

RESPONSE TO FEEDBACK RECEIVED - CONSULTATION PAPER ON SECURITISATION

1 General Comments

1.1 In April 2005, MAS issued a consultation paper inviting views on proposed changes to MAS Notice to Banks 628 on "Asset Securitisation by Banks". The proposed revisions seek to bridge the gap between the existing requirements and the forthcoming requirements under Basel II in a manner that is consistent with the current capital rules, market needs and regulatory practices in other jurisdictions.

1.2 MAS has considered carefully the feedback received, and where it has agreed with the comments, incorporated them into the Notice. We thank all respondents for their feedback. Comments of wider interest and MAS' responses are set out below.

2 Definition of Securitisation

2.1 MAS proposed to define securitisation as any transaction that involves the tranching of the credit risk associated with an exposure or pool of exposures and that has certain specified characteristics.

2.2 Some respondents suggested narrowing the scope of the definition so that it would not inadvertently catch: (a) the ramp-up phase of a securitisation where the credit risk associated with the exposures to be securitised is still accounted for on the bank's balance sheet; and (b) synthetic arbitrage transactions which involve the use of credit derivatives or guarantees that do not hedge any part of the bank's balance sheet.

MAS' Response

2.3 MAS agrees and has amended the definition so that the securitisation rules will apply only where the tranching of credit risk is accompanied by the transfer of credit risk associated with one or more of the resulting tranches. MAS will also exclude from the scope of MAS Notice 628 transactions where the tranching of credit risk is achieved by the use of credit derivatives or guarantees that do not serve to hedge any credit risk of the originating bank.

3 Application of Disclosure and Separation Requirements

3.1 MAS proposed to extend the disclosure and separation requirements to banks and their asset management subsidiaries that act as collateral managers for the underlying assets in a securitisation. This was on the basis that such collateral managers would typically advise on the construction of the underlying portfolio of the securitisation and would therefore be seen to have played a primary role in the transaction.

3.2 Several respondents suggested that passive collateral managers that only manage the underlying assets of a securitisation in accordance with a pre-specified mandate should not be subject to the disclosure and separation requirements as they do not play a primary role in the transaction.

MAS' Response

3.3 MAS agrees that passive collateral managers that are neither involved in the selection of the underlying assets of a securitisation nor subject to minimum performance targets in the management of those assets need not be subject to the disclosure and separation requirements.

4 Investment Limits

4.1 The current MAS Notice 628 provides that an originator may invest in the senior securities of a securitisation, but only up to 10% of the aggregate amount of securities issued. Further, to meet the separation requirements, a bank cannot hold more than 10% of each tranche of preference shares issued by the special purpose entity ("SPE") in the securitisation. In addition, an originator or ABCP programme sponsor may make markets in the securities of a securitisation only if they are of investment-grade.

4.2 Respondents commented that the investment limits would impede securitisation transactions where the originating bank is generally expected to hold the first-loss piece. This could comprise non-investment grade or unrated securities (including preference shares) that represent more than 10% of the aggregate amount of securities issued by the SPE. Some respondents added that the investment limits would restrict their underwriting activity. One bank suggested that an appropriate capital treatment be applied in such circumstances instead. Respondents also felt that the restriction on market-making would constrain the secondary market liquidity of the non-investment grade securities of a securitisation.

MAS' Response

4.3 MAS is of the view that an aggregate investment limit for an originator or ABCP programme sponsor will continue to be meaningful since it would be highly unusual for a bank to take up a major portion of a securitisation that it has originated. However, in view of market feedback, MAS will provide more flexibility by raising the threshold to 20% and abolishing the restriction that such investments be in investment-grade securities only. Accordingly, originators and ABCP programme sponsors will be allowed to make markets in all securities of the securitisation, subject to the 20% cap. The restriction on investments in preference shares has also been removed as there are other safeguards to prevent a bank from exercising control over the SPE in the securitisation.

4.4 To facilitate underwriting activity, MAS will exempt a bank from having to comply with the investment limits in respect of its holding of securities acquired pursuant to an underwriting arrangement. However, the bank will be expected to sell off its excess holdings within 8 weeks from the issue date of those securities. During this time, the bank must provide capital for the securities held in accordance with Annex G of MAS Notice 628.

5 Eligible External Credit Assessments

5.1 MAS proposed that, in accordance with Basel II, an external credit assessment (or "rating") must be publicly available to qualify as an eligible external credit assessment.

5.2 Two respondents suggested that a private rating should also qualify, since rating agencies adopt the same methodologies and criteria for both types of ratings.

MAS' Response

5.3 While the rating methodologies and criteria may be similar, MAS is of the view that public ratings provide valuable market discipline to the rating process. Therefore, we will retain the requirement for public ratings.

6 Capital Treatment for Securitisation Exposures

6.1 MAS proposed that securitisation exposures which are rated investment grade should receive a 100% risk weight while non-investment grade or unrated exposures should be deducted from Total Capital. This approach is consistent with the current capital treatment in MAS Notice 637.

6.2 Several respondents commented that the use of broad categories provides little incentive for banks to invest in highly rated securitisation exposures and suggested that the full range of Basel II risk weights be implemented.

MAS' Response

6.3 Introducing the full range of Basel II risk weights for securitisation exposures now would be inconsistent with the capital treatment for other instruments in MAS Notice 637 and international practices, and could give rise to opportunities for capital arbitrage. MAS will introduce the full range of Basel II risk weights, including those for securitisation exposures, at the time of Basel II implementation.

7 Capital Treatment for Unrated Securitisation Exposures

7.1 As an alternative to deducting an unrated most senior securitisation exposure from capital, MAS proposed to allow a bank to apply the average risk weight of the underlying assets to any such exposure that it holds or guarantees. This exception is consistent with the Standardised Approach under Basel II.

7.2 One respondent suggested that a bank that holds or guarantees a tranche of a securitisation which ranks above another tranche that is rated be allowed to infer the rating of the senior tranche instead of applying the average risk weight of the underlying assets.

MAS' Response

7.3 MAS notes that under Basel II, the Inferred Ratings Approach suggested by the respondents will be available only to banks that qualify to use the internal ratings-based approach to credit risk. As there is no certainty that all banks will qualify to use IRB when Basel II comes into effect, MAS is of the view that it would not be appropriate to make available the Inferred Ratings Approach to all banks now.

8 Eligible Liquidity Facility

8.1 MAS proposed that a liquidity facility may qualify as an eligible liquidity facility and therefore a lower capital requirement if, *inter alia*, the facility is subject to an asset quality test that precludes it from being drawn to cover credit risk exposures that have been classified substandard or worse under MAS Notice 612, on the basis that the facility could otherwise be used as a form of credit enhancement.

8.2 A respondent commented that while the current definition of substandard under MAS Notice 612 comprises both qualitative and quantitative criteria, rating agencies will not allow a bank to use qualitative criteria as a basis for reducing the liquidity facility.

MAS' Response

8.3 To address the concern raised, the asset quality test will be amended so that an eligible liquidity facility cannot be drawn to cover credit risk exposures where the obligors are not able to meet their contractual repayment terms.

8.4 MAS also proposed that a liquidity facility may qualify as an eligible liquidity facility if, *inter alia*, either (a) an independent third party co-provides 25% of the liquidity facility; or (b) the bank can reduce (and ultimately withdraw) the funding if the underlying assets of the securitisation fall below investment-grade.

8.5 One respondent commented that a bank would have difficulty complying with condition (b) as rating agencies typically require the liquidity facility to be available as long as the underlying assets of the securitisation continue to perform. The respondent suggested that an appropriate capital treatment be prescribed where the underlying assets fall below investment grade.

MAS' Response

8.6 MAS will provide another alternative to allow a bank to deduct from capital the amount of the liquidity facility used to support underlying assets that have fallen below investment grade.