TRINIDAD AND TOBAGO SECURITIES AND EXCHANGE COMMISSION

POLICY
FOR REGISTRATION OF SECURITIZED INSTRUMENTS

The securitization of assets may be defined as "…*the process by which loans, consumer installment contracts, leases, receivables, and other relatively illiquid assets with common features are packaged into interest bearing securities with marketable investment characteristics*[1]…".

For the most part, the Securitized Instruments that have been registered with the Commission have been based on plain vanilla bonds. These securitizations have been referred to as Certificates of Interest ("COI") and Certificates of Participation ("COP"). The Commission has also processed registrations of Securitized instruments that have been based on Viatical Life Settlements, Credit Card Receivables, Loans and Mortgages.

Securitized instruments by their very nature derive their value from the pool of assets upon which they are based.

Introduction

One of the concerns with the registration of Securitized Instruments with the Commission is the requirement to have the underlying security and Issuer of the underlying security registered with the Commission together with the registration of the Securitized Instrument. This practice would have been adopted in an effort to ensure that investors in a Securitized Instrument were provided with, or had access to information on the Issuer of the underlying instrument and the performance of the underlying instrument itself, when making the decision to invest in the Securitized Instrument.

This paper reviews the Commission's policy and practice with respect to the registration of Securitized Instruments and recommends a new policy framework to treat with these matters.

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[1] Bhattacharya and Fabozzi 1996

Review of Past Decisions and Possible Rationale

Prior to April 2006, applications for the registration of Securitized Instruments required the concomitant registration of the asset underlying the securitized instrument. Based on the structure of the Securities Industry Act, 1995 ("the Act") the registration of the underlying asset would have also necessitated the registration of the issuer of that underlying asset as a Reporting Issuer.

After April 2006 however, a decision was taken where the issuer of the underlying asset of a Securitized Instrument was not required to be registered as a Reporting Issuer. The underlying asset itself however, was still required to be registered.

Issues

Following, in the Staff's view, were the two primary issues that arose with respect to the approach to the registration of Securitized Instruments after April 2006:

1. Whether the Act makes provision for registration of a security, without the registration of the Reporting Issuer.
2. How does the Commission treat with the registration of the underlying instrument, where the said underlying instrument may not be a security as defined under the Act?

1. Registration of a Security without Registration of the Issuer

It may be argued that the registration of a security with the Commission tacitly implies that that security is the subject of an offer to the public under the Act and the Companies Act, 1995 Chapter 81:01 of the laws of Trinidad and Tobago ("the Companies Act"). Section 6(1) of the Companies Act states *inter alia*, that:

> "***…a share or debenture of a body corporate is part of a distribution to the public, when, in respect of the share or debenture there has been, under the laws of Trinidad and Tobago or any other jurisdiction, a filing of a prospectus, statement in lieu of prospectus, registration statement…***"

The above extracts imply that any security that is registered with the Commission, which must be accompanied by the filing of a registration statement, is the subject of a distribution to the public.

It therefore appears that before a security can be registered with the Commission, the Issuer of that security must be registered with the Commission as a Reporting Issuer in accordance with Section 64(2) of the Act as stated below.

"***…A person who proposes to issue securities to the public shall register with the Commission as a reporting issuer and file a registration statement in the prescribed form and within the prescribed time…***"

The practice of registering the asset underlying a Securitized Instrument without registering the issuer of the underlying asset therefore can be argued to be inconsistent with the provisions of the Act.

2. Applicability of Policy to Securitization of Assets that are not Securities

Even if it were possible to register the asset underlying a securitized instrument without registering the Issuer of that underlying asset, the Commission would find itself in a dilemma when processing applications for the registration of securities that were based on assets that are not securities, for example, loans.

Where the underlying asset is not a security, the Act does not provide for the registration of such an asset. The Commission therefore, would have to consider the following questions:

1. How does the Commission verify that the underlying asset exists?
2. How does the Commission verify that the Issuer of the Securitized Instrument owns the asset that is being securitized?
3. How does the Commission ensure that investors receive continuous disclosure on the performance of the Issuer of the underlying asset or the servicing of the underlying asset, so as to make investment decisions related to buying, holding, or selling the Securitized Instrument?

Revised Approach

The Staff has considered a revised approach based on the issues raised above. Where an applicant intends to offer Securitized Instruments *"to the public"* as defined at Section 3(1) of the Act, then the Commission would have to register the Securitized Instrument pursuant to Section 65(1) of the Act, (Section 65(1) of the Act states, inter alia, that no security shall be offered to the public unless it is registered with the Commission). If the asset underlying the Securitized Instrument is a bond or other security that is already registered with the Commission, then no further registrations in respect of the underlying instrument would be required.

If, however, the underlying Bond or other security has not been registered prior to the submission of the application for registration of the Securitized Instrument, then the Securitized Instrument, the underlying Bond or other security and the Issuer of that Underlying Bond or other security, must be registered with the Commission.

The requirements outlined in the paragraph above will vary however, where the underlying asset is not a security or is a security, but which security was issued by a foreign issuer or where the underlying asset is not a security as defined under the Act (for example, mortgage loans and credit cards). In instances such as these then some form of "Recognition" would be required.

“Recognition” of the Underlying asset

The process of “recognizing” or verifying the existence of the asset(s) underlying Securitized Instruments would apply where the underlying asset is not a security as defined under the Act or where the asset is a security issued by a foreign issuer that is not registered with the Commission as a Reporting Issuer.

It is important to note that in these circumstances the Issuer of the underlying asset would be automatically precluded from being registered as a Reporting Issuer based on that underlying asset alone.

Recognition or verification of the underlying assets (whether local assets or foreign assets/securities) would involve:

a. The Staff of the Commission confirming that the Issuer of the Securitized Instrument either already owns, or has the capacity to acquire the underlying asset[2]. This may require the submission of a statement from a service provider in the underlying asset which verifies the existence of the underlying asset and confirms who owns said instrument. Alternatively, the submission of a Balance Sheet by the Issuer of the Securitized Instrument (as at the end of its most recent month) will suffice to determine whether the Issuer has the capacity to acquire the underlying instrument.
b. A review of documentation/information with respect to the asset to determine whether there are any concerns surrounding same.
c. The Issuer of the Securitized Instrument undertaking to ensure that investors receive continuous disclosure on the performance of the Issuer of the underlying asset or the servicing of the underlying asset through the filing with the Commission of performance reports, interim and audited comparative financial statements. To this end the Issuer of the Securitized Instrument would be required to either:
    1 Provide a written undertaking to do same; or
    2 Insert clauses in the legal documents which provide for the acquisition and dissemination of these documents to investors in the Securitized Instrument.

The intention is that through this “recognition” process, the Commission will be able to:

a. verify the existence of the underlying asset;
b. verify that the issuer of the securitized asset either owns or has the capacity to acquire the underlying asset; and
c. ensure that investors in the securitized instrument receive continuous disclosure on the performance of the issuer of the underlying asset or the servicing of the underlying asset.

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[2] Being in possession of the underlying asset or having at least 8% of the value of the underlying asset in capital as well as being in possession of the same. The above is in keeping with the Guidelines on Capital requirements for underwriters and Issuers of Asset-Backed securities registered under the SIA, 1995.

Conditions for Approval

The Staff is cognizant of the fact that certain types of securitized instruments are offered to the general public in foreign markets (e.g. Mortgage Backed Securities). Notwithstanding this and taking into account the recent upheavals in the global financial markets in which securitized instruments were involved, the Staff is of the view that Securitized Instruments should be targeted to fewer than fifty sophisticated investors under Section 75(2) of the Act. Section 67(2) of the Act defines a sophisticated purchaser as:

> *"…a person who participates as principal in any trade the consideration for which is no less than one hundred thousand dollars…"*

If the applicant would like to offer the Securitized Instruments to the public under section 3(1) of the Act, then the Commission may impose certain conditions on the distribution in keeping with section 76(5) of the Act. The Staff is of the view that these conditions under section 76(5) may also be used to redefine the investor to whom such an offer should be made.

Under the Securities Bill 2009 an accredited investor (similar to the sophisticated purchaser under the Act) is defined, among other things, as an individual who has a net worth of TT$1,000,000 or such higher amount as prescribed by the Commission.

Given the changes in the real value of the money since the Act came into force and taking into account the provisions of the Securities Bill 2009, the Staff recommends that the Commission define a sophisticated purchaser or an accredited investor as a person with a net worth of TT$3 Million regarding Securitized Instruments.

The Staff believes that if this condition is attached to the registration of Securitized Instruments, then only individuals that are more likely to understand the nature of the Securitized Instrument and/or be familiar with the risks associated with investing in the said instrument would have access to same. This should also protect those investors who may not have the means and/or resources to make a fully informed decision with respect to these instruments.

Summary

This guideline has several implications, not just for the Staff of the Commission but also for prospective issuers of Securitized Instruments. Going forward all issuers of Securitized Instruments:

a. Where the Securitized Instrument is based on a security that is issued by a local entity or a reporting issuer under the Act, will be required to register:
    i. the underlying security;
    ii. the Issuer of the underlying security; and
    iii. the Securitized Instrument itself.

b. Where the Securitized Instrument is based on an asset that is not a security, or is based on a security that is issued by a foreign issuer that is not a reporting issuer, will be required to have the underlying asset "recognized". In such circumstances the foreign issuer will not have to register as a reporting issuer under the Act. Recognition of the underlying asset will involve:
    i. Confirmation that the Issuer of the Securitized Instrument either already owns or has the capacity to acquire the underlying asset[3].
    ii. Review of documentation/information with respect to the assets, if there are any concerns surrounding same, then the Commission may require a statement or confirmation from the foreign regulator of a jurisdiction approved by the Commission, where applicable with respect to the said assets;
    iii. Submission of a statement from a service provider or trustee of the underlying instrument which verifies the existence of the underlying assets and confirms who owns the said instrument.
    iv. Trustee/Custodian must ensure that investors receive continuous disclosure on the performance of the Issuer of the underlying asset or the servicing of the underlying asset through the filing with the Commission of quarterly performance reports, interim and audited comparative financial statements.

c. Must ensure that the Securitized Instrument is offered to less than fifty (50) investors each of whom must have a net worth of at least TT$3,000,000.

It is the Commission's intention that these guidelines will provide a higher level of protection to investors as well as assist in reducing the potential for systemic risk in the local capital market.

August 10, 2009

[3] Being in possession of the underlying asset or having at least 8% of the value of the underlying asset in capital as well as being in possession of the same. The above is in keeping with the Guidelines on Capital requirements for underwriters and Issuers of Asset-Backed securities registered under the SIA of 1995.