Australian Securitisation Forum

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Dear Andrea,

Feedback on BBSW fallbacks in RBA-eligible securities

The Australian Securitisation Forum (ASF)[1] is pleased to continue its constructive dialogue with the Reserve Bank of Australia (RBA) regarding reforms to strengthen financial benchmarks and ensure sound practice in their use in the financial system, and specifically to provide feedback regarding the RBA's intention to require new securities that reference BBSW to include fallback provisions to be eligible collateral for repo with the RBA, as outlined in your email dated 1 February 2021.

This ASF feedback relates to asset-backed securities (including those that may be described as FRNs). We have, however, been co-ordinating with the Australian Financial Markets Association (AFMA), and understand they intend to separately provide feedback in relation to "vanilla" FRNs (for example, government, semi-government, financial and corporate FRNs).

The ASF Benchmark Working Group[1] has met to consider the draft Eligibility Criteria. Detailed responses to the RBA's four questions are outlined in the *Annexure* to this letter.

- The ASF is pleased with the constructive engagement it has had with the RBA in regard to benchmark reform, and wishes to continue that constructive engagement during the finalisation of the Eligibility Criteria;

[1] Please refer to page 11 for further information about the ASF and the ASF Benchmark Working Group

- The ASF agrees with the "high-level principles" approach designed to complement specific industry guidance intended to be published by the ASF, and considers that this broadly reflects industry views;

- The RBA's proposed timelines appear reasonable at this time. We have in the past discussed with you that it is desirable that BBSW fallbacks consider similar fallback practices in international securitisation markets. Some areas of clarity have emerged, for example ISDA fallbacks, however, there remains some uncertainty in international markets regarding benchmark reform for cash products. Notwithstanding these uncertainties, on balance it is appropriate that the Australian market move forward;

- The grandfathering of securities issued before 1 July 2022 is welcomed.

The ASF will continue to work with the RBA to ensure that the ASF's guidelines in relation to BBSW fallbacks are aligned with the RBA's approach and timing. In that regard, once the ASF is in a position to publish such guidelines we would suggest that the ASF and RBA collaborate in an industry information session towards the middle of 2021.

In the meantime, could we please suggest a meeting between the RBA and ASF representatives to discuss the responses and feedback described in this letter. We are available the week commencing 22 March and if convenient would be pleased to meet with you in person either on Tuesday 23 March or Wednesday 24 March. Alternatively, we could aim for a date in late March or just after Easter. Please let us know your preference for a date and time.

Looking forward to speaking with you soon.

Yours sincerely,

Chris Dalton

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Annexure: ASF response to RBA Request for Feedback – BBSW fallbacks in RBA-eligible securities

1. Are there any technical, practical or legal issues that would prevent industry developing fallbacks that meet these criteria?

As the RBA is aware, the ASF Benchmark Working Group has been developing industry guidelines for BBSW fallbacks (and also disclosures relating to benchmark reform risks and recommended practices where non-BBSW benchmarks are used (for example, AONIA)). In principle, the ASF believes its approach to developing industry guidelines for BBSW fallbacks aligns with the high-level principles proposed by the RBA. The ASF desires that its BBSW fallback guidelines, when finalised (ASF BBSW Fallback Guidelines), will meet RBA-repo BBSW fallback requirements.

The results of the ASF's November 2019 survey (from 51 respondents) (*previously provided to the RBA and available on request*) indicated that almost 100% of respondents saw that there was a role for the ASF to promote and encourage standardisation in fallback language. It is important to note that, while they are an authoritative resource for industry participants, it is not mandatory for ASF Members or other market participants to follow ASF guidelines. Based on these responses, we would expect strong (but not necessarily universal) take up of the ASF BBSW Fallback Guidelines once published.

Other technical, practical or legal issues

Topic	Description
"Robust" and "reasonable and fair"	The ASF welcomes the non-prescriptive approach taken by the RBA in describing acceptable fallbacks in the draft criteria. The ASF considers that a non-prescriptive approach will enable the industry to establish fallbacks that are suitable for the Australian securitisation market. However, we expect that the qualitative terms included such as "robust" and "reasonable and fair" may be difficult for parties to assess a fallback against with certainty. To balance this, we request that the RBA consider adding: • an ability for a fallback to be approved by the RBA, such that parties can have certainty that if they use a fallback which is substantially in an approved form the relevant fallback will meet the qualitative criteria and be acceptable to the RBA. In this context, the ASF would be pleased to work with the RBA in the

Topic	Description
	design of ASF BBSW Fallback Guidelines, such that its more prescriptive requirements are aligned to RBA preferences. In this respect, please see further under “Approval of ASF BBSW Fallback Guidelines” below; • any additional (non-exhaustive) examples of acceptable fallbacks (other than AONIA plus or minus a fixed spread) that the RBA considers to be acceptable.
“Clear and unambiguous trigger event”	The ASF similarly welcomes the non-prescriptive approach taken by the RBA in describing acceptable trigger events. However, the ASF would like to better understand: • any (non-exhaustive) examples of acceptable trigger events that the RBA currently considers to be acceptable; • whether the RBA considers forms of “pre-cessation” triggers to be acceptable (noting in this context that although Australia does not have a regulatory mandate for pre-cessation triggers, these triggers may still be considered to be commercially appropriate by market participants and/or the RBA). In this context, the ASF would also welcome an ability for the triggers to be approved by the RBA as part of the requested fallback approval process as highlighted under ““Robust” and “reasonable and fair”” above, such that parties can also have certainty on the trigger component of relevant fallbacks.
Robustness to future market and practice changes	One further issue that the ASF has raised in its discussions with the RBA to date is the difficulty in making further amendments to the fallback terms once formally included in a transaction. As the RBA is aware, this is because, for example, of the potential requirement for further consent solicitation processes to effect these changes (noting that the securitisation market does not have access to multilateral standardised amendment platforms of the kind available in the derivatives market, and the fact that legal maturities in securitisations may extend to 30 years).

Topic	Description
	Noting the RBA's comments in the draft Eligibility Criteria that a discretionary limb must sit below other fallbacks together with the requirement for triggers to be "clear and unambiguous", the ASF would like to further discuss and understand the RBA's position on how this issue may be accommodated within the RBA's proposed Eligibility Criteria. In this context, the ASF notes that future issues could arise, for example, where: a) a "hardwired" fallback waterfall (designed to meet the "robust" and "reasonable and fair" requirements) is included; b) a "clear and unambiguous trigger event" occurs, causing the waterfall to apply; c) the first limb of the waterfall: • is available at that time, and accordingly becomes applicable under the terms. However, at that time the first limb of the waterfall is not (or is no longer) in customary market usage in comparable securitisations, making the application of that rate off market; or • is not available at that time (as may arise, for example, if term AONIA is included in the waterfall), and accordingly does not become applicable under the terms (and instead for example, the second limb of the waterfall applies). However, the first limb of the waterfall later comes to be in customary market usage in comparable securitisations, making the continued application of the second limb off market at that later time In this context, the ASF remains of the strong preference that the provisions could be constructed in such a way as to address this issue without the need to complete further consent and amendment processes as market thinking and practices develop. Options as to how this might be addressed could include: • allowing a fallback to be triggered if the then applicable rate ceases to be in customary market usage;

Topic	Description
	• allowing a level of the fallback waterfall to be skipped if the applicable rate is not at the time of the trigger in customary market usage; • allowing a previously skipped level of the waterfall to be retriggered if that rate subsequently becomes available or customarily used in the market; • allowing some form of discretionary (but qualitatively constrained) overlay to be included to govern the overall navigation of the fallback waterfall. The ASF would welcome the opportunity to further discuss this issue and the way in which it might be acceptably addressed within the Eligibility Criteria (and, in particular, how this could be developed consistently with the requirements for "robust" and "reasonable and fair" fallbacks with "clear and unambiguous" triggers).
Approval of ASF BBSW Fallback Guidelines	As a courtesy, the ASF would plan to discuss the proposed ASF BBSW Fallback Guidelines with the RBA before they are finalised. Given that the RBA's proposed guidelines are principles-based rather than prescriptive (which as noted above is an approach appreciated by the industry), the ASF would be grateful if the RBA would consider reviewing the ASF BBSW Fallback Guidelines for compliance against those principles-based criteria as part of this process. Once finalised, to the extent the RBA were willing to endorse, or otherwise publicly acknowledge the ASF BBSW Fallback Guidelines and their compliance with the RBA BBSW fallback requirements, we think that this would provide greater certainty to the market. In this respect, please see further under ""Robust" and "reasonable and fair"" above.
Consistency with similar products	The ASF sees benefits for the broader market in there being a degree of consistency between the fallbacks used for securitisation and the fallbacks used for similar products such as FRNs. In light of this, if in its assessment of fallbacks the RBA comes to accept fallbacks that have meaningful differences to the proposed ASF Benchmark Fallback Guidelines, the ASF would also be grateful for an

Topic	Description
	opportunity to discuss those proposed differences and potential ways in which greater consistency could be achieved.
Grandfathering	The grandfathering of securities issued before 1 July 2022 is welcomed. The results of the ASF's December 2020 survey (from 29 respondents) (*previously provided to the RBA and available on request*) indicate that 83% of respondents think that it is impractical to amend fallbacks in existing publicly issued securities due to the complexity and costs of soliciting the consents of noteholders, trustee and rating agencies. We consider that seeking to amend historical transactions would be a substantial distraction and resource diversion for participants in the industry and are grateful for the RBA's confirmed position.

2. Do these criteria provide sufficient flexibility for industry participants to develop fallback language that meets the requirements of each relevant market?

Yes, subject to our response to Question 1.

3. Assuming the Bank publishes the final criteria in the first half of 2021, is there sufficient time for industry participants to develop and implement fallback language for the criteria to come into effect on 1 July 2022? How does this align with current workstreams underway, such as the LIBOR transition and the development of industry standards for products that reference AONIA?

Yes, in principle the RBA's proposed timelines appear reasonable at this time. In terms of the timeline, it is constructure to break down our feedback into 1) the timing for development of ASF Benchmark Fallback Guidelines, and: 2) the implementation of the guidelines by industry participants.

The timing for development of ASF Benchmark Fallback Guidelines

It is the intention of the ASF to progress its development of the ASF BBSW Fallback Guidelines in parallel with the RBA's plans to publish the final criteria in the first half of 2021, so that the industry is able to work through technical details and raise any further issues with the RBA on a timely basis, especially those that may lead to changes to the RBA's final published criteria.

The ASF would prefer the RBA not to publish its final criteria before the ASF has substantively engaged with the RBA on the terms of the proposed ASF BBSW Fallback Guidelines. In this regard, whilst the ASF will develop its guidelines as quickly as feasible, it is possible that finalisation of the published guidelines may extend beyond 30 June 2021. It would be desirable for the RBA to clarify whether in principle it is amenable to this timing.

The implementation of the guidelines by industry participants

If the ASF BBSW Fallback Guidelines were to be completed by 30 June 2021, this would give industry participants around 12 months to implement any changes. In line with previous discussions between the ASF and the RBA, it is in principle relatively straight forward for industry participants to adopt appropriate fallback language in legal documentation for new transactions.

The more challenging aspect of adopting fallbacks is that market participants should be comfortable that they are operationally ready or have plans to become operationally ready on a timely basis, to manage the transaction if the fallbacks are triggered. This contingent exposure to managing fallbacks (such as compounding AONIA) is a risk that industry participants must evaluate notwithstanding that BBSW is expected to continue for the foreseeable future. This would affect a range of parties to the transaction including the transaction sponsor, investors, facility providers (such as swaps and liquidity facilities) and service providers (such as trust managers, trustees, custodians, calculation and paying agents, servicers (including back up servicers)).

Operational readiness includes systems to book securities, value securities and calculate cashflows that reference the fallback rates (such as compounding in arrears AONIA) and related operational processes. Other considerations may include models, credit risk and market risk policies and procedures. Larger market participants affected by LIBOR reform are more likely to be operationally ready given their experience becoming operationally ready for LIBOR alternatives such as SONIA and SOFR, although are more likely to be impacted by material uncertainties in the LIBOR transition timeline (such as the rate of SOFR adoption and the timing of USD LIBOR legacy active conversion). Smaller industry participants whose business activities are principally connected with Australia may take longer to become operationally ready.

The ASF would recommend that parties that do intend to adopt its fallback guidelines ensure that, at the time of entering into the transaction, they are comfortable that they are operationally ready or have plans to become operationally ready on a timely basis, to manage the transaction if the fallbacks are triggered.

Operational readiness in this context is an issue for all transaction participants (including for example support facility and service providers, and not just the transaction sponsor and investors). It is challenging to measure readiness across the entire market given it is comprised of a broad range of participants. Given the large number of transaction parties involved in securitisation, it will be important that the industry en masse is ready. The ASF has conducted surveys of market participants to raise awareness of these operational readiness considerations, and to obtain feedback from market participants on their expected readiness timeframe.

The results of the ASF's December 2020 survey (from 29 respondents) indicate that the main challenges delaying adoption of fallback language are:

- 71%: systems are not operationally ready
- 67%: other operational readiness
- 33%: legal due diligence
- 24: governing authority approval (i.e., management / Board approval)

The results of the ASF's November 2019 survey (from 51 respondents) indicate that respondents were generally of the opinion that it will take greater than 1 year to implement. More specifically, respondents indicated as follows:

- ~30%: less than one year
- ~45%: one to two years
- ~ 25%: greater than two years

In light of the ongoing industry and ASF commentary regarding fallbacks, it would be reasonable to assume the implementation timeframes would now have reduced, or are no worse, than indicated by survey respondents in November 2019.

In relation to parties being "operationally ready or having plans to become operationally ready on a timely basis", the timing of plans to be operationally ready would largely depend on views about how much notice might market participants have of BBSW's actual cessation i.e. how much time would market participants have between adopting BBSW fallback language from 1 July 2022, to completing implementation plans to manage fallback rates at the time of actual BBSW cessation.

- Would it be a limited notice period of several months, or might it be several years notice as in the case of LIBOR and other IBORs?
- Would the cessation notice commence in the near future or be some time away? If the market were to adopt the most conservative view, market participants would need to be fully operationally ready from 1 July 2022 when the RBA rules come into effect.

These views would be further informed by the overall market “readiness” to deal with BBSW cessation. For example, if Australian market authorities and market participants would need to explore issues that have arisen in other IBOR/LIBOR jurisdictions (such as mitigants for so-called tough legacy contracts such as “synthetic” BBSW or safe harbour legislation), then the notice period may be longer. Or will these matters be addressed in the near future so overall the Australian market is in a heightened state of readiness for BBSW cessation, and market participants would need to be as well?

Against this backdrop, the ASF would like to request further clarification from the RBA on its expectations around operational readiness for BBSW fallbacks (separately from its expectations around the timing for implementation of the formal legal changes contemplated by the draft Eligibility Criteria).

4. Are there any other issues related to fallbacks for BBSW-linked securities that the Bank should be aware of?

Whilst much has been done towards BBSW transition to date, more work is needed to educate industry participants on the importance of robust fallbacks, how these fallbacks operate and would be integrated into securitisation transactions, and operational readiness for alternatives to BBSW. The ASF will continue to work with industry participants to raise awareness and to help progress this transition.

The ASF will also continue to work on the development of industry guidelines for the use of BBSW alternatives (such as compounding AONIA in arrears) in primary market issuances, and notes that that there is a degree of interconnectedness between these workstreams.

About the ASF

The ASF is the peak body representing the securitisation industry in Australia. The ASF's role is to promote the development of securitisation in Australia by facilitating the formation of industry positions on policy and market matters, representing the industry to local and global policymakers and regulators and advancing the professional standards of the industry through education and market outreach opportunities. The ASF is comprised of a National Committee, specific subcommittees and a national membership of over 150 organisations.

The ASF has formed the ASF Benchmark Working Group. The working group is comprised of a range of ASF members including banks, non-bank lenders, investors and industry service providers. Its objectives are:

- to raise awareness of benchmark reform amongst industry participants; and
- to establish industry consensus and develop market practice recommendations that ASF members could use in response to benchmark reform in the Australian and cross-border markets.