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The Hon. Audrey Eu, SC, JP
Chairperson
Bills Committee on Companies (Amendment) Bill 2004
c/o Ms. Connie Szeto, Clerk to Bills Committee
Legislative Council Secretariat
3/F, Citibank Tower
3 Garden Road, Hong Kong.

Dear Ms. Eu

Bills Committee on Companies (Amendment) Bill 2004
Proposed legislative amendments to the definition of "subsidiary"

Following our letter of 22 December 2004 to you, we are very pleased to present a brief survey on securitisation practices and market activities in other jurisdictions for the consideration of the Bills Committee. We have consulted with members of the Asian Securitisation Network in preparing this survey and are grateful for the kind assistance of Fitch Ratings Limited, Linklaters, Freshfields Bruckhaus Deringer, Drew & Napier, Deloitte Touche Tohmatsu, Mallesons Stephen Jaques, PricewaterhouseCoopers, and Heller Ehrman White & McAuliffe in providing the information summarised in the survey.

The survey sets out in a tabular format for ease of comparison, securitisation practices and market statistics for the following selected jurisdictions: Korea, Japan, Australia, Singapore and the United States. The results of the survey are significant and show that for those markets where the government has taken an active role in promoting its securitisation industry by providing a conducive legislative or accounting framework, there has been tremendous growth in both the number and volume of transactions over a relatively short period of time.

In the case of Korea, since the enactment of the relevant legislation in 1998/1999, the volume of asset-backed securities issuances has reached KRW39.9 trillion in 2003 (equivalent to US$33.5 billion at exchange rates on 31 December 2003). The Japanese securitisation market has seen similar spectacular growth since the enactment of its securitisation laws in the early 1990s and the volume of asset-backed securities issuances amounted to ¥5 trillion in 2003 (equivalent to US$46.8 billion at exchange rates on 31 December 2003).

Despite not having any specific enabling legislation, Australia too has developed a substantial securitisation industry with issuance volume of A$50 billion (US$37.5 billion) in 2003. This was possible due to the conducive accounting approach taken by the Australian accounting profession on off-balance treatment for securitisation transactions until recently. Now that the accounting approach has changed, the industry is making strong representations to the International Accounting Standards Board ("IASB") and has recently kicked off a global project, with the endorsement of the IASB, to consider the development of a revised accounting framework for securitisation transactions.

The Singapore government is keenly aware of the benefits of the securitisation market and the current demand for highly rated investment products, and is playing its part in developing the securitisation market in Singapore. It has recently announced an SME Loan Securitisation Project which will repackage loans to small-and medium-sized enterprises into tradeable securities.

The United States securitisation market is one of the largest capital markets in the world. From its inception in the early 1970s, it now exceeds US$7 trillion in size, and despite the controversy over the abuse of special purpose entities, in particular instances such as the Enron case, the off-balance sheet accounting treatment accorded to Qualifying SPEs still remains untouched.

Accordingly, the HKMC would argue that it is possible for Hong Kong to develop a substantial and vibrant securitisation industry to allow a more efficient use of capital, provided that there is a conducive legislative and accounting environment which supports and does not hinder genuine securitisation activity by removing one of the major drivers of securitisation, namely, the possibility of off-balance sheet treatment.

We hope that the Bills Committee finds the information useful, and we would be happy to attend before the Committee again to elaborate further on the comments set out in our submission.

Yours sincerely,

SUBMISSION TO BILLS COMMITTEE
SURVEY OF REGIONAL SECURITISATION MARKETS

	Jurisdiction	**Remarks**
1.	**Korea**	
1.1	Enabling legislation for securitisation	The ABS Act was enacted in 1998. In addition to the ABS Act, Korea Mortgage Corporation ("KoMoCo") was established by the enactment of the MBS Act in 1999, based on which KoMoCo has issued MBS. In March 2004, Korea Housing and Finance Corporation ("KHFC") was established to take on the role of KoMoCo and has since been issuing MBS through the MBS Act.
1.2	Effect of enabling legislation	There were no domestic securitisation transactions within the Korean market until the ABS Act was enacted, with the exception of a few cross-border transactions that used foreign special purpose entities ("SPEs"). The ABS/MBS Acts were passed as a means for an alternative source of funding for Korean companies which had been going through difficult times since the IMF crisis of late 1997. This has reduced the cost of funding for firms and has also been used by the government to support small and medium size companies.

<table>
<tr><th></th><th>Jurisdiction</th><th>Remarks</th></tr>
<tr><td>1.3</td><td>Growth of securitisation market</td><td>(Unit: No. of transactions, KRW trillion)

<table>
<tr><td></td><td>1999</td><td>2000</td><td>2001</td><td>2002</td><td>2003</td><td>2004 1st half</td></tr>
<tr><td>Issue Amount[1]
(Growth Rate)</td><td>6.8
-</td><td>49.4
(626.5%)</td><td>50.9
(3.0%)</td><td>39.8
(-21.8%)</td><td>39.9[3]
(0.1%)</td><td>11.3
(-40.2%)</td></tr>
<tr><td>No. of Transactions</td><td>32</td><td>154</td><td>194</td><td>181</td><td>191</td><td>69</td></tr>
<tr><td>Issue Amount[2]
(IPO)</td><td>4.4</td><td>41.0</td><td>39.6</td><td>29.0</td><td>27.7</td><td>7.3</td></tr>
</table>

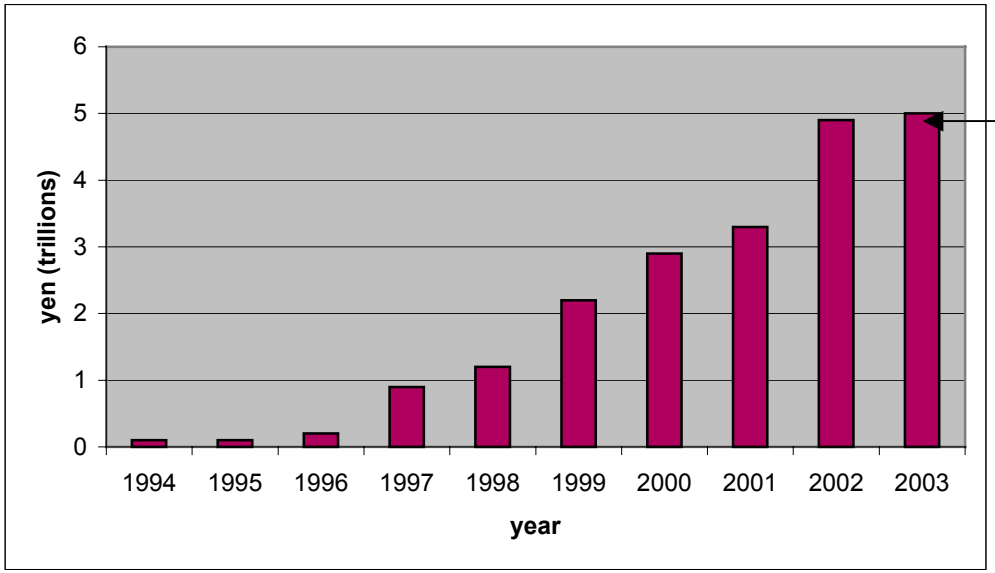
Notes : (1) Public and private placements included, KoMoCo and KHFC-issued MBS included, ABS Equity and ABS Beneficiary Certificate excluded.
(2) Private placements excluded.
(3) US$33.5 bn equivalent.
Source : Financial Supervisory Service</td></tr>
<tr><td>1.4</td><td>Do accounting standards require consolidation of securitised assets?</td><td>As long as the securitisation is recognized as a “true sale” from a legal standpoint and from an accounting standpoint, securitised assets are not consolidated with the originator’s balance sheet.</td></tr>
<tr><td>1.5</td><td>Do accounting standards require consolidation of subsidiaries, including any SPEs?</td><td>Korean accounting standards do have requirements for consolidation of subsidiaries (including SPEs) depending on ownership percentage of the subsidiary by the parent company. The main criteria are:

(i) holding over 50% ownership stake of the subsidiary; or
(ii) holding over 30% ownership stake of the subsidiary and is the largest shareholder.

However, Korean SPEs are established so that the originator usually holds less than 2% ownership stake in the SPE and a third person is appointed as its sole director. Thus, SPEs are usually not consolidated with the originator.</td></tr>
<tr><td>1.6</td><td>Importance of off-balance sheet treatment</td><td>As in other countries, local transactions are done for the purposes of (i) lower cost funding; (ii) increasing liquidity and (iii) transferring assets off-balance sheet. Many transactions are done for the sole purpose of</td></tr>
</table>

	Jurisdiction	Remarks
		removing the assets from the balance sheet and disallowance of such off-balance sheet treatment would likely have a huge impact on the securitisation market.
1.7	Convergence with International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS)	Korean accounting standards are established by the Korea Accounting Standards Board ("KASB"). KASB maintains a careful observation of the International Accounting Standards Board's ("IASB") operations and decisions but there are no stated plans for wholesale adoption of IAS/IFRS.
2.	**Japan**	
2.1	Enabling legislation for securitisation	The Law on Securitisation of Specific Assets enacted in September 1998 and referred to in paragraph (ii) below is sometimes referred to as the "securitisation law" of Japan. However, this is only one of a number of laws enacted and measures taken in the last five to eight years to facilitate securitisation in Japan. Some of the most significant of these are set out below: (i) the Law Relating to the Regulation of the Business of Specified Claims (Law No. 77 of 1992), which came into force in June 1993 (the "**MITI Law**"); (ii) the Law on Securitisation of Specific Assets by a SPE which came into force in September 1998 and was amended in May 2000 (the "**SPE Law**"); (iii) the Law Prescribing Exceptions to the Civil Code Requirements on Assignment of Claims (Law No. 104 of 1998), which came into force in October 1998 (the "**Perfection Law**"); (iv) the Law for Special Measures Relating to Debt Collection Business (Law No. 126 of 1998) which came into force in April 1999 (the "**Servicing Law**"); and (v) the Law Relating to the Issue of Bonds by Finance Companies for Money Lending Business (Law No. 32 of 1999), which came into force in April 1999.

	Jurisdiction	Remarks
2.2	Effect of enabling legislation	1.1 **The MITI Law.** The MITI Law was enacted to provide for the disapplication of the Japanese Civil Code in certain limited circumstances to facilitate securitisation. Although its scope is limited, the MITI Law was instrumental in the rapid development of the Japanese securitisation market in the mid-1990s. 1.2 **The Perfection Law.** The MITI Law was a significant encouragement for securitisation in Japan. However, it applies only to a very limited class of assets. The Perfection Law of 1998 (although not intended solely to encourage securitisation) established an alternative to the MITI Law structures which could be used to securitise a broader class of assets. 1.3 **The SPE Law.** The SPE Law of 1998 (as amended in 2000) established a new type of Japanese corporate entity known as a *tokubetsu mokuteki kaisha* ("**TMK**"). Prior to the enactment of the SPE Law the only types of Japanese entities that could be used for securitisation were the *kabushiki-kaisha* (the Japanese equivalent of an English public limited company, with onerous capital (¥10 million) and reporting requirements) or the *yugen-kaisha* (a limited liability company). The capital and reporting requirements of a TMK are far less onerous (minimum capital requirement is ¥100,000) than the *kabushiki-kaisha*, and it offers certain tax advantages over the *yugen-kaisha*. 1.4 **The Servicing Law.** The Servicing Law provided that corporations meeting certain requirements such as a minimum capital of ¥500 million and which have a qualified lawyer on its board of directors could be approved as servicers. This greatly facilitated structures using the originator as servicer of the receivables. 1.5 **Other Development.** Further legislative developments led to the removal of other obstacles to securitisation in Japan.

	Jurisdiction	Remarks
2.3	Growth of securitisation market	 In 2003, issuance volume was equivalent of US$46.8 billion. Note: These figures do not include asset-backed commercial paper and real estate investment trusts. Source: Report of the Securitisation Market Forum dated 22 April 2004, Bank of Japan.
2.4	Do accounting standards require consolidation of securitised assets?	Different requirements apply to real estate and to financial assets. The guidelines published by the Institute of Certified Public Accountants of Japan in July 2000 apply to transfers of real estate. These provide that an originator seeking to obtain off-balance sheet treatment for the transfer of real estate to an SPE must not retain more than 5% of the risks and rewards associated with such assets. For transfers of financial assets, the relevant standards are those published by the Business Accounting Council of Japan in January 1999. These provide that where all risks associated with financial products are transferred, such assets may be removed from the balance sheet of the originator.
2.5	Do accounting standards require consolidation of subsidiaries, including any SPEs?	A company that prepares its accounts in accordance with accounting principles generally accepted in Japan is required to consolidate companies in which (i) it holds more than 50% of the voting rights, directly or indirectly, and (ii) not less than 40% but not more than 50% of the voting rights but over which the parent

	Jurisdiction	Remarks
		company exercises control. In general, special purpose entities used in Japan are held either by another SPE such as a Cayman Islands SPE or a *chukan-houjin* (a non-profit making entity that may be used in transactions as a holding entity in order to create a bankruptcy remote orphan SPE for a transaction) and are not therefore consolidated with the originator.
2.6	Importance of off-balance sheet treatment	This depends on the originator and the purpose of the securitisation. However, many of the recent large scale Japanese securitisations have been driven by balance sheet concerns. Japanese banks have been under pressure in recent years to remove bad loans from their portfolio, and improve their capital adequacy ratios. Securitisation was used to achieve this. Other regulated entities such as insurance companies have also used securitisation as a means of improving their solvency ratios. Japanese corporates may wish to achieve off-balance sheet treatment to improve their financial ratios.
2.7	Convergence with IAS/IFRS	We understand from unofficial sources that the Japanese authorities may be considering the adoption of IAS but we are not aware of any official statement on this.
3.	**Australia**	
3.1	Enabling legislation for securitisation	As a common law jurisdiction, no legislation was required to enable securitisation. The first securitisation was launched in Australia (an Australian bond issue and a eurobond issue) in 1986. In the late 1980's a range of existing laws were amended to remove impediments to the growth of the securitisation market in Australia. Stamp duty laws were amended to exempt from duty a range of transactions associated with a securitisation that would otherwise have been dutiable. At the same time Trustee Acts and equivalent legislation governing insurance companies were amended to permit institutions such as trustees and insurance companies to invest in rated debt securities.
3.2	Effect of enabling legislation	See above.

	Jurisdiction	Remarks
3.3	Growth of securitisation market	Number of New Australian Securitisation Transactions 		QTD 30/11/04	% QTD 30/11/04	3Q04	% (3Q04)	2Q04	% (2Q04)	YTD 2004	% YTD 2004	2003	% (2003)	2002	% (2002)
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ABS	4	25.00	6	22.22	3	10.34	16	15.84	12	8.82	11	14.10
RMBS	8	50.00	13	48.15	16	55.17	57	56.44	59	43.38	43	55.13
CMBS	1	6.25	1	3.70	5	17.24	8	7.92	8	5.88	15	19.23
CDO/Repack	3	18.75	7	25.93	5	17.24	20	19.80	57	41.91	9	11.54
TOTAL	16	100.00	27	100.00	29	100.00	101	100.00	136	100.00	78	100.00 | Volume of Term Australian Securitisation Debt Issued (Bil. A$) |	QTD 30/11/04	% QTD 30/11/04	3Q04	% (3Q04)	2Q04	% (2Q04)	YTD 2004	% YTD 2004	2003	% (2003)	2002	% (2002)
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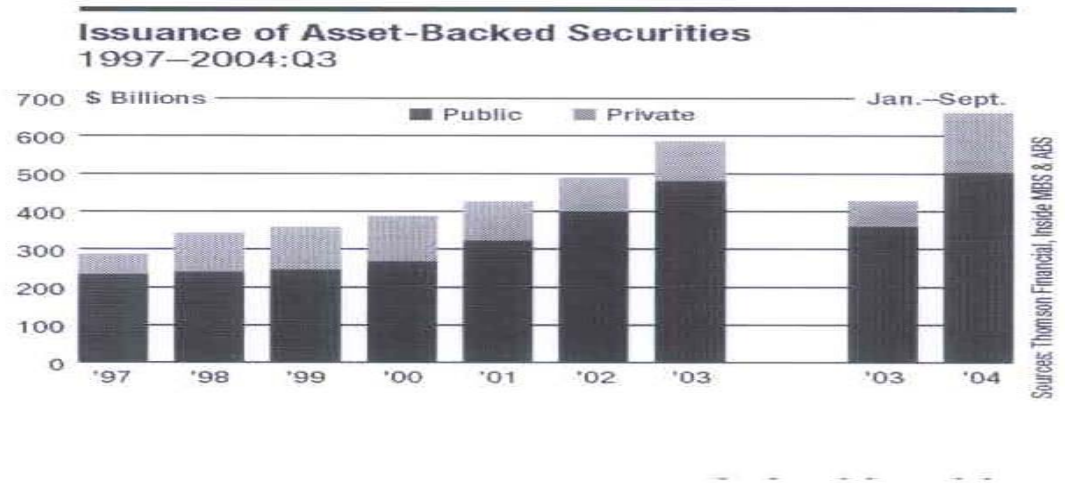
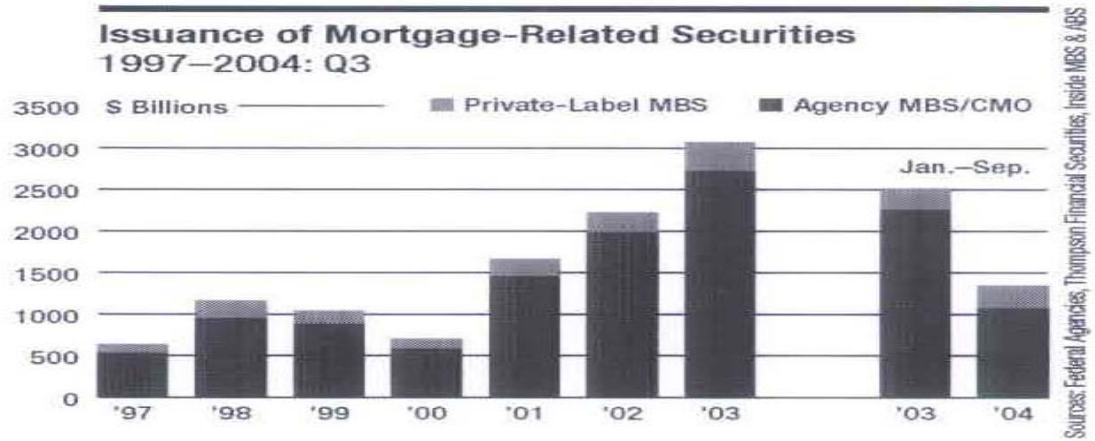
ABS	0.97	14.41	0.84	5.02	0.24	1.55	3.4	5.57	2	3.90	3	6.74
RMBS	5.506	81.73	14.77	88.16	13.32	87.54	55.0	90.12	45	88.44	32	83.00
CMBS	0.002	0.03	0.00	0.02	1.48	9.75	1.7	2.79	2	3.78	3	8.10
CDO/Repack	0.258	3.83	1.14	6.80	0.18	1.16	0.93	1.52	2	3.88	1	2.16
TOTAL	6.736	100.00	16.75	100.00	15.21	100.00	61.03	100.00	50	100.00	38	100.00	 In 2003, issuance volume was equivalent of US$37.5 billion. Source: Standard & Poor's
3.4	Do accounting standards require consolidation of securitised assets?	Prior to July 1999, Australia applied its equivalent of IAS 27 (AASB 1024) to SPEs involved in securitisation transactions by using US accounting standards as a reference since it was felt that the US had the most substantial guidance in accounting for securitisation SPEs. Even when the equivalent of SIC-12 (UIG-28) came in, and provided guidance locally on how to apply AASB 1024 to SPEs, this approach did

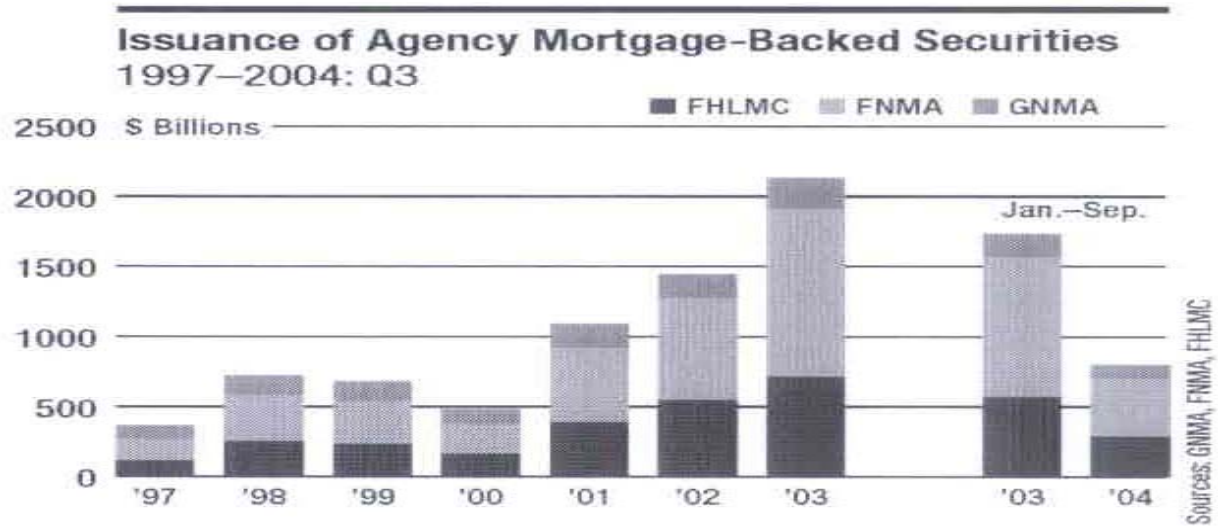
	Jurisdiction	Remarks
		not change and the Australian industry continued to interpret SIC-12 in accordance with US accounting standards. However, in Europe SIC-12 was interpreted differently to require the consolidation of most securitisation vehicles. In October 2003, the view emerged that the Australian interpretation of UIG-28 would have to align with the European interpretation of SIC-12 as from 1 January 2005 with the adoption of IFRS. Accordingly, it is expected that the adoption of IAS/IFRS from 1 January 2005 will cause all traditional securitisation vehicles to be consolidated by the sponsor. As a result the Australian Securitisation Forum has recently kicked off a global project, with the endorsement of the IASB, to develop a revised model for accounting for securitisation transactions. There are four co-chairs of the project, one from, two from the American Securitisation Forum and one from the European Securitisation Forum. Deloittes UK have been engaged jointly by the forums to prepare the project outline and act as the consultants to the project.
3.5	Do accounting standards require consolidation of subsidiaries, including any SPEs?	As above.
3.6	Importance of off-balance sheet treatment	Off-balance sheet treatment remains important for corporates, notwithstanding the regulatory capital relief available for entities regulated by the Australian Prudential Regulatory Authority ("APRA"). In the context of the banking regulator's assessment of the risks retained by the bank, which affects the regulatory capital required of the bank, the regulators may need to develop standards for capital treatment different to the accounting standards in order to assess properly the capital requirements of the consolidating bank. For instance, APRA has indicated that after the IAS/IFRS have been adopted in Australia, from 1 January 2005, as an interim measure pending an assessment of the impact such adoption will have on APRA's prudential and reporting standards, a bank will have to submit a separate set of accounts prepared under the previously prevailing Australian accounting standards until further notice.

	Jurisdiction	Remarks
3.7	Convergence with IAS/IFRS	Full convergence on 1 January 2005. However, the Australian accounting profession notes that a different interpretation of the requirements for consolidation will be adopted in Europe under IAS 27 and SIC-12 and that once IAS/IFRS are adopted throughout the European Union as from 1 January 2005, the more restrictive European interpretation may have to be applied in Australia and a bank would thereafter be required to consolidate the SPE in many Australian transactions. Accordingly, the Australian Securitisation Forum has joined with the American and European Securitisation Forums to develop a revised model for the accounting treatment of securitisation SPEs.
4.	**Singapore**	
4.1	Enabling legislation for securitisation	There is no specific legislation that "enables" securitisation as such. Asset securitisation by banks, however, are regulated by the Monetary Authority of Singapore (MAS), which has issued notices that banks in Singapore are required to comply with. These are : (a) Asset Securitisation by Banks (MAS Notice 628) (b) Capital Treatment for Credit Derivatives (MAS Notice 627). Banks in Singapore are also required to comply with banking secrecy laws in relation to the transaction.
4.2	Effect of enabling legislation	See above. MAS Notice 628 sets out the requirements applicable to banks participating in securitisation transactions. MAS Notice 627 addresses the capital treatment for credit derivative products that may be used in securitisation transactions.
4.3	Growth of securitisation market	The asset securitisation activity in Singapore is still at its initial stage having made its presence felt only some time in the 1990s. The major securitisation transactions involved mainly commercial real estate, residential sales progress payments, credit card receivables, bonds and loans. Of late in 2003, Singapore began to witness increased activity in commercial mortgage-backed securitisation debt issuance and synthetic securitisation.

	Jurisdiction	Remarks
		The Singapore Government is aware of the benefits of the securitisation market and the current demand for highly rated investment products and is playing its part in developing the securitisation market in Singapore. It has recently announced Small-Medium Enterprises ("SME") Loan Securitisation Project which will combine loans to small-and medium-sized enterprises and repackage such loans into tradeable securities. The issue will be worth some S$300m (US$176.6 milllion) and will assist start-up companies without track records and small- and medium-sized enterprises without collateral
4.4	Do accounting standards require consolidation of securitised assets?	Singapore adopted the equivalent of IAS 27 and SIC-12 in February 1990 and March 2000 respectively. The accounting standard and accounting interpretation are applicable for financial periods beginning on or after 1 January 1990 and 1 January 2000 respectively. Where the securitisation of assets involved the setting up of SPE and they fall within SIC-12, the originator is required to consolidate the SPE. Prior to the adoption of the equivalent of SIC-12 by Singapore, international accounting standards and general accounting principles were used, alongside with the accounting standards and guidance promulgated by the US and the UK when dealing with accounting for securitisation in Singapore. With the compulsory adoption of FRS 39 (which is the local equivalent of IFRS 39) taking effect in Singapore for financial periods beginning on or after 1 January 2005, it is challenging for the originator / transferor to be able to derecognize the assets from their standalone balance sheet. FRS 39 contains some grandfathering rules such as any transfer of the assets for securitisation purposes before the adoption of FRS 39 which were previously considered to be derecognized in the past under the old GAAP will not be required to be recognised back on the balance sheet on adoption of FRS 39.
4.5	Do accounting standards require consolidation of subsidiaries, including any SPEs?	As above.
4.6	Importance of off-balance sheet treatment	This depends on the objective of the originator and the purpose of the securitisation. Where the originator is a banking corporation or a financial institution, the motivation is often driven by

	Jurisdiction	Remarks
		enhancement of capital adequacy ratio. So far, Singapore saw a large asset securitisation exercise carried out by Development Bank of Singapore in 2000 for the purpose of improving its capital adequacy ratio. Where non-financial corporations are concerned, they are mainly motivated by potential improvement to balance sheet ratios.
4.7	Convergence with IAS/IFRS	The Singapore Accounting Standards are almost identical to the IFRS, with a few differences such as the effective dates and the absence of the equivalents to IFRS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions and IFRS 40 Investment Property.
5.	**UNITED STATES AND QUALIFYING SPECIAL PURPOSE ENTITIES ("QSPE")**	
5.1	Enabling legislation for securitisation	The corporate laws of the various state jurisdictions in the U.S. are permissive rather than restrictive in their application. Thus, specific enabling legislation has not been necessary for the development of the U.S. securitisation market, the largest in the world. Various laws must be considered for various transaction structures and types of assets, however, such as tax rules governing mortgage-related transactions (e.g. REMICs) and SPE structures, perfection of asset transfers, SPE bankruptcy consolidation issues and applicable securities laws governing the offering of securitised interests.
5.2	Effect of enabling legislation	See above.

	Jurisdiction	Remarks
5.3	Growth of securitisation market	The U.S. securitisation market is one of the largest capital markets in the world. From its inception in the early 1970s, it now exceeds US$7 trillion in size. Issuance has steadily grown over the years. The following charts show the trends in asset-backed securities, mortgage-related securities and agency mortgage-related securities:  

	Jurisdiction	Remarks
		
5.4	Do accounting standards require consolidation of securitised assets?	The U.S. accounting standards generally provide that a securitisation receives off-balance sheet treatment only if the transaction fails to meet one or more of FASB Statement No. 140 criteria for "sale accounting." FASB 140 provides that a transfer of financial assets will be accounted for as a "sale" to the extent that the transferor surrenders control over the financial assets and receives consideration other than beneficial interests in the assets in return. Surrender of control occurs if three conditions are met: (i) the transferred assets have been isolated from the transferor–put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy; (ii) the transferee has an essentially unconstrained right to further pledge or exchange the transferred assets or the transferee is a QSPE and its holders have an essentially unconstrained right to transfer their interests in the SPE; and (iii) the transferor does not maintain effective control over the transferred assets through an arrangement that entitles and obligates the transferor to repurchase the transferred assets through a call option on the transferred assets (other than a permitted clean-up call by the servicer when the amount of the outstanding assets fall to a level at which the cost of servicing those assets becomes burdensome).

	Jurisdiction	Remarks
		Under FASB 140, a QSPE is a trust, corporation or other "legal vehicle" that is limited to performing the activities involved in the securitisation and which has "standing at law distinct from the transferor" with essentially no ability to take discretionary actions. In accountants' parlance, a QSPE must be "brain dead" or on "automatic pilot."
5.5	Do accounting standards require consolidation of subsidiaries, including any SPEs?	Even if sale accounting is achieved under FASB 140, the U.S. accounting standards may require consolidation of a subsidiary (including SPEs) unless that subsidiary is a QSPE. FIN 46 provides which entity or entities are required to consolidate the subsidiary. The normal consolidation rule is consolidation based on majority of voting interests. However, in case of certain entities, called "variable interest entities" under FIN 46, consolidation will be based on variable interests, and not based on voting interests. The primary variable interest in any entity is its equity: equity is defined as residual economic interest. The rationale of capturing variable interest other than equity contemplates that there are certain entities where the legal equity is insignificant and irrelevant from the viewpoint of risk/rewards. In such cases, consolidation based on equity does not serve the purpose of effective reporting. Most of the securitisation transactions in the U.S. are structured with a QSPE to avoid consolidation. *FIN 46 means FASB Interpretation No.46 which requires the consolidation of "variable interest entities". However, notwithstanding the tightening of reporting standards in relation to these variable interest entities, the qualifying SPE exemption for securitisation entities, together with a few other exceptions, were expressly excluded from the consolidation.
5.6	Importance of off-balance sheet treatment	Most securitisations in the U.S. are structured for off-balance sheet treatment which generates significant benefits to issuers including (i) lowering the cost of funding, (ii) swapping lower quality assets (e.g. receivables) for higher quality assets (cash) and improving the issuer's balance sheet strength and risk profile, (iii) transferring credit and other risks associated with the transferred assets, (iv) lowering required regulatory capital (e.g. for banks) and (v) diversifying funding sources. Inability to achieve off-balance sheet treatment would have a serious negative impact on the U.S. securitisation market.

	Jurisdiction	Remarks
5.7	Convergence with IAS/IFRS	While there has been much discussion of the trend to convergence with IAS, nothing is imminent in the United States in this area.

Submitted by
The Hong Kong Mortgage Corporation Limited
10 January 2005

Acknowledgement
The following organisations have made contribution on various countries' accounting and legal information covered in this survey:
Korea – Fitch Ratings Limited
Japan – Linklaters
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