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By email: baselcommittee@bis.org

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs

Consultation Document on Criteria for identifying simple, transparent and comparable securitisations (December 2014)

We refer to the consultative document on “Criteria for identifying simple, transparent and comparable securitisations” issued by the Basel Committee on Banking Supervision (BCBS) and Board of the International Securities Commissions in December 2014. On behalf of our members, we set out in the annex our detailed comments on the proposals in the consultative document.

We hope you find our comments useful. For any questions, please do not hesitate to contact Ms Emily Ngan of the Secretariat at (852) 2526 6080.

Yours faithfully


Henry Chan
Secretary

Enc.

c.c. Ms Karen Kemp, Executive Director (Banking Policy), Hong Kong Monetary Authority

Chairman The Hongkong and Shanghai Banking Corporation Ltd
Vice Chairmen Bank of China (Hong Kong) Ltd
Standard Chartered Bank (Hong Kong) Ltd
Secretary Henry Chan

主席 香港上海匯豐銀行有限公司
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Annex: HKAB's comments on the BCBS Consultative Document

Criteria for Identifying Simple, Transparent and Comparable Securitisations (Dec 2014)

We agree with the BCBS proposal to adopt a principles-based approach in identifying simple, transparent and comparable securitisations in order to allow more flexibility as market practices evolve. This approach will have the advantages of resolving much of the current regulatory uncertainty, allowing the criteria to be applied in a flexible, purposive manner and prevent “gaming” of the regulatory framework.

The ultimate purpose of this proposal is 1) to add transparency to facilitate investors conducting their own proper due diligence on securitisations, 2) to rebuild confidence in the securitisation markets post the financial crisis period and 3) to maintain a well-functioning securitisation market as an alternative funding channel to the real economy and enhanced risk-sharing. Hence, we recommend the BCBS should consider the following areas as well:

- *Balancing the needs of investors and the interests of originators*
Reassuring investors' confidence in securitisation assets is invaluable. Balancing this with the benefits of securitisation to the originator is also crucial to ensure a continuing healthy supply side of the securitisation market, in particular on how to define significant risk transfer under this approach.
- *Allowance of transition relief or grandfather exemptions*
Allow a transitional relief or grandfather exemptions in order to avoid unnecessary market shocks in disposals of securitisations that fail to meet these criteria. This is to prevent a speedy sale of such positions at inappropriately low prices purely on the basis that a later-issued transaction structured to the new specifications would have better capital treatment.
- *Conducting a totality assessment and incorporation of this proposal into BCBS other frameworks*
The BCBS should consider treating simple and transparent securitisations as High-Quality Liquid Assets (HQLA) under the Liquidity Coverage Ratio (LCR). The BCBS should also revisit the finalised version of “Revisions to the securitisation framework” to reduce or to remove risk weight floors on simple and transparent securitisations in order to ensure that the capital requirements calculated using the risk weight floor (at 15% risk weighted) for holding the securitisation notes can be as low as the capital requirements for holding the underlying assets directly.

We also set out our comments to the questions on page 10 of the consultation document below:

1. Do respondents agree that the criteria achieve the goals they aim to achieve? In particular, do respondents believe that the criteria could help investors to identify “simple”, “transparent” and comparable” securitisations?

In general, we are of the view that the criteria could help investors to identify “simple”, “transparent” and “comparable” securitisations with the listed 14 criteria which have intensive focus on the investors’ interest. With enhanced transparency due to greater investors access to comprehensive and reliable information (on repayment, delinquent and default history) and standardisation of legal documents, this should enable the investors to conduct their own due diligence and accurate risk assessments before investment and ongoing monitoring. BCBS should provide further incentives to regulated investors by incorporating these instruments in LCR and reducing or removing the risk weight floor under the revised securitisation framework.

The BCBS should also strike a balance with the originators’ interest as well in terms of data availability, system infrastructure and without adding additional burden to originators in defining the significant risk transfer for RWA relief entitlement.

2. Do respondents agree with the STC criteria set out in the annex of this paper? In particular, are they clear enough to allow for the development by the financial sector of simple, transparent and comparable securitisations? Or do respondents think they are too detailed as globally applicable criteria? The annex provides guidance on each criterion. Which additional criteria would respondents consider necessary, if any, and what additional provisions would be useful or necessary to support the use of the criteria? What are respondents’ views on the “additional considerations” set out under some criteria in the annex? Should they become part of the criteria? Are there particular criteria that could hinder the development of sustainable securitisation markets due, for example, to the costliness of their implementation?

Please refer to Appendix I for comments on respective principles.

- 3. What are respondents' views on the state of short-term securitisation markets and the need for initiatives with involvement from public authorities? Do respondents consider useful the development of differentiating criteria for ABCP, in a manner similar to that of term securitisations? The BCBS and IOSCO would particularly welcome any data and descriptions illustrating the state of short-term securitisation markets by jurisdiction and the views of respondents on concrete comparable criteria that could be applied to short-term securitisations.**

ABCP is a key part of securitisation markets and provides an important source of funding to the economy. We believe that setting similar governing criteria can facilitate the development of short-term securitisation.

We would suggest that the criteria should include (i) that the ABCP transaction be sponsored by a credit institution that is subject to the liquidity coverage requirement; (ii) that the sponsoring institution provides full liquidity support to the transaction; and (iii) that the maximum maturity for any instrument be 397 days (or two years with a rate reset within 397 days).

- 4. What are respondents' views on the level of standardisation of securitisation transactions' documentation? Would some minimum level of standardisation of prospectuses, investor reports and key transaction terms be beneficial? Do respondents think there are other areas that could benefit from more standardisation? Would a standardised template including where to find the relevant information in the prospectus be helpful? The BCBS and IOSCO would particularly welcome a description, by jurisdiction, of the extent to which different elements of initial documentation are standardised.**

We agree that further simplifying work could be undertaken regarding prospectuses and investor reports. However, a balance will need to be struck between the need to achieve greater standardisation (and simplicity) on the one hand and the legal obligation to make appropriate disclosure under the terms of applicable legislation on the other.

We also agree that standardised templates could be helpful in facilitating investors' understanding in the securitisation and enhance the comparability of securitisations. Standardisation should not lead to "box-ticking", derail from the need for sensible flexibility (the "comply or explain" principle), unreasonably restrict the freedom of commercial parties to agree suitable terms or unreasonably restrict the choices of consumers.

Appendix 1 – Comment on criteria for identifying simple, transparent and comparable (STC) securitizations

1. Nature of the assets

We consider that the requirement on homogeneity of underlying asset classes is reasonable. However, it should be applied in a broad way. For example, auto loans and auto leases could be in the same securitised portfolio.

In addition, we consider that the specific requirements on homogeneity of jurisdiction, legal system and currency are overly punitive. In fact, securitisations with underlying assets in different currencies and in different jurisdictions could still be simple and transparent. For example, it is common that securitisations include assets from multiple branches in different countries of the same bank originator. These assets benefit from identical risk and control requirements of the same originator.

It is suggested that the referenced interest payments or discounts should be based on commonly encountered market interest rates but should not reference complex or complicated formulae or exotic derivatives. However, the interest rates on the assets are not always based on a market standard; this is especially the case for consumer loans that almost invariably have an element of the bank originator's standard variable rate.

2. Asset performance history

We supports the inclusion of the criteria in principle although it would likely increase the entry barrier for new originators, the securitisation of new asset classes and the securitisation of traditional asset classes in new jurisdictions.

We are also concerned about a situation where a portfolio of eligible assets is purchased from another institution, and then securitised by the purchaser. The onus would then be on the purchaser to ensure the historical portfolio analysis was purchased with the portfolio.

In addition, the fiduciary responsibility assessment of the originator, sponsor, servicer and other parties to the securitisation has already been detailed in criteria 13 “Fiduciary and contractual responsibilities”, thus should not be considered again in the asset risk category.

3. Payment status

We would query the requirements to meet this criterion under a Master Trust structure. Under such a structure, it is highly likely that there will be obligations that are in default or delinquent. Would each issuance from a Master Trust be subject to a retesting of the STC securitisation criteria or would a Master Trust be able to obtain this designation as a whole? It is worth including a small percentage of delinquencies in the STC definition.

We assume that credit claims from previously credit impaired borrowers should be allowed to be included in the underlying assets of a securitisation.

4. Consistency of underwriting

We agree with this criteria and believe such assurances can be given during due diligence and in the normal representations and warranties.

5. Asset selection and transfer

We agree with this criterion and welcome the expansion of the transfer definition to include transfers by other means than true sale.

In determining the selection of assets, BCBS should consider the practical reasons and allow selection of exposures to achieve the desired economics (including capital treatment) of the transaction and on the basis of data availability should not in principle be considered to be cherry picking.

We would like to emphasize that synthetic securitisations should not be excluded from the STC securitisation framework. In some cases, synthetic securitisations can be less complex than traditional securitisations, as legal, tax, encumbrance and cashflow issues associated with the transfer of legal ownership of assets are not applicable for synthetic securitisations. In addition, most synthetic deals are on-balance sheet transactions originated by banks, and hence would be subject to review by regulators, enhancing their appeal to STC securitisation investors.

6. Initial and ongoing data

We agree with the criteria.

7. Redemption cash flows

Whilst this will be detrimental to CMBS structures which are known to have refinancing needs, we believe it is broad enough to allow interest only loans (such as buy to let) and/or bullet structures to be eligible, as long as the pool is sufficiently granular and the maturity profile is not too concentrated.

8. Currency and interest rate asset and liability mismatches

We agree with the criteria. It would be helpful to have a definition for genuine hedging purposes.

9. Payment priorities and observability

We request clarification on whether this requirement effectively means that all payments must be fully sequential throughout the life of the securitisation. A number of structures currently allow for a pro rata repayment profile once certain events are achieved, for example, credit enhancement doubles from its original support.

Although we assume this is not the case, if a fully sequential payment priority is required, this may lead to a STC securitisation not being economically viable for some entities, due to the cost involved in having the junior series outstanding for longer rather than being repaid at a gradual rate during the life of the transaction.

In respect of the criteria for transactions featuring a revolving period, certain typical features should be considered. Firstly, materiality is important: a minor and insignificant deterioration in credit quality will not and should not lead to early amortisation. Secondly, short term assets such as trade and other receivables often experience seasonal variations in amounts outstanding because they are directly connected to the real economy; this should not trigger early amortisation, especially as the structures financing such assets contain dynamic credit enhancement as a mitigant for the risk. Lastly, other types of transactions such as granular consumer portfolios are unlikely to reference credit quality specifically. As a proxy for credit quality, certain other ratios and triggers will be included such that the substance of the criterion is nonetheless fulfilled.

In the event of the circumstances listed in the criterion, the securitisation should not be forced to switch straight to sequential payments, the requirements should allow for firms to be able to use other solutions to resolve problems.

10. Voting and enforcement rights

We agree the criteria could enhance the clarity on the securitisation.

11. Documentation disclosure and legal review

We have no objection to disclose transaction documents relevant to the ongoing transaction. From a practical perspective, it is not always possible to finalise all transaction documents with sufficient time before issuance, especially as we are in doubt whether the documentations listed in footnote 13 should be fully negotiated and finalised for review by investors within a reasonably sufficient period of time prior to issuance.

The disclosure of information before issuance should be of practical value to the investor without increasing risk for issuers. A possible approach would be to ensure that the offering circular contains enough detailed information to cover the salient points of the underlying documents. Focusing attention – and the majority of time – on this document could be more beneficial to an investor than supplying additional documents.

12. Alignment of interest

We agree such a criterion is necessary for consistency with regulatory requirements. However, given it is a standard mandatory requirement to retain material economic exposure of 5% under both European and US capital rules, it may be beneficial to specify the same percentage as part of the STC securitisation criteria.

We would like BCBS to define the term “financial incentive” in the criteria. Would it be possible for the originator or sponsor to meet this requirement by including this as a representation in the transaction documentation or would this be subject to a particular calculation?

13. Fiduciary and contractual responsibilities

We agree with this criteria and additional consideration.

14. Transparency to investors

Whilst we are supportive of the transparency around the transaction’s income and disbursements, we would caution that an itemised breakdown of fees by counterparty should not be expected, as some fees and charges will be subject to private commercial arrangements. Disclosing the consolidated fees as a line item does not have a direct linkage to the transparency and visibility of the securitisation’s financial position to investors.

The disclosure of this level of detail would require system development especially for a securitisation with a highly granular pool. We would need development work for preparing the performance report in a timely fashion. The requirement would be particularly costly to new originators to the market.