different jurisdictions.

For these reasons, while there may be scope for reconsidering criteria for "sophisticated" or "qualified" investors under various bodies of national securities law and regulation[4], leaving the determination of which investments are "suitable" to parties other than institutional investors themselves is contrary to longstanding market structure and function, and does not directly address the need for certain (institutional) investors to enhance their credit assessment and risk management practices. We believe that enhancements to investor credit assessment practices should be implemented more directly.

For example, in Europe, the recently-enacted Article 122a amendments to the Capital Requirements Directive will require a significantly enhanced investor credit assessment process for bank investors, which the industry supports. Similar requirements are found in Solvency 2 for insurance companies, as well as in the current proposed directive on Alternative Investment Funds. As for asset managers, IOSCO SC5 is in the process of developing similar principles, and the industry (ESF, the European Fund and Asset Management Association and the Investment Managers Association) also recently published best practices for credit assessment by asset managers investing in structured products, which will also serve to reduce undue reliance on credit rating agencies.

Investor education initiatives generally also can play a key role, and each of ASF, ESF and other securitization industry organizations maintain active programs in this area.

We acknowledge and share regulators' concerns regarding the involvement of local governmental authorities and similar investors in securitizations and other structured investment products that may require specialized investor expertise. However, we believe these concerns would be better addressed

[4] We note that initiatives of this type are already underway within certain jurisdictions that would have broad applicability to securitizations and other financial market instruments.

via additional requirements regarding investment restrictions and investment advice applied directly to specific categories of institutional investors deemed to present the greatest level of risk.

As a result, we believe that it would be important, as a first step, for IOSCO to review existing suitability and sophistication regulatory standards (and pending revisions to those standards) in place across IOSCO members. The industry has performed and submitted to IOSCO significant research in this area several years ago, which IOSCO may find helpful. As emphasized in that prior work, it will be extremely important that any revisions to the standards of suitability and sophistication do not operate the blur the line and/or introduce confusion between retail and institutional investor protection needs.

Finally, this section of the report also includes the following recommendation: "Encourage the development of alternative means to evaluate risk with the support of the buy-side." We wholeheartedly support this recommendation. Our associations have consistently promoted the value and necessity of effective risk management techniques among investors and other parties who assume risks created and transferred via securitization transactions, and have sponsored educational, training and other initiatives to enhance knowledge and proficiency relating to this topic. Lack of understanding and mismanagement by some parties of the credit, market, liquidity and other risks presented by certain securitization transactions and instruments clearly played a role in recent market dislocations. We believe that an enhanced commitment to risk management education and training is an essential response to these deficiencies.

F. Regulatory Structure and Oversight

The report states that the principal challenge for regulators is to help create conditions under which information-rich securitization business is encouraged to resume, consistent with investor protection and to encourage globally coordinated solutions. We agree wholeheartedly with this observation.

The report also notes that all of the interim recommendations presented above "suggest some expansion to the current ambit of regulation." While we agree that some additional regulation is likely required, we believe it very important for regulators and the industry to coordinate closely on their respective responses on a global level, as each will play an essential role in restoring function and confidence to the securitization markets. We believe that IOSCO can be instrumental in helping to promote this ongoing coordination and connectivity.

In pursuing its further work, we encourage IOSCO and national market regulators to undertake a logical and deliberative process that seeks 1) to reach consensus on specific regulatory actions that may be needed to help restore function and confidence to securitization markets (and greater refinement and specification of TFUMP recommendations, as outlined above), and 2) to assess the scope and reach of current regulation as applied to this market, before pursuing enhancements to those regulatory powers. We fully agree with the need to promote additional international coordination in this area before significant new regulatory responses are undertaken. There is a significant risk that unduly hasty and/or uncoordinated regulatory policy responses will impede, rather than promote, recovery of the securitization sector.

The report also indicates that in addition to regulatory initiatives, the Task Force will consider the need for a special committee to be established that will focus on industry developments as securitization markets restart, and that IOSCO should consider undertaking further works to improve international supervisory practices in the field of securitization. We welcome and strongly support the proposal to work directly with the industry to develop necessary securitization infrastructure and market practice improvements, and to monitor their application over time. Our organizations are willing and equipped to support special committee function to focus on these matters, given breadth of our membership which includes issuers, investors, financial intermediaries and other transaction participants and service providers who perform essential securitization market functions.

IV. CDS – Interim Recommendation 4

1. Regulatory Structure for CCPs

a) resources
b) transaction / market information
c) co-operation with regulators

We agree with the thrust of this point, which we view as addressed primarily to regulators. We would, however, note the following additional points.

Under point “a)”, it is important to recognize that clearing members are an integral part of the hour-by-hour functioning of a CCP upon a default – not just its financial support. In this respect, a CCP is different in important ways from an arms-length service, as close collaboration with clearing members is not just desirable but essential. In particular, collective actions upon the default of any one clearing member to help the CCP manage its book of trades may be a crucial part of the central clearer’s arrangements.

On “b)”, while a CCP may be a source of information, we note that the key issue for the financial system is position information, particularly the aggregate position of any one firm, to which supervisors have always had a right of access, and which has been made more tractable by the development of data warehouses. The aggregation of risk information *within* firms is clearly also an important dimension – especially as any genuine concern with systemic risk would also take into account the make-up of any given firm’s overall credit exposure, across all relevant instruments, rather than splitting it up by instrument type. So, for example, it would be important for a risk-supervisor to assess if a large insurance company was using CDS to hedge existing bond positions or add to them. We would also like to point out that, while regulation of CDS (and OTC markets in general) might differ from one jurisdiction to another, the CDS market is not “unregulated” as the title of this consultation suggests. Better use of transaction reporting data by regulators (firm supervisors) will help in assessing firm-specific risk, and aggregate market data available from a CCP should be useful for the purposes of market surveillance by regulators.

We stress that the question of valuation of *individual* positions will remain problematic as long as markets are susceptible to variations in levels of liquidity – and see no means of guaranteeing that liquidity. As the history of exchange products shows, the mere fact of creating a centralized facility for a given instrument does not ensure liquidity in that product – only trading capital can provide that, and there may be times where market users are simply not prepared to commit that, for example in times of macro-economic uncertainty when a long-term price trend is reversing.

On a more general note, as regards standards, in order to ensure that systemic risk is reduced rather than increased, it is vital that the extension of clearing is handled in a disciplined manner. Risk management practices entails setting limits on what may sensibly be centrally cleared, given that a CCP must be able to model the risk and handle the positions associated with instruments. If it cannot do so safely, it is better to avoid the concentration of counterparty risk that a CCP can represent.

2. Standardization of CDS Contracts

This is an area where developments are quite rapid. Nonetheless, there is room for supervisors to reinforce the principle and the trend. In order to be able to do this effectively, we believe that it is important to analyze standardization in all its facets.

For one thing, the credit *derivatives* market benefits from a high initial level of economic standardization. In fact, it is precisely because the credit derivative itself is a relatively simple instrument that it can apply to a wide range of underlying exposures, a small proportion of them highly structured bonds. But (contrary to popular opinion) the vast majority of CDS do *not* relate to any specific bond (relating instead to the solvency of an *entity*, whether corporate or sovereign); let alone to a structured one.

Surveys (e.g., BBA 2006) show that the majority of application of CDS is indeed to relatively simple underlying credit exposures, i.e., standard single-names (entities) and indices made up of the same. Taking into account index tranches, over 70% of the market consists of such products, with a further 10% made up of closely related instruments such as swaptions, baskets and credit spread options. Overall, the majority of the market has been focused on investment grade names, albeit with some expansion in the high-yield sector.

So, the nature of the product is that it can apply to almost any form of underlying credit exposure – whether a ‘single-name’ (such as an individual corporate or sovereign obligor), through to highly structured credit instruments (such as a particular tranche of a CDO-squared). But this should not obscure the fact that the credit derivative itself retains the same structure and features. Thus, a regular premium will be payable (approximating the spread over the risk free borrowing rate – and effectively making that spread ‘tradable’ as a separate factor[5]). And any possible (contingent) payout will depend upon clearly identified factors.

These features have been reflected for many years now in industry-standard documentation, which sets out the key elements and thereby ensures a sound, common legal basis for contracts.

As regards the *settlement* of CDS upon a credit event, a major organizational step forward was the ‘hardwiring’ protocol of April 2009, which formalized industry’s existing, de facto adoption of efficient means of settling CDS. This ‘auction’ methodology was developed in 2005-06 (before the advent of the credit crisis) and, as highlighted in the SSG report, has served the market well, supporting an underlying trend of continuing volume growth in CDS (as market participants have sought a means to express views on the credit market in the face of extreme illiquidity).

[5] This feature of CDS is no less important than ‘disaster-insurance’, in terms of motivation for entering contracts.

Further progress is now in hand, as the market extends the auction methodology from settlement upon the two common types of credit event (Bankruptcy and Failure to pay) to the very rare contingency of Restructuring events. At the same time, industry is introducing 'standard coupons' for CDS. Each of these initiatives has the further benefit of increasing the efficiency of central clearing, where this is feasible[6].

At the same time the industry program of improving post-trade procedures continues at an ever faster pace, as illustrated by the most recent commitments to the international regulatory community[7]. It is worth noting that this program builds on deep foundations that industry had the foresight to put in place many years ago, viz:

- The creation in 1999 of the FpML language (under the aegis of ISDA), which has enabled the 'game-changing' development of a) industry-standard electronic communication, as well as b) related applications such as automated confirmation-matching tools;
- Initiatives to identify post-trade challenges (as measured in the ISDA Operations Benchmarking Survey, published annually since 2000) and promote awareness of importance of these issues across the industry, ensuring that there was collective commitment to develop. These initiatives have led directly to streamlined documentation in a number of product areas, which has facilitated automation.
- Collateralization of OTC derivatives, which has been the subject of continuous focus for over ten years; has led more recently to specific initiatives such as portfolio reconciliation standards and refinements to the approach to dispute resolution; and has resulted in a clear long-term growth trend in the use of collateral.

3. CDS-Specific Standards for CCPs

Standards for CCPs should indeed take into account the key feature of the CDS and the way those can interact with clearing house arrangements.

a) The CDS itself entails exposure to the creditworthiness of a reference entity. Counterparty exposures arise as and when there are changes in the creditworthiness of that reference entity, and this will potentially entail some element of 'jump-to-default' – a sudden increase in the value of the contract that counters any sudden decline in the recovery value of all debt obligations of the reference entity. If a clearing house was to have a heavily concentrated portfolio in any single name in relation to which such a jump-to-default occurred, it would need to model and (through margin policy) mitigate that risk accordingly[8].

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[6] Information on the 'Big Bang' protocol, by which ISDA introduced 'hardwiring' and which over 2,000 parties adhered to, is available at: www.isda.org/companies/auctionhardwiring/auctionhardwiring.html This also includes full details on the creation of the 'Determinations Committee', which provides clarity as to the occurrence of a credit event and related issues such as deliverability of obligations. At the time of writing, ISDA is finalizing information on the 'Small Bang' (for Restructuring events).

[7] For details, see www.ny.frb.org/newsevents/news/markets/2009/ma090602.html

[8] Please note, however, that an impending default may be priced into the market before any formal declaration of bankruptcy, because the event is foreshadowed (as was the case with General Motors).

b) At the same time there are other credit-related variables, namely: the creditworthiness of either party to the trade (at least one of which will be a clearing member of the CCP – possibly both); and any collateral that consists of instruments that themselves entail credit-risk[9]. At the extreme, a CCP might even wish to set some sort of limits on how much risk it takes on in a given name with a given counterparty, or at adjust margin levels accordingly.

4. Transparency

An integral part of central clearing is post-trade transparency, which will take the form of end-of-day fixings for those liquid ('on-the-run') indices that make up the majority of trading volume at any given point in time. This gives tradable levels and, when combined with pre-trade transparency, gives significant access to market information.

This manner of generating PTT protects individual participants (from predatory actions by others, when the individual participant commits capital to a transaction) while giving meaningful information to the broader market.

The phenomenal growth of derivatives has occurred on the basis of this being a private market. It would not, therefore, seem credible to suggest that the private nature of the market has prevented participants from using it.

A number of commercial pre-trade transparency services exist in the market, allowing the wholesale participants that make up the market to transact with confidence.

As mentioned above, the over-riding issue is in our view regulatory transparency, i.e. transparency to supervisors, taking into account the full range of exposures that a supervised firm faces across the full range of financial instruments in which it has exposures. The advent of warehouses (e.g., DTCC in credit derivatives[10]) is clearly important in this respect, as are the services that track market consensus prices for instruments. Warehouses not only allow all observers to build up a picture of the size of the market in a given CDS name – both the true size and the aggregate notional amounts indicating gross turnover; they also give a picture as to which market participant is facing which – in other words, giving a significant insight as to counterparty exposure.

5. Information Sharing Among IOSCO Members and Other Regulatory Bodies.

This issue clearly is related to 4b, regulatory access. If a common source of data is available for CDS trade information, then it becomes possible for a range of interested supervisors to pursue that information directly, rather than relying on indirect access via other supervisors.

Relevant supervisors also have direct access to data from any individual firm (and always have had). If properly exploited, this access allows those supervisors to monitor a firm for which they are responsible, particularly checking its susceptibility to default by any one counterparty.

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[9] In the bilateral OTC derivative market, the trend is increasingly towards use of cash as collateral (with over 80% taking that form). See table 3.2 of the ISDA Margin Survey 2009 at www.isda.org/c_and_a/pdf/ISDA-Margin-Survey-2009.pdf

[10] DTCC has recently changed its status such that it is submitted to regulation

Clearly a firm’s counterparty may itself require monitoring by its own supervisor, but the supervision of a given single firm can nonetheless be powerful, if combined with other aspects of prudential oversight, particularly of collateral arrangements (taking note of whether these are true mark-to-market arrangements or, for example, are contingent upon a ratings downgrade). It is worth remembering in this context that major revisions to the Basel Accord have been agreed, which particularly address potential inadequacies as regards treatment of credit-linked items in the Trading Book. In particular, this takes into account the dynamics of credit tranching, which is a feature common to securitisation and some credit derivatives.

6. Operations Issues

The IBOC (ISDA Board Oversight Committee) is a good model for industry-regulator interaction, bringing together as it does operations initiatives across the various asset classes and providing a means of facing supervisors. Operational targets are evolving through this dialogue.

Automation of post-trade processes (particularly trade confirmations) is a powerful tool, in support of good order and allowing prompt updates to the information within a firm about its net risk position.

One important weakness uncovered by the crisis was the absence of timely, accurate management information about the scale of risks taken in credit. While this clearly needs to include CDS, the real challenge is to aggregate this with all other credit exposures – whether adding to those exposures or mitigating them – to a given ‘name’ and to track their changing value.

As regards tracking changes in value, it is clear that the very existence of credit derivatives allows market participants far greater scope to mark credit exposures to market than they previously had (though the earlier existence of asset swaps did permit an approximation). This does not necessarily oblige participants to mark all assets to market for accounting purposes: notably, it can still make sense to treat a loan portfolio as held to maturity. Nonetheless, there is valuable management information in the changes in spread shown in CDS, which is not available from ratings (even assuming those are produced with integrity, which has of course been questioned); and which is not even available in ‘clean’ form from other market instruments, since the spreads on those will, by virtue of their being fully funded, be affected more than CDS are by liquidity considerations.

Collateral management practice is evolving. Supervisors have an important role to play in reinforcing practice in the area of portfolio reconciliation, which removes the main potential source of contention as to the amounts of collateral that should flow at any given point in time.

Further work is under way at the time of writing on dispute resolution more broadly. Apart from discrepancies as to trade population, disputes can arise where counterparties do not agree as to the value of a particular transaction. Industry participants have long considered it important to have a robust means of resolving such disputes (even though exposures that, as a result of a dispute, remain uncollateralized will be subject to full capital requirements, which would otherwise be reduced by the collateral). Therefore, work is underway to enhance the current approach (which relies on polling other dealers), to pursue a tighter time frame for resolving disputes and doing so definitively, while affording some flexibility for a bilaterally negotiated solution early in the process.

It is worth stressing that significant disputes will arise very rarely indeed, and in those transactions that are more unusual in their exposure profile – in other words, in highly structured transactions. It is not therefore a solution to clear such trades, since they will by definition not be acceptable to any prudent CCP. Nor will putting them on an electronic trading platform or exchange address the underlying issues, namely that they are illiquid precisely because they address an exposure, in relation to which each party has an equal but opposite position but for which each may legitimately make different assumptions as to relevant valuation parameters. In credit instruments, this may be a function of indirectly measurable factors such as correlation of probable default.

Trade compression reduces operational burden and counterparty exposures. It can be applied equally to a number of different types of OTC derivative – not just CDS, where the notional amounts have been reduced by over $30 trillion in a little over a year (illustrating in the process that gross notional amounts are a poor measure of risk in the market).

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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 foregoing comments, please do not hesitate to contact any of the undersigned individuals.

American Securitization Forum
/s/ George Miller, Executive Director

European Securitisation Forum
/s/ Rick Watson, Managing Director

International Swaps and Derivatives Association
/s/ Richard Metcalfe, Deputy Regional Director, EMEA

Securities Industry and Financial Markets Association
/s/ Bertrand Huet, Managing Director, European Legal & Regulatory Counsel

Annex I

The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. The ASF, therefore, is uniquely positioned to provide the Commission with comprehensive, balanced and practical recommendations reflecting a meaningful consensus among the various market participants, including investors and issuers. The ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com. The ASF is an affiliate of the Securities Industry and Financial Markets Association.

The European Securitisation Forum, an affiliate of SIFMA, is the voice of the securitisation market place in Europe, with the purpose of promoting efficient growth and continued development of securitisation throughout Europe. Its membership is comprised of over 140 institutions involved with all aspects of the securitisation and CDO business, including issuers, investors, arrangers, rating agencies, legal and accounting advisors, stock exchanges, trustees, IT service providers and others. The ESF is a sister organisation of the American Securitization Forum and ASIFMA. For more information on ESF please visit www.europeansecuritisation.com.

ISDA, which represents participants in the privately negotiated derivatives industry, is among the world's largest global financial trade associations as measured by number of member firms. ISDA was chartered in 1985, and today has over 830 member institutions from 57 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

The Securities Industry and Financial Markets Association brings together the shared interests of more than 600 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. For information on SIFMA, please visit www.sifma.org.