

06 Oct 2008 18:02 GMT Risk Retention Rule Not Needed For U.K. ABS – Regulator

LONDON - (Dow Jones)- A new rule on securitization, included in updated proposals to ensure the financial soundness of banks and investment firms in the European Union, may be unnecessary as far as the U.K. securitization market is concerned, an official at the U.K.'s Financial Services Authority said Monday.

Last week, the European Commission published proposals for revisions to the Capital Requirements Directive, or CRD.

One proposal is that originators and sponsors of securitization transactions will be required to retain, on an ongoing basis, no less than 5% of the overall risk that is being transferred to investors.

Paul Sharma, director of wholesale and prudential policy at the Financial Services Authority, told a conference in London that in U.K. securitizations, it has already been usual for originators to retain a significant part of the risk themselves.

"The retention of first loss pieces, and the presence of sellers' shares [in U.K. residential mortgage-backed securities master trusts] means that an originator typically has a very considerable interest, like the holders of rated securities do, in ensuring that the credit quality of the underlying pool is maintained," Sharma told the second annual European CLOs, Structured Credit Products, and Credit Derivatives Summit Monday.

"So it is far from clear to us that the [European] Commission's idea to make it mandatory for originators to retain risk would be best practice for the U.K.," Sharma said.

The first loss piece, or equity tranche, in a securitization is the riskiest slice of debt that has exposure to any initial losses in the underlying pool of loans.

And the seller's share in an RMBS master trust is that chunk of mortgage collateral that acts as a cushion to protect bondholders. Master Trust programs were set up by several major U.K. mortgage lenders to issue RMBS as the securitization market grew.

Doubts about the relevance of the 5% proposal are not restricted to the mortgage-backed securities market.

"As a CLO [collateralized loan obligation] manager, we are one of the largest equity investors in the deals that we run," David Matson, Managing Director, IKB Fund Management, told the Summit.

"That means that there is always an alignment of interest between the manager and investor," he said. "I suspect that investors have always asked managers what interest they have in their deals performing well and based their investment decisions on the level of alignment of interest. It is fundamentally good practice, but I don't think you need to enforce it via legislation."

CLOs repackage leveraged loans, or loans made to small and medium-sized enterprises, into bonds.

In a note last week, Hans Vrensen, Head of European Securitisation Research at Barclays Capital, said that the "retention requirement makes securitization less attractive than previously," but pointed out that the proposal still needs to be approved by the European Parliament, which would not want to put EU-based banks at a competitive disadvantage.

If adopted, the new rules on securitization would come into effect from Jan. 2011, Vrensen said.

Monday's Summit was co-hosted by conference organizers IMN and the European Securitisation Forum.

-[Mark Brown](#), Dow Jones Newswires