

Australian Securitisation Forum

Comments on final Consultation Paper of the Australian Securities and Investments Commission on ongoing licensing relief for securitisation issuers and managers

1 Introduction

We would like to thank the Australian Securities and Investments Commission for the time and effort taken by it and its officers in meetings and discussions with the Australian Securitisation Forum. We appreciate in particular the effort taken to understand our industry. We hope that the communication platform which we have established through this process can be maintained and developed even after the process is complete.

In its “Licensing: Securitisation” final Consultation Paper, ASIC has invited comment on the proposals and on the specific questions asked by ASIC. In this response, we set out some general comments on the proposals, followed by our responses to ASIC’s specific questions.

2 General comments

We agree with that securitisation special purpose vehicles should be exempt from the requirement to hold an Australian Financial Services Licence. However, we are concerned that some of the proposed conditions placed on the availability of relief to SPVs are sufficiently impracticable to satisfy that the vast majority of the industry would not be able to take advantage of it. The concerns are set out in the answers to ASICs specific questions below, but in summary they are:

- the requirement that an SPV only issue once;
- requirement to ensure that retail clients do not acquire securitised notes¹;
- the unavailability of relief to an SPV which issues to another SPV; and
- the requirement that a licensee take responsibility for the SPV’s conduct and in particular:
 - the extent of this requirement;
 - its application to SPV’s sponsored by ADIs; and
 - its application to breaches of trust.

Although we continue to submit that securitisation managers whose ongoing role is merely administrative should not be required to hold a licence (particularly where those managers are themselves essentially special purpose in nature), we note the position ASIC has taken

¹ The instruments issued by SPVs are referred to as “notes” in this paper.

in relation to the licensing of securitisation managers. As a result, we do not restate our position and reasoning in relation to securitisation managers in this submission.

3 Answers to specific questions

We set out our answers to the specific questions raised in the Consultation Paper below.

SPVs

- 3.1 ***Are there any reasons why ASIC should consider giving relief to securitisation issuers who are not SPVs but carry on business only as trustee of other securitisation trusts, each of which is structured so as to eliminate the risk of being affected by other securitisation trusts for which the issuer is trustee? If so, please provide details.***

The Consultation Paper has placed a surprising restriction on what constitutes a SPV. An SPV for the purposes of the Consultation Paper is one that is incorporated for the purpose of carrying on business only in relation to a particular securitisation transaction. Although this was not uncommon many years ago when the securitisation industry was in its infancy; it is not at all common now. In fact, the majority of corporate securitisation vehicles issue from time to time more than one series of debt instruments, although each series is a discrete and segregated transaction (see the diagram in paragraph 3.3 below). The savings which result from not having to establish a new company for each issue of debt securities allow the securitisation vehicles to provide their products more efficiently.

The legal framework which is used to segregate multiple issues is robust, and the rating agencies are careful to ensure that rigorous criteria in this regard are met. Even though an SPV is used for multiple transactions, the parties to each transaction are not subject to any additional risk from those other transaction being conducted by the SPV.

Although an SPV may conduct a number of discrete issues, the fundamental basis of the need for it to be exempt from the requirement to hold an AFSL are unchanged and it is not the case that an SPV which issues more than once is, by that fact, more able to get a licence.

For these reasons we request that ASIC remove the single-issuance requirement. Because of the wide-spread use of multiple issuance SPVs, if it is not removed, very few participants in the market will be able to take advantage of the relief.

Dealing by issuing securitisation products

- 3.2 ***Are there any reasons why we should not give licensing relief to the SPV? If relief subject to the above conditions were granted to the SPV, would there be a risk to market integrity? If so, what are the risks?***

For the reasons presented in our previous submissions to ASIC, licensing relief should be granted to the SPV. We have not set out those reasons once more in this response, but would be happy to provide them at your request.

We do not believe that exempting the SPV from the requirement to obtain a licence is a risk to market integrity. Nearly all of the entities with whom the SPV contracts are licensees or exempted from the licensing requirement. On the basis that it is the

presence of licensed (or exempted) participants in the market which provides its integrity, it is difficult to see the incremental benefit in requiring the SPV to have its own licence.

3.3 Are there any practical difficulties for the SPV in taking steps to ensure that there is no acquisition by a retail client? For example, are the following steps practicable: not preparing a prospectus or product disclosure statement to facilitate secondary trading involving retail clients, imposing restrictions in the constitution or trust deed that only wholesale clients may be holders, and including provisions in the constitution permitting that they may require that a transferee must prove they are a wholesale client in relation to the acquisition? Are there other practical steps to limit any primary or secondary acquisition to wholesale clients?

We have two comments to make in response to this question:

- on the prevention of acquisition by retail clients; and
- on the need for the initial subscriber to be a licensee.

These are set out below.

3.3.1 Prevention of acquisition by retail clients

The overwhelming majority of securitisation issues are wholesale issues in the sense that no disclosure document is prepared under Part 6D.2 of the *Corporations Act* because at least one of the tests set out in section 708 of the *Corporations Act* is satisfied. Most commonly this is the requirement that the consideration provided by each subscriber for notes is at least \$500,000.

In addition, it is not uncommon for there to be a prohibition on the transfer of notes where the transfer would itself attract the requirements for a disclosure document under Part 6D.2 to be prepared. This prohibition is contained in the conditions of the notes, the trust deed, the information memorandum or some other transaction document. Again requiring that transactions of this nature be in minimum parcels of \$500,000 is a simple yet effective means of regulating the matter.

As a result, there should not be practical difficulties in a requirement that:

- no prospectus or product disclosure statement be prepared for the issue or to facilitate secondary trading; and
- transfers of notes not be permitted if a prospectus or product disclosure statements would be required to be prepared in connection with the transfer.

However:

- (a) in the case of notes which are securities, it is more appropriate for the requirement to refer to there being no need to prepare a prospectus rather than the status of holders as “wholesale clients”.

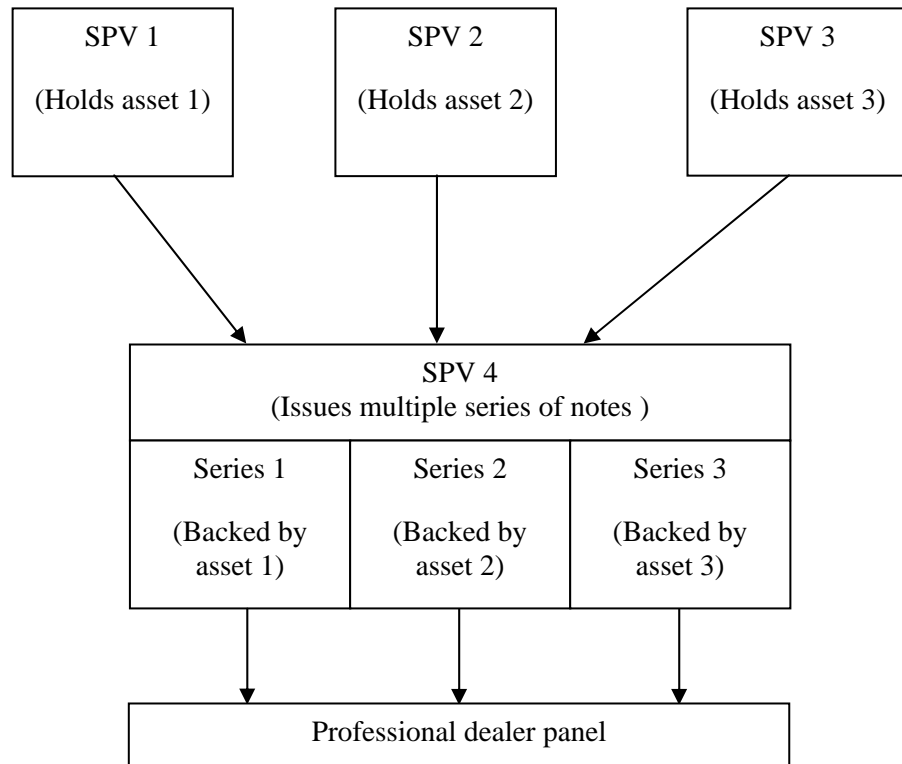
This is because the circumstances in which an offer of securities for issue require a prospectus are different to those in which an offer of other financial products for issue require a product disclosure statement. It would be inappropriate to attempt to regulate disclosure for an offer for securities by reference to the wholesale/retail client distinction when the *Corporations Act* clearly states that the disclosure standards for securities offerings are dependent on whether section 708 is applicable, not whether the subscriber is a retail client for the purposes of Chapter 7.

- (b) a requirement that the SPV monitor the status of holders throughout the term of the notes is not appropriate. This because the relevant financial service with which we are concerned is the *issue* of a financial product. This is not an ongoing service, provided throughout the term of the notes issued. As a result, a requirement that the SPV monitor the status of holders throughout the term of the notes is inconsistent with the financial service being provided.
- (c) in a secondary sale, it is not practicable to require prospective holders to prove to the SPV that they are wholesale clients before a note is transferred to them.

This is because, it is not practicable to require that the consent of the SPV be obtained at all before a transfer of notes takes place. The contract to transfer a note is a bilateral contract between two entities, and it is usually effected by a third party professional registrar who maintains the register on behalf of the SPV. To require the SPV to consent to each transfer of a note would have the result of giving a commercial benefit by regulation to other forms of wholesale instruments (such as corporate debt securities) over securitisation debt instruments. This is because the ability to freely transfer the debt securities (subject to applicable law) is considered an important commercial factor by many investors.

3.3.2 *Initial issuance to a licensee*

As an additional point, we note the requirement that all notes are initially issued to a licensee, or a person exempted from the requirement to hold a licence. This follows the common practice that notes are issued to a professional dealer panel. However, in some securitisation structures, one SPV issues to another SPV and the second SPV issues to a professional dealer panel. This arises most often where the second SPV can issue more than once and, as a result, there is a preference to segregate the assets in a separate SPV for each issue. This is represented in the following diagram:



We do not believe that the imposition of another SPV between SPVs 1, 2 and 3 in the example warrants that SPVs 1, 2 and 3 not be able to take advantage of licensing relief for the issuance of their notes. As a result, we suggest that the requirement be that notes be issued to either licensees, persons exempt from licensing or other securitisation vehicles entitled to the exemption themselves.

3.4 Are there any practical difficulties in requiring an AFS licensee to assume responsibility for the provision of this financial service? ASIC is aware that under APRA's requirements an ADI could not take up the role of being the licensee responsible for the conduct of the SPV. ASIC also understands that there may be adverse consequences for an ADI if a subsidiary were to take that role. Are there circumstances in which these adverse consequences for an ADI mean that it is impracticable for any licensee to be responsible for the conduct of the SPV? If so, what alternatives can you suggest to deliver the regulatory outcomes proposed by this licence condition?

As a general matter, we do not agree that making a licensee liable for the limited actions of an SPV is necessary for the purpose of ensuring market integrity.

In addition, we have three specific comments to make in response to this question:

- the lack of clarity in the requirement;
- the effect on ADIs; and

- the requirement that the licensee comply with the *Corporations Act* as if the SPV were its representative.

These are set out below.

3.4.1 *Lack of clarity.*

SPVs are usually off balance sheet vehicles and are designed to be remote from the bankruptcy of any other person. As a result, it is critical in their structuring there not be a link between the performance by the SPV of its contractual obligations other persons.

The proposal forms a link between the *conduct* of the SPV in issuing its instruments and the licensee. A note is made in the Consultation Paper that:

“The licence conditions would provide that they do not require that the licensee have arrangements under which the licensee accepts liability for non compliance with any undertaking to repay as a debt money deposited with, or lent to the issuer, or any interest payable on such money under a debenture issued by the issuer,”

Despite this, the responsibility appears to be excessively defined and there is no clear congruence between this responsibility and the fact that the financial service is only the issuance of the instruments which ends after the time of issue. The issuer is being exempted from the financial service of *issuing* the instrument, not “conduct relating to the issuance of the instrument”. Such related conduct is regulated by other parts of the *Corporations Act* and other legislation, such as section 12DA of the *Australian Securities and Investment Commission Act*. The licensing regime is not needed to regulate it further.

As a result, if relief must be harnessed to this responsibility concept, we suggest that the scope of the responsibility of the licensee:

- be limited to conduct of the issuer in issuing the notes; and
- to exclude the performance of any contractual obligations that the SPV has in connection with those instruments.

Where the SPV’s client in relation to its issuance of the notes is a licensee (or an exempted person) itself, the requirement that a licensee take responsibility for the issuance would appear to further the aim of market integrity very little. We suggest that in these circumstances, the taking of responsibility by the licensee not be required.

3.4.2 *ADIs*

The separation and disclosure requirements set out in Australian Prudential Standard 120 - in particular in Australian Guidance Note 120.1 - are fundamental requirement of the prudential regulator of ADI’s. “AGN 120.1, paragraph 10, states - “...securitisation schemes should stand clearly separate from any ADI involved in the schemes, and there should be **clear limits** governing the extent of that involvement”. [emphasis added] Reference to the ADI in this paragraph includes subsidiaries of the ADI

including the entities that act as managers of ADI sponsored securitisation vehicles (see footnote 1 to APS120).

The limit of the ADI's exposure under the proposed rules is far from clear.

In addition, one of the fundamental basis, both in Australia and offshore, of the involvement of regulated entities or their subsidiaries in managing securitisation SPVs has been that the manager will not be directly liable to investors (but rather will be indirectly liable by way of contractual promises made to the SPV). The proposed rule clearly runs contrary to this principle.

The regulatory capital implications of any; proposed rule (both for Australian and foreign ADIs) should be resolved prior to its finalisation so that there is no uncertainty as to the implications from a regulatory capital perspective of any final rule. If the proposed rule does not take account of the requirements of APRA and other regulators it is likely to be of little benefit to the securitisation industry.

3.4.3 Compliance with Corporations Act as if SPV were its representative

On a related matter, we note that a licensee will need to comply with the *Corporations Act* as if the SPV were its representative. In summary, this will require the licensee to:

- do all things necessary to ensure that the SPV provides financial services under the exemption efficiently, honestly and fairly;
- ensure that the comply with the conditions on the licensee's AFS licence with respect to the activities carried on under the exemption;
- take reasonable steps to ensure that the SPV complies with financial services laws with respect to the activities carried on under the exemption;
- ensure that the SPV has available adequate resources (including financial, technological and human resources) to provide the financial services using the exemption;
- ensure the SPV maintains the competence to provide financial services under the exemption; and
- ensure the SPV is adequately trained, and are competent, to provide the financial services under the exemption.

In particular, the last of these is difficult to construe when the SPV may be a company with only 1 to 3 directors and no employees. Is ASIC's intention to require that the directors of SPVs need to meet particular training requirements?

Dealing by issuing derivatives or FX contracts

3.5 *Are there any reasons why we should not give the licensing relief proposed in paragraphs 22 and 23 to the SPV? If relief subject to the above conditions were granted to the SPV, would there be a risk to market integrity? If so what are the risks?*

Our response set out in paragraph 3.2 above applies to this question also.

In addition, we note that in entering into a derivative, the SPV both issues and acquires the derivative. As the self-dealing exclusion in section 766C(3) does not apply to dealings in financial products by the issuer of them², it is necessary that dealing in derivatives by the SPV acquiring them also be included in the exemption.

3.6 *Are there any practical difficulties in requiring another AFS licensee to assume responsibility for the provision of this financial service by the SPV? If so, what alternatives can you suggest to deliver the regulatory outcomes proposed by this licence condition?*

Our response set out in paragraph 3.4 above applies to this question also.

As a result, we suggest that the scope of the responsibility of the licensee:

- be limited to conduct of the issuer in dealing in the derivative or foreign exchange contract; and
- to exclude the performance of any contractual obligations that the SPV has in connection with that derivative or foreign exchange contract.

For the same reasons as are set out in paragraph 3.4.1, we suggest that the requirement for responsibility being taken by a licensee not be applicable where the counterparty to the SPV is itself a licensee or is exempted from the requirement to hold a licence.

Providing custodial services and dealing in the underlying assets of the trust

3.7 *Are there any reasons why we should not give the licensing relief proposed in paragraphs 24 and 25 to the SPV? If relief, subject to the above conditions, were granted to the SPV, would there be a risk to market integrity? If so what are the risks?*

Our response set out in paragraph 3.2 above applies to this question also.

3.8 *Are there any practical difficulties in requiring another AFS licensee to assume responsibility for the provision of this financial service? If so, what alternatives can you suggest to deliver the regulatory outcomes proposed by this licence condition?*

Our response set out in paragraph 3.4 above applies to this question also.

However, the practical result of this requirement is even more serious in this circumstance. Making the licensee liable for any breach of trust by the SPV removes the separation of performance risk from the licensee, to the extent where it is likely that either the SPV will need to get licensed or the sponsor will need to find a licensee to replace the existing trustee.

² Other than the exception in section 766C(4) in relation to securities.

Securitisation managers

3.9 ***Should ASIC consider giving licensing relief to securitisation managers? If so, what are the grounds to give relief that is not provided to other providers of wholesale financial services?***

As mentioned in paragraph 2 of this paper, we have submitted to ASIC previously that securitisation managers who do not have ongoing obligations other than reporting or administrative requirements should not need to obtain a licence.

However, there is an additional consideration for securitisation managers who are subsidiaries of ADIs. APRA's guideline APS 120 requires that ADIs not be securitisation managers themselves, but a subsidiary of an ADI may act as a securitisation manager. ADIs have no choice but to comply with this requirement. However if these subsidiaries are required to obtain a financial services licence they will be subject to the capital requirements set out in ASIC's Policy Statement 166. These capital requirements will cause ADIs to capitalise their subsidiary managers to satisfy licensing requirements. This capitalisation will result in liquid assets of an ADI being isolated from its asset base and, therefore, from the immediate access of deposit holders of the ADI. Although the amount may not seem material in the case of large ADIs, it may be in the case of some ADIs and reflects a conceptual conflict between this licensing requirement and the prudential regulatory regime administered by the APRA.

3.10 ***If relief was to be considered for securitisation managers, what conditions should apply? For instance, should there be a condition that an AFS licensee is responsible under its licence to comply with the Corporations Act, as if any securitisation manager that it has notified to ASIC for that purpose were a representative of the licensee within the meaning of Chapter 7, and be liable for the managers conduct as if the manager were its representative reflecting the conditions for issuer relief above? If this would not be practicable, please explain why this is so.***

Although we are not commenting generally on the licensing of managers, the "responsibility" approach may not be of practical use in this circumstance.