



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 53

Licensing: Securitisation

August 2004

AFS licensing for securitisation issuers and managers

1 This Consultation Paper sets out ASIC's proposals for ongoing relief from the Australian financial services (AFS) licensing requirements for:

- (a) issuers of securitisation products; and
- (b) securitisation managers.

2 Current interim relief under ASIC Class Order [CO 03/1098] expires on 30 September 2004: see ASIC Information Release 03/43: *ASIC provides temporary relief during period of consultation*. ASIC proposes ongoing licensing relief for securitisation special purpose vehicles. ASIC will provide further temporary relief during the consultation period for this Paper. We have extended our current relief until **31 March 2005**, to facilitate transition to any final policy: see paragraphs 36–37.

3 This Consultation Paper is not in ASIC's usual format for consulting on policy proposals. It reflects the discrete and technical nature of these policy proposals and recognises that the policy proposals demonstrate that extensive industry consultation has already taken place.

4 We invite you to comment on the proposals, and on the questions we have included. Please provide us with any additional information (both qualitative and quantitative) to support any comments, issues or arguments you raise.

5 Submissions are due by **Friday, 17 September 2004** and should be sent to:

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What is securitisation?

Structure of a securitisation transaction

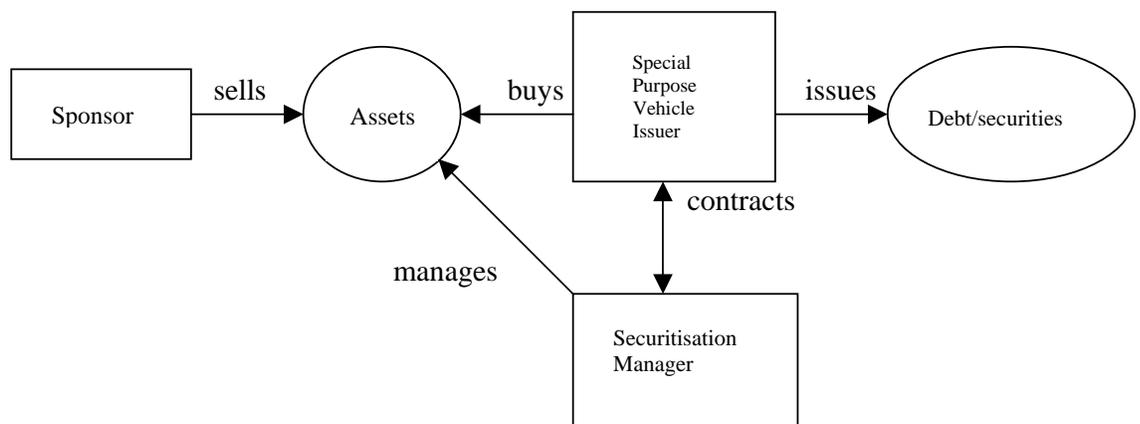
6 A securitisation arrangement typically involves a complex set of structured finance transactions where a number of entities are often established just for the purpose of the transaction. The classic definition is, a process where a portfolio of relatively illiquid assets is packaged into marketable securities that are sold into the capital markets. The benefits payable to investors from a securitisation will depend at least partly on the return from the underlying securitised assets (“securitisation products”).

7 The securitisation industry operates almost exclusively in the wholesale market, where the financial product (for example a debenture) is sold to wholesale investors, invariably through the on-sale of the financial product by a licensed dealer.

8 The legal structure of a securitisation will depend on the type of asset to be securitised, the type of market access desired by the seller of the securitised assets (“the **sponsor**”) and any relevant taxation, prudential or regulatory issues. In Australia, a sponsor will typically be an Australian ADI. Further, securitisations generally have common features to ensure viability because of prudential regulatory requirements and the need to obtain a high credit rating to promote marketability of the scheme.

9 A securitisation arrangement structured with a special purpose company can be illustrated generally in the following example:

Diagram



Parties to a securitisation transaction

Issuers

10 In a securitisation transaction, an entity (“**the issuer**”) purchases assets from a sponsor and issues fixed income securities (typically a debenture or a unit in a unit trust), and also enters into ancillary arrangements to hedge risk.

Note: The sponsor is defined in paragraph 8.

SPVs

11 The issuer may be a **special purpose vehicle issuer (“SPV”)** in that it is incorporated for the purpose of carrying on business only in relation to the particular securitisation transaction. Alternatively, the issuer may be an entity that is not a special purpose vehicle. Where the issuer is not a special purpose vehicle, the entity will generally act as trustee of a trust that is a special purpose trust i.e. a trust is established and operates only for a single securitisation transaction. A securitisation transaction may involve a special purpose trust to ensure that the outcomes for investors in the securitisation transaction cannot be affected by what may happen with any other activity.

The SP company and SP trustee

12 The SPV can either be formed as a special purpose company that issues debentures (“**SP company**”), or as trustee of a trust that issues interests in a managed investment scheme (“**SP trustee**”).

The securitisation manager

13 Whether the SPV is structured as an SP company or SP trustee, typically a manager (“**securitisation manager**”) is appointed under a contractual arrangement with the issuer, to manage the securitisation transaction and perform other duties. Its role includes engaging in all direct dealings, collect moneys owing (to be directed through to the issuer) and keep records. The securitisation manager will be a separate legal entity from the sponsor (typically being an ADI). However, the discretions of the manager are closely circumscribed by the securitisation documentation to ensure that a high credit rating is obtained for the issue, which is critical to distribution.

The custodian

14 There may also be a custodian to hold the securitised assets. The custodial services may be provided by the securitisation manager or by another entity.

Why securitise?

15 An important objective of the securitisation is to access a lower or alternative cost of funds for the sponsor. Securitisation can be an effective financing technique because it enables a sponsor to convert non-liquid assets into cash. The securitised assets and related funding might then be able to be taken off the statement of financial position of that entity for accounting purposes. Whether this is the effect of the arrangement or not depends on the application of applicable accounting standards to the particular circumstances. If the securitised assets cease to be assets of the sponsor this will affect its liquidity, debt/equity ratio, profit margin and borrowing costs as it appears from its financial statements as well as compliance with relevant prudential standards.

16 Securitisation may also be a means of offering flexible funding and improving longer term financing or accessing funds at a more attractive rate. The securitised assets, isolated from the other assets of the entity whose assets are being securitised, may be given a higher credit rating and may provide a more secure form of investment. In addition securitisation products are typically fungible, liquid, negotiable and marketable.

ASIC’s proposals for ongoing licensing relief

SPVs

17 ASIC proposes conditional ASF licensing relief for SPVs for:

- (a) dealing by issuing securitisation products (see paragraph 21);

- (b) dealing by issuing derivatives or foreign exchange (“FX”) contracts (see paragraphs 22–23); and
- (c) providing custodial services and dealing in the underlying assets of the trust (see paragraph 24–25).

18 The basis for relief is that an SPV is created for the sole purpose of effecting a particular single securitisation. Further, the securitisation process is largely a predetermined one where the documentation provides for only very limited ongoing functions and discretions for the SPV. In these circumstances, it would be burdensome for the licensing requirements to apply. The proposed conditions of the relief are intended to ensure that our relief will not affect services provided to retail clients, and that an AFS licensee accepts responsibility for financial services provided by the SPV.

19 ASIC does not propose to give AFS licensing relief to issuers that are not SPVs. In these circumstances, it is not clear that there is a disproportionate burden that would justify a departure from the general principle that in the interests of market integrity, the providers of financial services should be subject to the AFS licensing requirements. Where an issuer acts on multiple securitisation schemes over a period of time, it is unlikely to be unduly burdensome for it to obtain an AFS licence.

Your comments

- Q1** 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.

General approach to conditions

20 ASIC proposes to provide relief for the financial services that an SPV will generally provide in relation to a securitisation transaction. The relief will only apply when all clients of the SPV are wholesale clients. Further, in order to have relief, the SPV must arrange for an AFS licensee to:

- (a) apply for a licence variation so that its licence has conditions that require it to assume certain responsibility for the conduct of an SPV; and
- (b) notify us that these conditions apply to the particular SPV.

Note: The AFS licensee is able to assume responsibility for more than one SPV so long as the AFS licensee notifies ASIC that the relevant conditions apply in relation to each separately notified SPV.

For particulars of these and other conditions see at paragraph 20 to 25.

Dealing by issuing securitisation products

21 ASIC will continue AFS licensing relief for SPVs issuing securitisation products. The relief set out in the interim Class Order [CO 03/1098] will apply until 31 March 2005. After 31 March 2005, ASIC proposes that relief will be given to SPVs on the following conditions:

- (a) The issuer must initially issue all securitisation products to an AFS licensee (or a person exempt from licensing for acquiring financial products distributed by an AFS licensee under ASIC Policy Statement 176 *Licensing: Discretionary powers – wholesale foreign financial service providers* [PS 176]) and take reasonable steps to ensure that the financial products are not subsequently acquired by a retail client.

Note 1: PS 176 provides that ASIC will exempt a foreign financial service provider from the AFS licensing provisions for financial services it provides services only to wholesale clients that are regulated by overseas regulatory authorities in certain circumstances.

Note 2: In Class Order [CO 03/1098], ASIC allowed as an alternative to the condition requiring issue of the securitisation products to an AFS licensee, that an AFS licensee arrange for the issue in a way that did not require a disclosure document under Part 6D.2 for debentures or a Product Disclosure Statement under Part 7.9 for other financial products. ASIC understands market practice is that all securitisation products are issued to an AFS licensee or person exempt under PS 176 and so does not propose to offer this alternative in the ongoing relief.

- (b) An AFS licensee (being the AFS licensee to whom the securitisation products are to be issued or another AFS licensee) has licence conditions requiring that the AFS licensee must:
 - (i) comply with the Corporations Act as if any issuer, that it has notified us the condition applies to, were a representative of the licensee within the meaning of Chapter 7; and
 - (ii) without limiting (i), have arrangements in place under which the licensee accepts liability, as between the licensee and clients of any issuer (that it has notified us in writing the condition applies to) for any conduct of the issuer relating to the issue of securitisation products, as if the issuer were a representative of the licensee.

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, or for any liability of the issuer as trustee for which the issuer may be indemnified from the trust property of the trust established for the securitisation transaction. The relief would cease to apply if the AFS licensee notified us in writing that it will not accept liability for any subsequent conduct of the SPV.

Note 1: For example the licensee may be liable for any loss suffered by a client if the SPV was liable to a client for misleading or deceptive conduct relating to the issue of the financial products.

Note 2: An example of an arrangement to assume liability would be to enter an enforceable deed poll for the benefit of clients of the SPV.

Note 3: This proposed condition would be expressed in broadly similar terms to condition 55 in ASIC Pro Forma 209 *AFS licence conditions* [PF 209].

Note 4: An AFS licensee will have to apply to ASIC for a variation of its licence to include this condition if an SPV is eligible for relief because that licensee accepts responsibility for it.

Note 5: The licence conditions will clarify that the licensee is not required to treat the SPV as if it were a representative or assume liability for any conduct of the SPV after the licensee has notified us in writing that it will not accept liability for any subsequent conduct.

- (c) An AFS licensee, that is subject to licence conditions complying with paragraph (b)(i) and (ii), has notified ASIC in writing that those conditions apply in relation to the SPV.

Note: The details of the notification that an entity is an SPV to ASIC for the purposes of the relief will be set out in the final policy.

Your comments

- Q2** 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?
- Q3** 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 the acquisition?
Are there other practical steps to limit any primary or secondary acquisition to wholesale clients?

- Q4** 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?

Dealing by issuing derivatives or FX contracts

22 ASIC proposes conditional relief from AFS licensing for securitisation SPVs issuing derivatives or FX contracts after 31 March 2005. Similarly to the interim Class Order relief that applies until 31 March 2005, the proposed relief would be on condition that:

- (a) the issuer is not making a market,
- (b) it is managing a financial risk that arises in the securitisation transaction, and
- (c) the counterparty is a wholesale client.

23 ASIC proposes that this relief would also be conditional on an AFS licensee assuming responsibility and liability for the conduct of the SPV in relation to providing that financial service. The relief would apply if:

- (a) An AFS licensee has licence conditions requiring that the AFS licensee must:
 - (i) comply with the Corporations Act as if any issuer, that it has notified us the condition applies to, were a representative of the licensee within the meaning of Chapter 7; and
 - (ii) without limiting (i), have arrangements in place under which the licensee accepts liability, as between the licensee and counterparties to FX contracts or derivatives not entered on a financial market, for any conduct of any issuer (that it has notified us the condition applies to) relating to the issue of the derivatives or FX contracts, as if the issuer were a representative of the licensee; and

The licence conditions would provide that they do not require that the licensee accept liability under any derivative or FX contract issued by the issuer. The relief would cease to apply if the AFS

licensee notified us in writing that it would not accept liability for any subsequent conduct of the SPV.

Note 1: For example the licensee may be liable for any loss suffered by a client if the SPV was liable to a client for misleading or deceptive conduct relating to the issue of the derivative or FX contract.

Note 2: The licence conditions will clarify that the licensee is not required to treat the SPV as if it were a representative or assume liability for any conduct of the SPV after the licensee has notified us in writing that it will not accept liability for any subsequent conduct.

- (b) The AFS licensee that has licence conditions complying with paragraph (a)(i) and (ii) has notified ASIC in writing that those conditions apply to the SPV.

Your comments

- Q5** 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?
- Q6** 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?

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

24 Similar to the relief granted by Class Order [CO 03/1098], ASIC proposes to exempt an SPV that acts as an SP trustee from the requirement to be licensed to:

- (a) provide custodial services in relation to any assets of the trust that are financial products (including where it holds a beneficial interest in such a product); and
- (b) deal (other than by way of issue unless under the exemption proposed at paragraphs 22 and 23 above), in assets that are financial products.

25 ASIC proposes that this relief will be conditional on an AFS licensee assuming responsibility and liability for the conduct of the SPV in relation to providing that financial service. The relief would apply when:

- (a) the client of the custodial or depository service or dealing provided by the SPV is a wholesale client;

- (b) an AFS licensee has licence conditions requiring that the AFS licensee must:
- (i) comply with the Corporations Act as if any issuer, that it has notified us the condition applies to, were a representative of the licensee within the meaning of Chapter 7; and
 - (ii) without limiting (i), have arrangements in place under which the licensee accepts liability, as between the licensee and clients of an issuer (that it has notified us the condition applies to) for any conduct of the issuer relating to the provision of a custodial or depository service in relation to financial products that it holds as SP trustee (including a beneficial interest in such financial products) or to dealing in those financial products, as if the issuer were a representative of the licensee; and

The licence conditions would provide that they do not require that the licensee accept liability for any liability of the issuer as trustee for which the issuer may be indemnified from the trust property of the trust established for the securitisation transaction. The relief would cease to apply if the AFS licensee notified us in writing that it would not accept liability for any subsequent conduct of the SPV.

Note 1: For example the licensee may be liable for any loss suffered by a client if the SPV was liable to a client for breach of trust due to an unauthorised dealing.

Note 2: The licence conditions will clarify that the licensee is not required to treat the SPV as if it were a representative or assume liability for any conduct of the SPV after the licensee has notified us in writing that it will not accept liability for any subsequent conduct.

- (c) The AFS licensee that has licence conditions complying with paragraph (b)(i) and (ii) has notified ASIC in writing that those conditions apply to the SPV.

Your comments

- Q7** 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?
- Q8** 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?

Securitisation managers

26 ASIC does not propose granting any ongoing class order licensing relief for securitisation managers. This applies to financial product advice given to the SPV or to the investors in the securitisation scheme. It also applies to dealing by arranging for the SPV to engage in dealings. This section of the paper briefly explains how we consider (without relief) the AFS licensing regime applies to those entities involved in securitisation.

27 ASIC is not convinced that there is a disproportionate burden that would justify departure from the general principle that, in the interests of market integrity, the providers of financial services should be subject to the AFS licensing requirements. The securitisation manager may act on multiple securitisation schemes over a period of time and therefore it would not be unduly burdensome for it to obtain an AFS licence.

Your comments

Q9 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?

Q10 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.

The AFS licensing regime

28 Under the Corporations Act as amended by the *Financial Services Reform Act 2001*, it is arguable that securitisation issuers and securitisation managers may require an Australian financial service (AFS) licence. This section of the paper briefly explains how (without relief) we consider the AFS licensing regime applies to those entities involved in securitisations.

29 Parts 7.6 to 7.8 of the *Corporations Act 2001* (Corporations Act) set out the AFS licensing requirements for carrying on a business of providing financial services (unless an exemption applies under s911A(2)). ASIC has the power to exempt a financial service provider under s911A(2)(1) from the requirement to hold an AFS licence. ASIC's Policy Statement 167 *Licensing: Discretionary powers and transition* [PS 167] explains how ASIC will exercise this power. ASIC has the

power under the Corporations Act to give partial or complete relief from the licensing requirements (including imposing conditions).

30 A general exemption will not be given to those persons providing a financial service in the wholesale market only, as this would be contrary to Parliament’s intention to apply the AFS licensing regime across both retail and wholesale sectors.

31 In considering whether any licensing relief should be given in relation to securitisation issuers and managers, ASIC will consider a number of regulatory objectives including:

- (a) ensuring that the licensing regime is flexible, cost effective, and neutral in its regulatory impact across different financial service providers;
- (b) taking into account the different services that are offered by financial market participants and recognising different levels of regulatory intensity appropriate to those services; and
- (c) balancing market integrity objectives in the wholesale markets with facilitating an innovative and efficient financial services industry.

Securitisation SPVs and SP trustees

32 ASIC considers that without licensing relief, an SPV may require AFS licensing in each of the following areas of conduct.

<p>Dealing by issuing debentures or interests in managed investment schemes</p>	<p>A SPV will be involved in issuing financial products, either debentures or interests in a managed investment scheme. SP companies may not be considered to be “dealing” as they might be able to rely on the exclusion for self dealing from the meaning of “dealing”. However some SP companies may not be sure they can rely on the self dealing exclusion as the debentures might be, at least indirectly, offered to a section of the public. SP trustees will be dealing when they issue interests in managed investment schemes and the self dealing exemption does not apply to interests in managed investment schemes.</p>
<p>Dealing by issuing derivatives or FX contracts by the SPV</p>	<p>SP trustees do not act on their own behalf and therefore cannot rely on the exemption in the Corporations Regulation 7.6.01(1)(m). Some SP companies may not be sure they can rely on Reg 7.6.01(1)(m) because entering derivatives may be a significant part of their business.</p>
<p>For SPVs that are trustees, providing custodial services and dealing in the underlying assets of the trust</p>	<p>An SP trustee may hold financial products or a beneficial interest in financial products on trust for the holders of securitisation products under the arrangement with the investors so as to provide a custodial or depository service. To the extent that any of the assets it holds are financial products that are dealt with (for example, by closing out a derivative), it will be dealing on behalf of the holders of the securitisation products.</p>

Securitisation managers

33 ASIC considers that without licensing relief, a securitisation manager may require AFS licensing in each of the following areas of conduct.

<p>Providing financial product advice to the SPV and arranging for the SPV to deal</p>	<p>Securitisation managers may provide opinions or recommendations to the SPV that may constitute financial product advice e.g. as to what derivative to enter, if the credit worthiness of the counterparty to an original derivative has fallen below the ratings agency trigger point so that a new one must be obtained. The securitisation manager may also deal. For example, the securitisation manager may arrange on behalf of the trustee for investors to acquire securitisation products or for counterparties to acquire a derivative.</p>
<p>Providing financial product advice by the securitisation manager when issuing an Information Memorandum ("IM")</p>	<p>The IM may be prepared by the securitisation manager to be distributed to potential investors. It may contain general advice. A debenture issuing SPV can obtain the benefit of ASIC Class Order [CO 03/911], which exempts debenture issuers that issue wholesale IMs, but this will not apply to the securitisation manager as the advice by the securitisation manager is not given in relation to its own securities.</p>

ASIC interim Class Order [CO 03/1098]

34 In December 2003, ASIC granted interim conditional licensing relief under Class Order [CO 03/1098] for:

- (a) securitisation issuers for dealing, providing a custodial or depository service, and issuing debentures or interests in a managed investment scheme; and
- (b) securitisation managers for dealing in a financial product or providing financial product advice.

35 The purpose of the interim relief was to enable ASIC to further consider the appropriateness of the AFS licensing requirements to the securitisation industry and to have discussions with industry about the form and content of any ongoing relief.

36 Due to an extension of the interim relief, this relief will now expire on 31 March 2005. ASIC is now seeking comments on the proposals in this Consultation Paper about providing ongoing conditional licensing relief for participants in the securitisation industry.

Transitional relief until 31 March 2005

37 ASIC has extended the interim relief under Class Order [CO 03/1098] until 31 March 2005, to facilitate finalisation of the policy and industry compliance.

38 We consider that extending this relief until 31 March 2005 provides a reasonable length of time for relevant securitisation entities to comply with any licensing requirements recommended in these proposals.

Development of policy

39 This Consultation Paper is not final ASIC policy. We plan to publish a final policy by late October or early November, after considering any comments or feedback that we receive on the proposals.

Regulatory and financial impact

40 In developing these proposals we have considered their likely regulatory and financial impact. Based on the information that we currently have, we believe that our proposals strike an appropriate balance between facilitating financial services activity and market integrity. To ensure that we achieve an appropriate balance, we are also developing a Regulatory Impact Statement. We ask for information on the costs and benefits of the proposals and any alternative options.

Key terms

In this Consultation Paper:

“ADI” means an approved deposit-taking institution within the meaning of the *Banking Act 1959*

“AFS licence” means an Australian financial service licence under s913B that authorises a person who carries on a financial services business

“authorised representative” of an AFS licensee means a person authorised in accordance with s916A or 916B to provide a financial service(s) on behalf of the licensee

“APRA” means the Australian Prudential Regulatory Authority

“ASIC” means the Australian Securities and Investments Commission

“[CO 03/1098]” (for example) means a reference to an ASIC Class Order (in this example numbered 03/1098)

“Corporations Act” means the *Corporations Act 2001* and includes regulations made for the purposes of the Act

“FX contract” means a foreign exchange contract

“issuer” means an issuer of securitisation products

“licensee” or an “AFS licensee” means a person who is licensed to carry out a financial services business to provide financial services

“Part 7.6” (for example) means Part 7.6 of the *Corporations Act 2001*

“reg 7.6.01” (for example) means a regulation of the Corporations Regulations 2001 (in this example numbered 7.6.01)

“securitisation transaction” means a scheme to purchase a pool of assets and issue debentures or interests in the managed investment scheme where the payments under the products depends on the securitised assets and any ancillary arrangements to hedge risks

“securitisation manager” means a manager appointed under a contractual arrangement with the SPV to manage the securitisation transaction

“securitisation products” means debentures or interests in a managed investment scheme issued by an SPV

“securitised assets” means a pool of assets purchased by an SPV for the purposes of a securitisation transaction

“SP company” means a company that is an SPV that issues debentures

"SP trustee" means an SPV who acts as trustee and issues interests in a managed investment scheme

"sponsor" means the seller of the securitised assets to the SPV

"SPV" means a special purpose vehicle issuer that is a body corporate that carries on business solely as part of a single securitisation transaction.