



15th June 2009

Mr Greg Tanzer
Secretary General
IOSCO
c/- Oquendo 12
28006 Madrid
SPAIN

Dear Mr Tanzer

**Technical Committee of the International Organisation of Securities Commissions -
Unregulated Financial Markets and Products Consultation Report - May 2009 (“the Report”)**

1 Introduction

Thank you for your invitation for the Australian Securitisation Forum (“ASF”) to participate in this consultation process.

By way of background, the ASF was formed in 1989 to promote the development of securitisation in Australia. It was the world’s first securitisation forum. As the peak industry body representing the Australian securitisation market, the ASF performs a pivotal role in the education of government, regulators, the public, investors and others who have an interest or potential interest both in Australia and overseas in securitisation.

Traditionally, the Australian securitisation market has provided an efficient and cost effective means of access to the wholesale capital markets, the benefits of which have resulted in alternate and lower cost of funds being passed through to large and small businesses as well as retail consumers. The historical performance of Australian securitisations has generally been strong, and within the expectations of the particular transaction and asset class. In particular, The Australian securitisation market, which is dominated by RMBS, has not suffered the problems that arose in other markets.

The ASF agrees that the issues raised in the IOSCO Report are critical issues that need to be considered carefully and whilst international cooperation is important the appropriateness of any regulation in each market needs to be carefully assessed. The ASF is encouraged to see IOSCO’s focus on obtaining feedback from all industry participants as to the suitability and desirability of the recommendations in the IOSCO Report. We would also urge IOSCO to

extend, if required, the time frame for industry consultation and the development of regulatory principles to ensure that an efficient and effective outcome is achieved for all stakeholders.

Whilst ASF's submission on the IOSCO Report is limited to those parts of the IOSCO Report that relate to securitisation, it also incorporates the ASF's views on post-trade transparency with respect to securitisation. The ASF's submission has been developed through the consideration of IOSCO's Interim Recommendations by the ASF's regulatory working group and from wider consultation with the members and other stakeholders of the ASF. Our response is in the format requested by ASIC.

Executive Summary of ASF general response to the IOSCO Report recommendations

The ASF submits that IOSCO should introduce a global framework of principles which will then be applied specifically to each market. That is, where regulations are imposed on a securitisation transaction, they should be tailored to reflect Australian circumstances to foster sustainable competition in the Australian lending market and improve investor confidence.

The ASF believes the following three key topics of the IOSCO Report are likely to be of significance to securitisation in Australia. The ASF response addresses each of these matters.

- (i) Originator/Sponsor Retention of Economic Interest – “skin in the game”*
- (ii) Disclosure and Reporting*
- (iii) Pricing and Valuation*

Retention of long term economic interest – skin in the game

- *The ASF supports regulatory responses which encourage the alignment of interest amongst parties in a securitisation transaction.*
- *The ASF believes that a differentiated approach needs to be considered with respect to originators and/or sponsors maintaining a long term economic interest in the securitisation.*
- *A “one-size-fits-all” approach is suboptimal. The ASF suggests an approach which is risk adjusted and recognises the existing skin in the game of originators and/or sponsors is more appropriate for Australian securitisations.*
- *As the Australian securitisation market is predominantly comprised of RMBS transactions, appropriate recognition of the role and benefit of local market features in transactions - such as full recourse lending, the originator's/seller's exposure to net income or excess spread throughout the life of the transaction and the use of Lenders Mortgage Insurance provided by APRA regulated insurers - needs to be recognised.*
- *The ASF believes that the quantum of any long term economic interest retained in a securitisation needs to reflect the risk of the asset pool to avoid arbitrage opportunities for sellers of higher risk asset pools.*
- *The ASF proposes that the differentiation of “Qualifying” and “Non-Qualifying” mortgages be established for Australian assets.*
- *The ASF does not support any proposal that all transactions must comply with the IOSCO requirements. An issuer and investors must have the ability to structure transactions in an unregulated environment, and take the necessary actions and protections that they require as part of their involvement in that transaction.*
- *The ASF proposes that an appropriate transitional period should be considered so as to ensure there are no adverse consequences for competition in the short term in the markets.*

Accordingly, and by way of summary, the ASF proposes a risk adjusted matrix be introduced for Australian securitisations as set out in Appendix 1.

Disclosure and Reporting

- *The ASF sees improvements in the standardisation and quality of disclosure to be a positive development to increase the level of investor confidence in securitisations. We have no concerns about the introduction of specific information which must be included for securitisation transactions that require disclosure under Part 6D.2 of the Corporations Act.*

- *The ASF believes that any enhanced principles for disclosure and reporting need to take into account any specific features of a local market.*
- *The ASF believes that issuers should continue to be able to structure transactions to classes of appropriate sophisticated investors where the level of disclosure is free from regulatory oversight.*

Pricing and Valuation

- *The ASF supports efforts to improve the transparency of pricing and valuation, but points out difficulties exist in a small market such as Australia's securitisation market and the thinness of trade in the secondary market.*
- *The ASF recommends that the securitisation industry must work with relevant parties to develop a synthetic RMBS pricing benchmark akin to the BBSW benchmark using in the Australian banking market.*

Enhancement to Regulatory Power

- *Subject to any amendments being made to the Corporations Act to deal with the above recommendations, it is not clear that there is any need to enhance the regulatory powers of ASIC.*

- 1 The ASF supports a differentiated approach to any “skin in the game” requirement based on a detailed assessment of the securitisation transaction in order to appropriately align the economic interests of parties. This means not just looking to the long term economic interest retained by originators and/or sponsors but also other factors that contribute to such an alignment, including:
 - (a) Whether there is a full recourse/all monies regime applying to underlying borrower at the collateral level;
 - (b) Whether lenders mortgage insurance (from appropriately rated counterparties which are subject to prudential supervision by APRA, and on acceptable terms to all parties) is available for the benefit of lenders and investors; and
 - (c) Whether and to what extent long term economic interests are retained by the issuer (e.g. vertical or horizontal slices; residual income units; excess spread accruing from servicing activities; ability to access funding markets in the future to continue lending, and so on).
- 2 In other words, the ASF believes that this approach advances the policy requirements for a greater degree of alignment of interests between participants, but retains the flexibility in its application, so that the industry can continue to provide funding and innovative products. The ASF's concern is that a simple, “one-size-fits-all” rule will reduce the competitiveness of the industry and will not result in any overall improvement in the alignment of the interests of all parties.
- 3 Skin in the game has been present in many Australian securitisations prior to the GFC. The performance of transactions has varied for a number of reasons, most of which had little, if any, connection to the alignment of interests in the transaction.
- 4 With the current constrained credit markets putting in pressure on a bank balance sheets it is important to recognise and allow securitisation to continue to play its role in creating enough credit capacity in our economy to support economic growth and the efficiency of the private sector economy.

TC interim recommendation #1:

IOSCO encourages industry responses in the securitisation market and recommends the following regulatory responses:

- 1. Consider requiring originators and/or sponsors to retain a long-term economic exposure to the securitisation.*
- 2. 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;*
- 3. Require independence of experts used by issuers; and*
- 4. Require experts to revisit and maintain reports over the life of the product.*

Executive summary of ASF response to TC interim recommendation #1:

- Typically Australian ABS issuers already hold significant skin in the game. For example, the originator-servicer model and continued holding of residual income positions. In addition, the majority of ABS issues in Australia are prime residential mortgage assets that also benefit from 100% mortgage insurance by APRA regulated entities. Therefore, the requirement for originators to maintain an additional long term exposure should be limited in Australia.*
- In any event, if the requirement is to apply in any circumstances:*
 - (a) the required quantum should be risk weighted to reflect the risk of the securitised assets. A "one size fits all" approach may not encourage the right behaviours;*
 - (b) to promote competition, new entrants should be permitted to build up the required capital, for example by trapping a portion of excess spread;*
 - (c) given any retention of an economic interest by an originator could comprise a key asset of some originators, such economic interest should in appropriate circumstances be capable of being dealt with by such originators to fund its business.*
- The ASF believes that transactions targeted only at certain agreed classes of sophisticated investors should remain free from regulated disclosure requirements.*
- The ASF agrees that there is merit in ensuring that certain experts retained in securitisation transactions are independent from the originator of the assets, although we note that this should be limited to experts who are explicitly, or may be taken to be, providing information, services or reports for the benefit of noteholders (for example, trustee roles and auditors). The ASF believes that any expansion to the scope or definition of "expert" needs to be considered carefully to avoid any unintended consequences.*
- Provided ongoing reporting is limited to reports regarding asset performance and ratings, the ASF has a neutral view provided the costs of such reporting do not outweigh the benefits on for investors an ongoing basis.*

- 1 The ASF believes that it is crucial to align the interests of all parties to a transaction to ensure that the transaction, and its underlying collateral, perform optimally throughout the life of the securitisation.
- 2 The ASF's concern is that a "one size fits all" approach of requiring all sellers to retain a fixed economic interest in the transaction may produce unintended consequences, including the following:
 - (a) it may inhibit appropriate risk-taking (something that the Financial Stability Board recognises as an essential and appropriate feature of a well-functioning financial system);
 - (b) financial instability, in that this approach could result in an originator / seller looking to securitise more risky asset classes or more risky portfolios;
 - (c) credit creation (will inevitably make certain forms of appropriate credit creation and product innovation uneconomic).
- 3 The ASF supports the concept of classifying assets such as mortgages as being either "Qualifying" or "Non-Qualifying" (similar to the approach recently adopted in the US) in order to drive a regulatory outcome that properly reflects the degree of risk involved.
- 4 The ASF believes that the Australian market (together with other relevant markets) have features that result currently in an Originator / Seller's interest being aligned economically to that of investors such as:
 - (a) borrowers are subject to an all monies/full recourse bankruptcy/insolvency regime;
 - (b) LMI is almost universal in Australian RMBS and provides an independent level of scrutiny of loan underwriting and credit quality standards that benefit lenders and investors, and which also reduces the amount of risk held by the investors;
 - (c) excess spread is almost exclusively held by issuers/originators, and in particular:
 - (i) servicer fees are optimised when the underlying collateral performs well; and
 - (ii) the seller/originator is usually the part that takes the benefit and risk of the net interest income (excess income) flows from the transaction.
- 5 The ASF believes that the differentiation between asset classes is essential so that the optimal treatment arises, promotes the right behaviours, balancing the financial stability needs of an economy with its credit creation and economic growth needs.

To promote the right behaviours, the level of "skin in the game" should be aligned with the risk that is being transferred to investors. The retention of a 5% economic interest may appear to be simple to implement, but the ASF submits that for some asset classes it represents an excessive level, and for other asset classes and structures it will be an insufficient level, to achieve the objective of an alignment of interests.
- 6 The ASF believes that the securitisation industry needs to work with IOSCO and other general regulators to clarify this proposal, and worked examples need to be agreed as to the form and definition of the requirement for "skin in the game". That is:

- (a) For instance, would “skin in the game” disappear once a retained horizontal first loss piece was extinguished, leaving senior note holders without the benefit of any skin in the game going forward?
 - (b) Conversely, might a vertical retention approach merely neutralise any meaningful skin in the game that ultimately disappeared through re-pricing?
- 7 The ASF submits that the economic interest in a transaction (that is, the “skin-in-the-game”) is best represented by an originator’s or seller’s investment in the most junior tranche of a transaction (noting, however that any such investment may be shared with other parties to the transaction).
- 8 The ASF believes that the responsibility for the oversight of any “skin in the game” requirement needs clarification, such that an appropriate balance between industry-led self-regulation and regulatory oversight is likely to deliver the best outcome.
- 9 The ASF supports local implementation of any IOSCO recommendations, with mutual recognition by regulators of others’ regulatory regimes.
- 10 Transitional arrangements and relief should be considered so as not to disadvantage existing asset pools and forthcoming transactions, and to ensure that any such considerations do not have an adverse impact on competition in the short term.
- 11 Any requirements that arise under the IOSCO principles cannot be inconsistent with a local market’s prudential regulatory requirements. Any such inconsistency could lead to adverse capital treatment for regulated institutions and have the unintended consequence that a measure which is designed to foster competition and innovation in securitisation markets has an adverse regulatory capital (or other) consequence for such an institution. The ASF also believes that any IOSCO requirements need also to be developed in a manner which is consistent with global accounting standards.

TC interim recommendation #2:

IOSCO encourages industry responses in the securitisation market and recommends the following regulatory responses:

- 1. 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.*
- 2. Strengthen investor suitability requirements as well as the definition of sophisticated investor in this market.*
- 3. Encourage the development of alternative means to evaluate risk with the support of the 'buy-side'.*

Executive summary of ASF response to TC interim recommendation #2:

- *The ASF has no concerns about the introduction of specific information which must be included for transactions that require disclosure under Part 6D.2 of the Corporations Act*
- *However, issuers should be able to structure transactions to classes of appropriate sophisticated investors where the level of disclosure is free from regulatory oversight.*
- *With respect to the regulation of investor suitability, the ASF believes regulations are best placed to dictate the form of disclosure required depending on the targeted investors. Provided disclosure requirements are met, singling out certain types of debt products, such as securitisations, as being unsuitable for certain types of investors (such as retail investors or government bodies) is inappropriate given the ability of those investors to invest in securities such as direct equities without regulatory review as to whether those securities are suitable for those investors.*
- *It may be appropriate to increase monetary thresholds in the sophisticated investor definitions.*
- *The ASF welcomes the idea of further enabling industry participants to evaluate and price risk, however we are unsure as to the role of regulation to foster this.*

- 1 The ASF submits that an amendment be made to the first paragraph of interim recommendation #2 to recognise the manner in which many securitisation markets operate. The ASF's submission primarily relates to the requirement for disclosures to be made by the issuer in the Australian market.
- 2 However, as an overview, the ASF believes that any recommendation by IOSCO in relation to the enhancement of a disclosure regime should be implemented only after the industry initiative's in this regard have been finalised and implemented, and their effectiveness assessed. The ASF supports fully the need for improved levels of disclosure and reporting in

securitisation transactions; however, the ASF also believes that any such measures must be implemented in a cost effective and beneficial manner to investors.

- 3 In the Australian context it will be more appropriate for disclosures to be made by parties other than the issuer such as the sponsor, the originator or the trust manager of the transaction.
- 4 In Australia, securitisation typically involves funding being sourced, and then on-lent, by a special purpose entity, the proceeds of which are used to acquire a pool of financial assets from the seller/originator of those assets. The special purpose entity is usually a newly established trust, with a professional trustee company appointed to act as trustee.
- 5 The ASF believes that responsibility for the disclosures contained in the offering documents rests on the whole with the originator, the sponsor or the trust manager. The trustee itself typically only takes responsibility for matters in respect of its corporate status. It does not have any knowledge of the other matters contained in the offering document - the trustee has little or no information regarding the underlying pool or assets. The sponsor or the originator or the trust manager is responsible for disclosure and marketing to investors, including preparing the offer document.
- 6 Requirements relating to disclosure and ongoing reporting should be imposed on the sponsor or originator or trust manager (whichever party is responsible), not the trustee (as the issuer of the securities). Similarly, liability for failing to meet disclosure or reporting requirements should not rest with the trustee.
- 7 If ongoing compliance statements or reporting are required, the servicer or trust manager should be responsible, not the trustee. It is an inefficient and inappropriate allocation of responsibility of risk and liability to make the trustee issuer responsible for these matters. It would need to pass on the responsibilities to the servicer or trust manager and seek indemnities for breach. It is more efficient and effective to ensure risk is properly managed if the primary obligation falls directly on the relevant party.

1. Pricing and Valuation

The ASF believes that market participants must support valuation providers if their aspiration is a more liquid market in which confidence in price discovery exists. In this, valuation providers must also be willing to further disclose where, how and from whom a mark is obtained. In Australia, given its size, and market depth, securitisation pricing is fragmented because the market is characterised by a single, dominant pricing provider.

Furthermore, communication directly between the buy side and this provider is highly dependent (and therefore variable between participants) upon the contractual arrangements of the valuation service entered into; some participants have a direct engagement; others only through a custodian or administrator. The latter have no direct communication lines with this provider and do not receive any form of direct disclosure of pricing or the source price or assumptions. Even where there is a direct link, the pricing provider will not disclose the methodology and could use a number of different methodologies to “evaluate” a securitisation’s price. That is, it could ultimately use its own overlay or view of where the security should trade, rather than a “valuation” basis where a new issue of a similar security would occur.

EXAMPLE There is evidence of continuing deviation from broker valuations and their pricing in this regard (e.g. a tranche of the Liberty 2006 series RMBS is marked by Credit Swiss in the 70s where the pricing provider marked it in the 30s due to its view of where the tranche would trade).

In this example above, the concern is not the absolute price, but rather the methodology, inconsistency of approach across the securitisation sector, and the switching of methodologies without notice to the market.

The question of support then becomes one of navigating these commercial interests as buy side participants who do not have a contractual relationship with the pricing provider have no vested interest in supporting them, as it needs to be both ways, as the pricing provider will not provide buy side participants who do not pay for their service directly with a pricing guide, even when they use the pricing provider through a third party administrator.

The sell side appears not to have issue here, as they do not run portfolios within a Managed Investment Scheme environment, have choice of valuation methodologies through their regulator and can choose to use or discard the pricing providers prices.

In effect, to remove the subjective overlay of the pricing provider, and to realign their marks with the market view, it would be recommended that a centralised market committee could meet monthly to set the overriding assumptions for pricing for the market in the SPS space and specifically Australian RMBS, CMBS and ABS. This proposal is transparent and would be member driven. These assumptions should be a reflection of the market view, if made up of market participants and can be fed directly to the pricing provider.

To take it a step further, this committee could oversee benchmark pricing, similar to BBSW, whereby the whole market determines the price (spread) for a benchmark synthetic RMBS bond on a daily basis. These could also then be fed back to the pricing provider, who then has no dispute as to the ‘market view.’ It is also recommended that the pricing providers be regulated by their local regulators as they play, if not the most important, but a very important role in the financial markets.

Valuations should be accompanied by descriptive information and also reflect the genuine market view - as the pricing service is a commercial one, the instruction of this enhanced data description needs to be a directive of their parent. This committee must ensure that they are part of this discussion process to ensure the Australian Branch offices comply with the global standard and recommendations.

The market seeks a valuation based on where their existing portfolio is relative to where new issuance of existing or the same debt is issued or could be issued. This in its simplest form can be characterised by the daily change in T-bill yields which reflect the changing return for term money. With a credit security, much can be said in the same way, however due to the nature of the market, these securities have more extreme price ranges due to the credit risk. "Dumping" or "distressed" sellers act irrationally in times like the present and the "valuation" principal is discarded for short-term needs, such as liquidity.

There are many views on where a mark should arise, and in the OTC market, this view is debated every day. By way of comparison the equity market can mark their books to market based on traded prices. However they are almost guaranteed that if they try to trade the next day in a volume that has "market impact" they will not be able to trade at this price. This example is very similar to the heart of the debate in the OTC markets. All participants seek a mark for valuation purposes, but at the same know that due to the "market impact" phenomenon they will buy/sell around this mark, depending of the size of the trade and the liquidity of the day. The deviation from the "valuation" is what the equity market call "market impact".

In summary, OTC markets have participants that are both buyers and sellers, and to mark a bond at the lowest price is could possibly trade does not service all vested parties interests. i.e. "market impact" is not being taken into account for both sides of the equation.

TC interim recommendation #3:

IOSCO recommends that jurisdictions should assess the scope of their regulatory reach and consider which enhancements to regulatory powers to support TC interim recommendations #1 and #2 in a manner promoting international coordination of regulation are needed.

Executive summary of ASF response to TC interim recommendation #3:

Subject to any amendments being made to the Corporations Act to deal with the above recommendations, it is not clear that there is any need to enhance the regulatory powers of ASIC.

The ASF believes that domestic regulators are best placed to understand their markets. Accordingly, the ASF believes that subject to working within a global framework of agreed principles, a continuation of recent regulator/market relationship building and co-operation is very much to be encouraged. Our suggestion above on creating a domestic pricing and valuation committee made up of regulators and market participants is one such example of how this might be fostered.

Conclusion

Thank you for your consideration of our submissions. We would be happy to meet with you or discuss any aspect of this submission by telephone. Once again, we appreciate the willingness IOSCO is showing in ensuring the concerns of the industry generally are being heard in this process.

Yours sincerely
For and on behalf of the Australian Securitisation Forum

Stuart Fuller
Chairman

Chris Dalton
Chief Executive Officer

Guy Volpicella
Chairman, Regulatory Sub-committee

SIGNED

SIGNED

SIGNED

Copy
Mr Greg Medcraft
Commissioner
ASIC
Martin Place
Sydney NSW 2000

APPENDIX I - Treatment of Australian Qualifying and Non Qualifying Assets

ASF Matrix – a risk based approach for determining economic interest to be held

	Qualifying Assets	Non Qualifying Assets
LMI - APRA regulated	Nil	na
No LMI	0.5%	**Min 5% or B level

1. Access Benefit Applied

- If Seller = Servicer, a discount of [0.5%] applies to the Min amount held only
- If Seller = RIU holder, a discount of [0.5%] applies to the Min amount held only
- If Seller = Servicer + RIU holder, a discount of [1.0%] applies to the Min amount held only

2. Qualifying Mortgages – definition

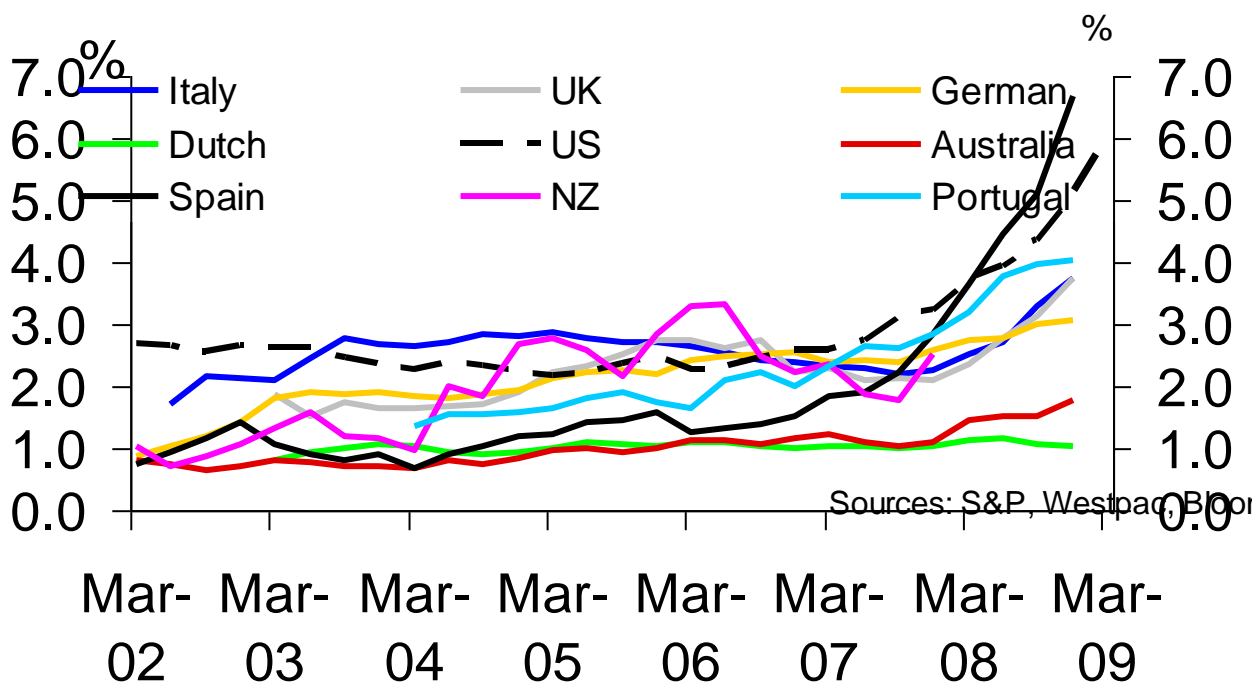
- Australian Prime mortgages.
 - Full Documentation
 - Lo Doc loans
 - Use the concept of 'insurable loans' similar to APS113.
- Seller is also the Servicer
- Seller is also the Residual Income Unit holder
- Seller has also purchased mortgage insurance

3. By way of illustration of what the appropriate amount of skin in the game could be the following table illustrates the credit protection available in a sample of outstanding Australian securitisations. The data has reflects a 'BB' rating level as more transaction data is available to BB level as opposed to B. ASF suggests a working group establish a 'B' level of support for Australian assets to be used in the application of this matrix approach.

In using the 'BB' level as a proxy for required skin in the game it appears excess for the average transaction for each asset class. However, 5% appears to be insufficient to cover BB risk for the 'riskier' deals for the majority of asset classes. We believe this analysis of outstanding transactions supports the view that a 'one size fits all' approach is probably not practical.

	Prime	Autos	Small Ticket CMBS	Credit cards	Non Conforming
BB (average)	1.0%	2.0%	2.0%	4.5%	4.0%
BB (High)	1.0%	2.6%	8.0%	8.0%	11.0%

APPENDIX II – PERFORMANCE OF AUSTRALIAN RMBS



Arrears Charts by Country.ppt.zip