Report on the Seminar to discuss: Should issuer-supplied Liabilities Waterfall Models be a transparency requirement for 'qualifying' securitisations?

Held at Laytons Solicitors, 2 More London Riverside, London SE1 2AP at 2pm on Monday 27 April 2015
Attended by interested global securitisation industry participants under the Chatham House Rule

1   Some Definitions

'ISLWM' means: Issuer Supplied Liabilities Waterfall Model

'LWM' means: Liabilities Waterfall Model

'The Requirement' means: ISLWMs would be required to be disclosed as one of several criteria for 'qualifying' securitisations

'Consultation Documents' means: EBA and BCBS/IOSCO consultations

2   A set of benefits was agreed:

1. The Requirement would facilitate a useful formal and transparent process for checking the liabilities waterfall and to flush out errors and problems – which have occurred and do occur from time to time.
2. The Requirement would incentivise issuers to ensure the liabilities waterfall is correct because of potential liability implications.
3. The Requirement would need to specify the need for a full set and full disclosure of input opportunities for the user to control that would cater for every eventuality the liabilities waterfall states consequences for – and would be of particular use and importance if the transaction became distressed.
4. ISLWMs would be useful in the event of a dispute between issuer and investor over the liabilities waterfall where ambiguity was found to exist in the documentation.

There was general agreement that a publicly available LWM showing all possible inputs would be beneficial.

3   A set of key points and arguments was raised:

3.1   The Requirement would be more useful for more complex transactions that would not 'qualify'

On the one hand:

- ISLWMs should not make or break whether a transaction is 'qualifying' or not – more complex transactions should be caught and forced out of scope by 'other criteria'
- ISLWMs would provide more value for transactions that fall outside the 'qualifying' requirements

But to counter:

- Both Consultation Documents are 'light touch' and high level with regard to liabilities waterfall complexity restrictions so the rationale for inclusion of a requirement for ISLWMs is at least in part:
  - To give issuers as free a hand as possible to structure the liabilities waterfall as they feel necessary, but then
  - Disclose how the waterfall works in practice in an ISLWM

The implicit alternative would be to further regulate, which might create 'cliff effects' – which it is understood that the industry would like to avoid.

3.2   Reliance by investors on ISLWMs

- There was a robust argument on both sides with a conclusion that if the Requirement is a good idea and introduced, investors are entitled to rely on it.
- It was accepted that consideration of investor due diligence requirements was not in scope.

3.3   Additional burden to the issuer

In any event, the issuance process necessarily requires the issuer or agent of the issuer to model the transaction. The Requirement could result in additional cost to the issuer. This was discussed in the meeting and not considered to be a high or prohibitive additional cost, neither was the task to meet the Requirement considered to be onerous.

3.4   Existence of more than one LWM could be confusing

It was argued that the existence of multiple LWMs would be confusing. i.e. Which one is correct and why? However, it was counter-argued that more than one LWM could be helpful. The implementation of a LWM is an objective task. Therefore each LWM for the same transaction, if correct, should yield identical results given identical inputs. Multiple LWMs could be checked against each other, identifying any inconsistencies and help flush out errors and differences in interpretation.

4   The following questions remain unanswered

4.1   Is the Requirement a good idea or would it be better to tighten or employ additional criteria to restrict liabilities waterfall complexity?

4.2   Should the issuer be responsible for supplying the LWM or is there an alternative supplier/solution?