Subject: Building a robust chain of synthetic risk transfers in the US

Recently, several positions have been taken in the press or in letters sent to the US Agencies notably by Sheila Bair and Senator Jack Reed, urging the federal regulators to scrutinize the risks associated with synthetic securitizations.

These transactions allow banks to safely mitigate risk and reduce their capital requirements, while investors participate in credit risk sharing.

During the last decade, the IACPM has gathered the experience from longstanding practitioners including banks, specialized investors and insurers, which have been using this risk sharing solution, most notably in Europe. These practitioners are able to demonstrate that **synthetic risk transfers can be conducted in a safe and sound manner** by risk sharing partners who fully understand the risks, while adhering to the strict control of banks' supervisors.

Synthetic risk transfers are not by principle riskier than true sale securitizations, as they enable banks to retain loan origination and portfolio management, given the banks are best positioned to monitor borrowers' risk through their broader customer relationship.

Synthetic transactions do not imply that the risk transfer instruments are only derivatives which are sensitive to market volatility. In fact, most of the credit linked notes issued by banks in Europe are structured with embedded financial guarantees or executed via credit insurance.

Counterparties sharing risk with banks are not "opaque" hedge funds or private credit funds and are not less capable to manage and absorb losses. Most importantly, these investors do not disappear when credit deteriorates. In fact, the opposite is true, as the experience built in Europe over the last decade shows that **investors (incl. US specialized investors) in European risk sharing transactions are long term partners of banks** along the whole credit cycle, acting for pension funds or directly as the credit arm of specialized and diversified non-life insurers. These risk sharing partners are fully aware of the risks, run extensive due diligence and stress tests, and close transactions throughout the entire credit cycle. All credit losses and claims are paid out of the cash posted on day one in a dedicated account. Therefore, banks have not been in a weakened position during recession years, because the sellers of credit protection act as **long-term partners** of banks managing their credit portfolio and capital in a responsible way.

Two conditions are needed to build a robust risk sharing process: 1) risk sharing must be effective for banks in terms of **amount and cost of capital relief**, and 2) transactions must be **transparent** and executed along **strict securitization regulations.**
The IACPM and its members in banking, investment and insurance devoted years with European regulators and supervisors to share best practices, conduct surveys, understand the impact on capital and define the due diligence, structuring and disclosure features required for effective risk sharing transactions. This joint investment emphasized the knowledge, built trust by all stakeholders, and finally demonstrated that **private risk sharing tools can be used in a safe and sound manner in support of real economy finance on core banks' lending products.**

After responding to the consultation on Basel 3 endgame, the IACPM and its members along the whole credit transfer chain stand ready to share data and experience with US federal regulators so that US banks can also share risk in an effective, safe, and transparent manner with specialized long-term partners.

The goal of the IACPM is to collaboratively work with the US Agencies to help build a safe synthetic securitization market that allows banks to effectively manage their credit portfolios in partnership with professional credit investors and insurers, and in turn support growth in the US economy.