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13 February 2015

Basel Committee on Banking Supervision
www.bis.org/bcbs/commentupload.htm

International Organisation of Securities Commissions
Consultation-2014-10@iosco.org

BCBS IOSCO Consultative Document: Criteria for identifying simple, transparent and comparable securitisation

Moody's Investors Service ("MIS") appreciates the opportunity to provide comments to the Basel Committee on Banking Supervision ("BCBS") and the International Organisation of Securities Commissions ("IOSCO") on the consultative document: *criteria for identifying simple, transparent and comparable securitisations* (the "Paper").

In the letter we have set out our comments on the concept of simple, transparent and comparable ("STC") securitisation. In Annex I, we have provided our comments to the questions posed in the consultative document.

1.1 The concept of simple, transparent and comparable securitisation

The Paper highlights a number of proposed principles that are considered necessary for a securitisation to be simple, transparent and comparable. MIS understands the benefit such a classification may have for policy makers, particularly in regard to the predictability, certainty and level of assessment of the risk particularly when read together with other policy maker initiatives in this area.[1]

As the Paper suggests, these STC principles are only the foundation on which additional criteria can be added, such as credit risk. In our view, the STC criteria should lay the foundation for securitisation to correlate with prediction confidence. Ensuring that a securitisation transaction's assets or structure has certain predefined features does not guarantee that its performance will be predictable to a high degree of confidence.

Assumptions about future asset performance and how well the structures can withstand legal and governance challenges leads to uncertainty in securitisation transactions. Specifically, uncertainty can arise from a combination of the following factors.

[1] Our views on "high quality" securitisation can be found in our Special Comment: *Key Factors in Assessing the Credit Quality of European Structured Finance Transactions (30 September 2014).*

1) **Collateral pool and structure:** Although all transactions are exposed to a variety of risks, the specific characteristics of the underlying portfolio and structure render some risks more relevant to a transaction than others. The nature of the pool and the structure, not the asset class, generally determines whether a transaction is simple or complex.

2) **Historical data adequacy, performance variability and quality of disclosure**: The length and quality of historical performance data and the extent, timeliness and quality of disclosure of collateral characteristics may vary significantly, even for transactions within the same asset class. In some cases, the historical data available may be insufficient to assess future portfolio performance with confidence. For example, the data may not reflect the performance of assets during an economic downturn. Even if data for numerous years is available, it may not specifically relate to the assets being securitised. We may not be able to use the data effectively to predict a portfolio's performance if there have been changes in the originator's method of origination, underwriting standards, product features, demographic or geographic target market, or if the originator has purchased delinquent receivables from a pool. In the past several years, regulatory and industry initiatives have made significant progress in defining the appropriate standard of data for securitisation transactions. In many markets, repeat originators have become adept at supplying an appropriate amount of data.

3) **Governance:** Although a transaction's documentation sets out how a transaction is supposed to work, in practice, numerous governance issues may come into play. These issues include the experience and ability of transaction parties, the alignment of interests among transaction parties and the impact of the legal and regulatory framework

1.2 Two essential factors for "simple, transparent and comparable" securitisation

There are two areas where we, as users of the information flowing from securitisations, continue to see as risk factors in analysing a securitisation (particularly in the EU). These are:

- Transparency, comparability and quality of data; and
- Legal certainty around the securitisation structure.

Taking each of these in turn:

1.2.1. Transparency, comparability and quality of data

As MIS uses financial data published by issuers as one of the key inputs for its credit analysis, we welcome regulatory initiatives focused on increasing the frequency, quality and consistency of publicly available information. The implementation of Article 8b of Regulation (EC) 1060/2009[2] and the creation of the website by the European Securities Markets Authority ("ESMA") relating to information on securitisation instruments should be an important step in the right direction.

[2] Article 8b (1) states that "the issuer, the originator and the sponsor of a structured finance instrument established in the Union shall, on the website set up by ESMA pursuant to paragraph 4, jointly publish information on the credit quality and performance of the underlying assets of the structured finance instrument, the structure of the securitisation transaction, the cash flows and any collateral supporting a securitisation exposure as well as any information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures."

These initiatives should allow detailed, consistent information about underlying credit risks to be provided by issuers to the investing public which in turn increases the diversity of opinion and level of debate in the market and improves the functioning of markets.

However, information disclosure is only the foundation of an effective market discipline framework. Enhancing the disclosure regime for issuers so that detailed, *consistent* quality information about underlying credit risks is provided by issuers to the investing public is important. Information should be disclosed at regular intervals or periods and in a consistent and standardised format that allows for comparability and be of sufficient quality that allows users of the information to rely on the information without an additional verification process. Currently, there is no standardisation with regard to terminology and calculations for ratios and triggers (particularly in the EU).[3] It would be beneficial if there was a focus on having consistent standards for measuring loan performance (such as aging and charge-offs). Furthermore, the definitions in the various transaction reports are often unclear or inconsistent. If definitions are not clearly provided, it is difficult for investors to ensure consistency of analysis across transactions and benchmark them appropriately. It is therefore imperative that all the terms are clearly defined in the investor report and detailed formulae are provided for ratios and triggers to support high quality monitoring analysis.

1.2.2 Legal certainty around the securitisation structure

A key component in determining the level of risk in a securitisation is whether the legal system provides certainty and an understanding of the implication of legal outcomes. The absence of a clear and consistent legal framework for transaction structures creates uncertainty in any analysis.

Criteria 11 in the Paper, *documentation disclosure and legal review*, is a welcome step to address this issue. More specifically, we believe that standardised terminology and documents that cover true sale, title to ownership, insolvency and bankruptcy provisions would help to reduce uncertainty around legal risk and would allow for greater comparability of transactions.

An additional benefit is that with a more certain legal environment and disclosure framework, potential barriers to the availability of transaction counterparties are reduced. Such a framework would reduce the risk of, and allow for, an easier interchange of transaction counterparties.

We trust that you will find our comments helpful and would be pleased to discuss our views with you at your convenience.

Yours sincerely

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Jim Ahern
Managing Director – Structured Finance

[3] For example, there is currently no consistency with regard to the delinquency definition across transactions. Some transactions report delinquency based on the number of days delinquent independent of the amount unpaid, while others report delinquency based on the ratio amount unpaid divided by the contract monthly obligation. Some transactions report defaulted loans and repossessed loans in the late stage of the delinquency bucket, while others report these loans separately.

ANNEX 1

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?*

Securitisations, by their nature, involve a specific analysis where confidence in the range of possible credit risk scenarios is more important than the likelihood of a single specific outcome. Whether the metrics of "*simple*", "*transparent*" and "*comparable*" ("STC") are the most appropriate will depend on how they are defined.

We believe simplicity is a useful goal but could limit innovation or discourage structural risk mitigation if not sufficiently flexible in its bounds. For example, swaps can add structural complexity to securitisations but may be effective in reducing risk when used for hedging. Incremental tranching can add complexity but it can also deliver more refined or targeted risk attributes to investors, allowing for a simpler risk assessment. A back up servicing arrangement adds complexity, yet is intended to bring a higher level of comfort to servicing risk.

Transparency is an appropriate objective provided it can be effective and beneficial for all transaction parties. Some existing rules promulgated in the interest of transparency have not delivered on their perceived goal and merely add operating costs to securitisation. For example, US SEC Rule 17-g5 was passed to promote competition among rating agencies, but to date compliance has proven to be burdensome and costly for issuers and arrangers, while the postings do not offer the sufficiency of dialogue and exchange necessary for rating agencies to confidently issue and maintain monitored ratings. We would advocate that transparency guidelines only be established via collaborative dialogue and consensus among the using parties (issuers, investors, regulators, service providers, etc.). An example which could be used as a model is the RMBS 3.0 white paper recently produced by the Structured Finance Industry Group in the US – this paper offers suggestions on a path forward for transparency standards, inter alia, in the US private label mortgage market, reflecting the shared views of the various stakeholders in the product.

Comparability, in order to be effective, would need to consider and respect the differing legal, prudential and financial accounting standards prevalent in global markets. For example, a 90 days delinquent charge off standard might be a comparability goal for auto loan securitisations, but this would only work to the extent that this is the standard used by auto lenders in their non-securitised lending practices. Otherwise comparability goals might instead discourage use of securitisation versus other funding sources. In addition, we are of the view that there is a big gap in the disclosure standards and levels of comparability between securitisation and covered bonds.

For more information, see our Special Comment on *Key Factors in Assessing the Credit Quality of European Structured Finance Transactions* which we have attached to this response for your further information and which is also available at the link below.

http://www.moodys.com/viewresearchdoc.aspx?docid=PBS_SF382435

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?*

As referred to in the letter, we believe that a structured finance transaction's assets or structure having certain predefined features such as STC does not guarantee "high quality", given that its performance may still not be predictable to a high degree of confidence.

To improve the predictability of performance, the legal frameworks and accounting standards would need to converge globally for any comparability criteria to be effective. As an example, fiduciary standards differ across countries – Trustees in Latin American securitisations have a higher fiduciary responsibility than in US securitisations. In addition, consumer charge off standards differ by product in the US – auto loans are typically deemed defaulted after 90 days past due, whereas for credit cards, the standard is 180 days past due, and for student loans 240 days past due (notwithstanding forbearance and grace) together with other such examples.

Regulations or standards that are to be passed in the spirit of these STC criteria would be better served to be passed at the entity level rather than at the securitisation level. For example, if we want all credit card securitisations to use 180 days past due as the definition for defaulted receivable, then legislation should be passed for credit card banks to maintain this default policy at an entity level to avoid arbitrage between securitisation and non-securitisation approaches to default recognition.

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.*

Regarding the state of the short-term securitisation market and data and descriptions illustrating the state of short term securitisation markets by jurisdiction, we enclose below some details from MIS' most recent ABCP Market Summary for Europe Middle East and Africa.

As at 30 September 2014 the EMEA rated ABCP programs had approximately USD71 billion of ABCP outstanding, split roughly equally between the USCP and ECP markets. The market has stabilized in the last 12-18 months leaving a remaining core of 25 issuers.

One of the most important distinguishing features between different programs is whether they are full-support or partial-support. 97% of transactions in programs rated in EMEA are fully-supported, i.e the bank sponsored liquidity facilities cover full and timely repayment of outstanding ABCP regardless of the underlying asset performance. For the remaining 3% of transactions (partial-support), the repayment of ABCP is dependent upon the performance of the underlying assets coupled with the terms of the supporting liquidity facilities (which invariably cover certain asset risks) and other support mechanisms provided by the sponsoring bank. It is worth noting that there are more partial-support US rated programs in which an understanding of the risks not covered by liquidity facilities and other support mechanisms becomes more relevant.

The EMEA market has become increasingly homogenized and is dominated by bank sponsored, multi-seller programs providing funding for core clients of that bank (c.87%). There are small legacy pools of securities-arbitrage investments (i.e term Structured Finance investments) which remain within a limited number of programs (c.2%), but these are diminishing rapidly and are all full-supported as well. There are no single-seller programs left in EMEA. Repo programs constitute c.11% of the market. Multi-seller programs are generally structurally very similar amongst themselves.

Whilst as a rating agency we don't analyse the underlying asset performance in full support transactions, investors may seek to "look through" this full support to gain an understanding of what the conduit contains. The market summary report contains asset composition data which evidence that trade receivables (48%) and auto loans/leases (28%) constitute the primary asset classes financed in ABCP programs with the only other asset class of any size being consumer loans (6%). Clearly, different programs will have different asset splits in terms of type and geographic origin etc.

https://www.moodys.com/research/EMEA-ABCP-Market-Summary-Q3-2014--PBS_SF392320

In addition, MIS also compiles a global Market Snapshot with respect to ABCP. Included in the Snapshot are exhibits offering comparative statistics about each program and a macro-level graphical view of the multiseller ABCP market. The exhibits track parameters using three main categories: outstanding amount of ABCP, asset purchase limits, and the number of transactions. Detailed descriptive information on each of the conduits mentioned in the report may be found in various ABCP Program Reviews and ABCP Program Overviews which cover specific conduits. Summary information on all Moody's rated ABCP programs may be found in the ABCP Program Index.

Regarding ABCP programs, we believe the only viable post crisis operating model for this product we have observed has been multi-seller (or single seller) ABCP programs where refinancing risk does not rely exclusively on markets but instead also on contingent liquidity commitments from third parties (typically regulated banks).

Please find below a link to our most recent ABCP Market Snapshot.

https://www.moodys.com/research/ABCP-Market-At-A-Glance-ABCP-Multiseller-Market-Snapshot-Sept--PBS_SF393426

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.*

As per our comments in 1.2.1 and 1.2.2 of our letter, we would welcome initiatives that would increase standardisation and the quality of information available in transaction documentation thus promoting legal certainty around the securitisation structure. Standardisation increases comparability between transactions and codifies good credit and legal practice as well as potentially reducing costs and execution risks for the Issuer.

Within structured finance it is common for certain documentary provisions including eligibility criteria, events of default, reps and warranties and triggers to be relatively standardised across transactions within individual asset classes. Additionally, US SEC Rule 17-g7 requires rating agencies to publish a report on a transaction's reps, warranties and enforcement mechanisms in the form of a benchmarking table against a standard applicable for the particular asset class. As a minimum this promotes transparency and may be a driver of standardization.

Repeat transactions, vanilla transactions and master trust issuances promote standardisation through using predecessor deal documents. There will, however, always be bespoke transactions which require bespoke documentation and it would not be desirable if the drive for standardisation choked off innovation in the market. Documents need to be flexible enough to address any specific credit concerns arising from esoteric asset classes.