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Basel Committee on Banking Supervision
Board of the International Organization of Securities Commissions

By upload www.bis.org/bcbs/commentupload.htm
By email to Consultation-2014-10@iosco.org

Dear Sir/Madam

**COMMENTS ON THE CRITERIA FOR IDENTIFYING SIMPLE, TRANSPARENT AND
COMPARABLE SECURITISATIONS**

The Australian Securitisation Forum (AuSF) appreciates the opportunity to comment on the Consultative Document on the Criteria for identifying simple, transparent and comparable ("STC") securitisation dated 11 December 2014.

The AuSF is the industry body representing participants in Australia's securitisation and covered bond markets. Our members include financial institutions regulated by the Australian Prudential Regulation Authority (APRA), credit providers regulated by the Australian Securities and Investments Commission (ASIC), domestic fixed income investors, arrangers, advisors and service providers to the securitisation and covered bond markets.

We would welcome an opportunity to elaborate on the matters outlined in this response.

Yours sincerely

A handwritten signature in black ink that reads "Chris Dalton". The signature is written in a cursive, flowing style.

Chris Dalton

Background

History shows that the Australian securitisation market did not reach the degree of complexity, nor the material misalignment or conflicts of interest, witnessed in some markets. Nevertheless, the Australian securitisation market has been impacted by the stigma that attached to securitisation during and after the financial crisis.

In recent years market participants have made significant progress in further enhancing Australian securitisation market practices. In particular:

- The AuSF established industry minimum disclosure and reporting standards for Australian RMBS and ABS including minimum sponsor representations and warranties and a common definition of mortgage arrears to improve standardisation and to aid investor due diligence;
- The Reserve Bank of Australia (RBA) announced that it would introduce new criteria for eligibility of ABS in its repo operations¹. The reporting templates subsequently released by the RBA, and currently being implemented by the RBA and market participants, are consistent with transparency and standardised disclosure initiatives of the AuSF, IOSCO and other central banks;
- APRA is consulting extensively with industry regarding the implementation of a updated prudential framework for securitisation for regulated financial institutions. One of APRA's key objectives is to make Australian securitisation issues among the safest and simplest securitisation investments available globally; and
- ASIC has also been focused on improving confidence in the securitisation market through direct initiatives and its participation in IOSCO. Direct initiatives have included the licensing of credit rating agencies and enhancing guidance to credit providers regarding their compliance with responsible lending regulations.

Global investors have long recognised the quality of securitisation product emanating from Australia, and continue to be an important component of the Australian securitisation market. Regulatory and market developments outside of Australia, particularly the United States, Europe and the United Kingdom, often have a direct impact upon Australian securitisation market participants.

¹ For further information refer: <http://www.rba.gov.au/securitisations/>

AuSF Response

Question 1.

The AuSF embraces a global approach to the principles of simplicity, transparency and comparability (herein “STC”) to further enhance the perception of, and investor confidence in the Australian securitisation market and global securitisation markets more generally. Whilst the principles underlying an STC framework are manifestly desirable, the success of the STC framework will come down to how successfully it is implemented: whether it is adopted universally; applied consistently, and; results in improved investor confidence in securitisation markets. In particular, we suggest the success of the STC framework could be measured in part by increased investment in securitisations by non-financial institutions such as insurance companies and fund management groups.

The majority of the following comments focus upon implementation considerations.

Objectives of STC

Securitisations are sophisticated financial products and securitisation markets are suited to sophisticated issuers, investors and other participants. As such, and as highlighted repeatedly in the Consultative Document, the AuSF reiterates that STC criteria do not serve as a substitute for due diligence by an investor or any other market participant.

Two important observations about securitisation markets today are:

- Market practices, including principles aligned with STC, have improved considerably since the financial crisis given the lessons learned by all market participants; and
- Investors of varying size continue to have different due diligence requirements and not all necessarily require or use all the information being made available to them today. This reflects the different risk-reward trade-offs made by individual investors.

The objective of STC is to assist market participants to better assess risk in securitisation transactions. Whilst not intended, the more the STC framework attempts to define low risk rather than merely providing a framework for risk assessment, the more likely the STC designation may result in incentives for reduced investor due diligence. Therefore the AuSF prefers the term “Standard” rather than “Simple”.

Standardisation of underlying assets, documentation and disclosure practices would assist in transparency and comparability and highlight securitisations that the industry identifies as non-standard and thus may highlight the need for additional due diligence. The term “simple” carries with it the risk of misconception that a securitisation is not complex, is inherently safe or low risk, all of which are subjective opinions.

Difference in treatment of STC and non-STC securitisations

To encourage their proliferation, qualifying STC transactions may receive beneficial regulatory treatment such as beneficial capital or liquidity treatment. The size and nature of these potential benefits may become a driver of market behaviour, both desirable and undesirable. Disproportionate incentives to achieve STC designation may drive inappropriate behaviour or inhibit the growth and development of new securitisation markets or innovation where it may initially be difficult to comply with all STC requirements.

Question 2.

A principles based framework

The AuSF believes a framework of broad principles is the most adaptable to current and future markets. It is our view that globally agreed principles are better benchmarks to use than those that are jurisdiction specific and that potentially give rise to varying and inconsistent definitions and criteria across markets. The STC framework could be defined in two parts broadly in line with the structure of the Consultative Document:

- (1) STC principles: the key principles defining the framework to assist industry to identify and adopt best practices with regard to STC securitisation;
- (2) Guidance notes, akin to the detail provided in the Annex to the Consultative Document, to supplement the broad principles. Such guidance notes would aim to reduce subjective interpretation and inconsistent application of the principles, but also not be exhaustive or binding.

Implementation of the framework

An effective framework will be one that is broadly adopted by the industry. Successful implementation of STC principles will require:

- detailed specification to limit subjective judgment, enhance transparency and comparability;
- confidence in the arbiter of whether a securitisation is a qualifying STC or not;
- international harmonisation: and
- integration with existing regulatory and market practices to reduce inefficiencies.

Subjective Judgment

Measuring individual transactions against a broad principles framework requires the exercise of subjective judgment. Such judgment elements permeate the Annex in the Consultative Document. For example:

- How is the homogeneity of an asset type determined? At a high level, there is a distinction between say a residential mortgage and an auto lease. But at a more detailed level it becomes more difficult to define. For example is a residential mortgage portfolio containing fixed rate and variable rate loans homogenous? Owner occupied and investor (“buy-to-let”) loans? Amortising loans and interest only loans? In an auto ABS portfolio, is a car, a bus and a tractor homogenous? Due to economies of scale, larger securitisation markets, such as the US, tend to accommodate more discrete and homogeneous transaction pools. In smaller markets, such as Australia, a broader range of asset types may be included in pools to create economically sized transactions – for example blended auto and equipment ABS pools. The STC framework should not hinder the development of new and smaller securitisation markets.
- With regards to jurisdiction, what is a jurisdiction? Nationality is one measure (for example Australia or France), but assets in a pool from a single nation may be subject to different state level laws or assets regulated by a certain code and others not.
- Regarding underwriting, how are “prudently stressed loan loss scenarios” or a “granular pool” determined?
- How is it determined when interest rate or FX risk is “appropriately mitigated”?

- Who determines when change in a transaction document has an impact on the structure risks in a securitisation?

This suggests detailed specification may be desirable to create more objective measures of for a qualifying STC. By way of example of such specifications, the PCS designation² is based upon detailed published transaction specifications.

Who determines whether a securitisation is STC?

Whether a securitisation is a qualifying STC could be determined by investors, issuers, a regulator or quasi regulatory body, or some other entity. There are pros and cons for each of these possible models. Investor confidence, standardisation, transparency and comparability are the key objectives.

What is most appropriate in fulfilling these objectives may depend on factors specific to a particular market. For example, in Australia new RBA reporting requirements aiming to increase the transparency and comparability of ABS may provide a useful benchmark for key aspects of STC in the Australian market. If an arbiter of STC rules were exposed to potential legal liability this may reduce their willingness to fulfil such a role. The framework will need to be sufficiently detailed to reduce subjective areas of judgment and provide a confident footing for the arbiter to make a determination.

International Harmonisation

Mutual recognition of different approaches between markets would avoid duplication of compliance costs. We suggest consideration be given to either mutual recognition or substituted compliance based on local regulations governing or applicable to securitisations.

For example:

- (1) The RBA is currently implementing a prescriptive set of loan by loan and cash flow reporting requirements for a security to be repo eligible. Thus could a securitisation that was repo eligible with the RBA be deemed to be STC by virtue of that security being required to comply with extensive RBA requirements?
- (2) The discussion contemplates that following a trigger event revolving structure should become sequential pay, largely reflective of current UK Master Trust structures. This may mean Australian master trusts, in the form currently being contemplated by APRA (with pro rata repayment of senior ranking Class A notes held by investors and the seller) may not meet these requirements, notwithstanding that the form being contemplated would meet other STC requirements.
- (3) Any skin in game requirements under STC principles should align to relevant regulations such as European PD Article 405 of Regulation (EU) No 575/2013 and Article 51 of Regulation (EU) No 231/2013 or equivalent regulations being implemented in other jurisdictions including those to be introduced by APRA in Australia.

² Refer <http://pcsmarket.org>

Question 3.

The Australian asset-backed commercial paper (ABCP) market has virtually disappeared since the financial crisis. While a few ABCP conduits remain, the securities are generally retained on the sponsor's balance sheet rather than being issued to money market investors. The disappearance of a public ABCP market in Australia is largely due to the changes to the regulatory changes to the capital charges for ABCP liquidity facilities. It is the expectation of the AuSF that the ABCP market in Australia is unlikely to return as a viable funding source for borrowers in the near term.

Given the variety of assets that were funded through ABCP programs in the past, we are not convinced that specific criteria for ABCP would be worthwhile. We favour that the proposed STC principles be also applied for ABCP.

Question 4.

The AuSF believes that while some greater standardisation of transaction documents may be a laudable goal it is likely to be a difficult goal to achieve in practice. Transaction documentation will need to reflect the jurisdiction of the issuer, the structure of the transaction and the nature of the underlying assets. Documentation will also reflect the specific provisions necessary to provide clarity of the legal framework and the risk management strategy of the sponsor or issuer. The transaction documentation will also reflect the legal style preferred by the counterparties to a particular transaction.

One area that could be investigated for greater standardisation could be the transaction prospectuses or information memorandum. However it is our view that the format of these documents will also need to reflect the requirements of the particular market and the applicable securities laws under which the securities are issued. A danger of standardisation can be to have a prospectus or information memorandum address prescribed topics but omit disclosure on a specific aspect that may be particularly pertinent to a particular transaction. The AuSF believes any desire to achieve greater standardisation of transaction documents should be addressed by local securities regulators.

The AuSF hopes the above comments and responses are useful to the finalisation of the criteria proposed by the joint working group. We would be pleased to elaborate further in a meeting or by teleconference.