Global Developments in Securitisation Regulation

Final Report

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Executive Summary

Since the Global Financial Crisis (**Crisis**) there has been a significant downturn in global securitisation market activity. IOSCO believes that, as an alternative source of funding for the banking sector, securitisation markets can play a role in supporting economic growth. However, the revival of confidence in these markets depends on a range of complex factors, and both securities and prudential regulators must continue to address the issues with securitisation that came to light through the experiences of the Crisis.

As part of its ongoing work into the shadow banking sector, the Financial Stability Board (**FSB**) is in the process of reviewing reforms of securitisation markets. Through this work, the FSB requested that IOSCO conduct a stock-taking exercise on certain aspects of securitisation and develop policy recommendations as necessary.

Pursuant to this request, IOSCO and the Task Force on Unregulated Markets and Products (**TFUMP**) engaged in a project to survey existing regulatory requirements and industry practice in securitisation and to consult with industry on possible recommendations and proposed further work (**Project**). The Project also took into account the findings of an analysis undertaken in late 2011 by staff of the US Securities and Exchange Commission (**SEC**) and the European Commission (**EC**) of developments in the US and the EU (**EC/SEC Staff Analysis**). The findings of the Survey and EC/SEC Staff Analysis are summarised in this report.

IOSCO's consultation with industry was based on the results of TFUMP's survey work and the EC/SEC Staff Analysis, but particularly focused on risk retention, transparency and disclosure standardisation, consistent with the FSB request. It also considered a broader set of issues important to the proper functioning of securitisation markets in the context of the work conducted by the FSB on the shadow banking sector.

Risk retention has been a focus of regulatory attention since the Crisis, and is seen as a way to address misaligned incentives arising in certain structures and practices that were prevalent in some markets prior to the Crisis. The EU has implemented risk retention requirements for EU credit institutions through the Capital Requirements Directive (**CRD**) and these requirements are to be extended to other types of institutions such as insurance companies. US requirements are still being developed through implementation of the Dodd Frank Wall Street Reform and Consumer Protection Act. Other jurisdictions vary as to whether there are specific regulatory requirements or an industry practice of retention, or other factors that align incentives in their securitisation markets.

During the consultation process industry participants commented that differences, particularly between EU risk retention requirements and US proposals, could have a significant impact on certain cross border transactions. IOSCO noted these submissions and that US risk retention requirements have yet to be finalised. **To assist in harmonisation, IOSCO proposes in its recommendations a roadmap intended to support incentive alignment in global securitisation markets, particularly through risk retention requirements, while reducing the risk that potential barriers to cross border securitisation markets may emerge.**

IOSCO also consulted on the need for disclosure of stress testing and scenario analysis by issuers. Responses uniformly acknowledged the benefits of clear and effective disclosure to assist investors in understanding their investments and the risks inherent in securitisation.

Stress testing was seen by investors as useful to this process of developing understanding. However, there was a divergence of opinion as to whether it was best for stress test results to be provided to investors by issuers, or whether it was more appropriate for investors to conduct their own stress tests and scenario analysis and therefore what was critical was to ensure that issuers provided sufficient detailed disclosure to enable investors to conduct their own analysis. **IOSCO concludes that it is essential to give investors the means to assess issuer disclosure regarding a securitisation structure's performance, in particular by receiving from the issuer a comprehensive set of data on the structure and its underlying risks. Hence, IOSCO recommends that investors should:**

- **receive information in relation to the base case and risk/reward profile of a product;**
- **be provided with modelling tools that enable investors to conduct cash flow analyses of a given securitisation transaction through its life; and**
- **receive any relevant documents and relevant data provided to Credit Rating Agencies (CRAs) that is necessary to analyse a product's creditworthiness, consistent with applicable privacy, confidentiality, and other laws.**

The Consultation Paper noted that standardisation of disclosure information and asset data may benefit investors in analysing their investments. Survey results indicated that few jurisdictions require standard disclosure templates, but there are some significant industry and regulatory initiatives underway in both Europe and the US.

Industry was generally supportive of the concept of standardised templates such as industry may have developed in some jurisdictions with the help of public entities. Yet it cautioned that there are real differences between jurisdictions, structures and assets that have developed over time for good reason, which should be taken into account in any standardisation initiatives. **In light of current developments and industry feedback (both in terms of presentation of asset data and disclosure documentation), IOSCO sees standardisation as a useful means to enhance transparency and facilitate disclosure. IOSCO's intention is not to develop new frameworks but rather to promote standardisation of asset level reporting (through asset level templates) in a bottom-up approach. IOSCO recommends that regulators do so by making use of existing work on standardisation where that has already taken place, before working further towards convergence.**

In addition to these core recommendations, IOSCO noted in the Consultation Paper a number of issues for further consideration, including standard definitions, selection and eligibility criteria, liquidity, access to information provided to credit ratings agencies. Some initial observations are provided on these issues in this report.

IOSCO notes that the revival of confidence in the securitisation markets depends on a number of complex factors. Aside from risk retention and disclosure reforms, there are prudential reforms underway which may have a significant impact on the future performance of securitisation markets, such as reforms to the capital treatment of securitisation. Given the importance of these markets to the global financial system and economic growth, and in the context of the more global work conducted by the FSB on the shadow banking sector, IOSCO considers it necessary to ensure that securities regulators work toward a sound market system in which all market participants have confidence and trust. **IOSCO especially draws attention to, and invites further consideration or work on:**

- **the relative prudential treatment of securitisation products;**
- **accounting issues, especially regarding consolidation and retention;**
- **developing guidance on possible measures that could eliminate or reduce the potentially negative effects of differences in securitisation regulation and terminology on cross border transactions;**
- **encouraging standardisation to increase liquidity in secondary markets; and**
- **encouraging sound mortgage underwriting practices (e.g. through implementation of FSB's Principles for sound residential mortgage underwriting practices).**

I. Introduction

Financial Stability Board Request

In response to requests from the G20, the Financial Stability Board (**FSB**), through its Standing Committee on Supervisory Co-operation (**FSB SRC**) is considering measures to strengthen oversight and regulation of shadow banking, including securitisation.

In July 2011, the FSB, through the FSB SRC, requested IOSCO, in coordination with the Basel Committee on Banking Supervision, to:

- Conduct a stock-taking exercise reviewing current national and regulatory initiatives on:
  - Risk retention; and
  - Measures enhancing transparency and standardisation of securitisation products; and
- Develop policy recommendations as necessary.

The request emphasised measures in the US and the European Union (**EU**) noting rulemaking in both places was in progress. The request also pointed to the benefits which other initiatives (such as product labelling and standardisation of products and disclosure) may play in the regulation of securitisation markets.

The request highlighted the following weaknesses in securitisation market practices and the way in which these markets were regulated:

- An overreliance on ratings;
- Lack of due diligence by investors;
- Inadequate pricing of risk;
- Reduced incentives for originators and sponsors to conduct sufficiently rigorous due diligence of asset pools which contributed to the creation of conditions for excessive leverage in the financial system.

A report of the results of the work was sought by July 2012. In February 2012, the then IOSCO Technical Committee (**TC**) requested that TFUMP undertake the Project to:

- Describe and analyse global regulatory and industry initiatives on risk retention, transparency and disclosure standardisation;
- Identify and assess material differences in regulatory and industry approaches and their impact; and
- If and where appropriate, recommend approaches to address differences identified as material.

The Project was intended to build upon earlier work undertaken by IOSCO and the Joint Forum on the regulation of securitisation markets. This earlier work is summarised in **Appendix One** to this Report.

The Project

The work undertaken on the Project is described in more detail in **Appendix Two**.

The main elements of the Project were:

- A survey of IOSCO members, during March 2012, about relevant regulatory developments and industry initiatives (**Survey**);
- A consultation paper (**Consultation Paper**) published in June 2012. The Consultation Paper described global securitisation markets, set out preliminary views about the extent of differences in regulatory approaches between jurisdictions participating in the Project, formulated policy proposals in relation to risk retention, transparency and standardisation and raised some other issues for comment. The Consultation Paper was based on an analysis of the results of the Survey and took into account the findings of an EC/SEC Staff Analysis undertaken in late 2011;
- A Round Table of industry participants in Madrid in early July 2012 to discuss proposals in the Consultation Paper; and
- Analysis of responses to the Consultation Paper.

Sixteen responses were received from regulators, industry associations and industry. A list of respondents is set out in **Appendix Three**.

The Consultation Paper raised the following policy proposals for comment:

- On *risk retention*, that industry experience and views on the impact of the differences in regulatory approaches to risk retention between jurisdictions be monitored (e.g. the US and the EU). The Consultation Paper indicated that should industry feedback and experience point to the envisaged impacts emerging IOSCO will consider developing appropriate regulatory responses and mechanisms to address those differences;
- On *transparency*, that IOSCO consults (through TFUMP) with investors about their appetite for stress testing information and, if appropriate, provides guidance on the disclosure issuers should be expected to make about stress testing and scenario analysis of pooled assets; and
- On *standardisation*, that industry be encouraged to develop best practice templates and to encourage industry bodies to work with their counterparts in other jurisdictions to ensure consistent and harmonised approaches. The Consultation Paper also raised the question of

whether IOSCO should consider developing principles to support harmonisation in these approaches.

The Consultation Paper also noted further policy issues (including definitions, the role of CRAs and governance of the securitisation process). As these were considered second level priorities, policy proposals were not developed for consultation.

This Report builds on feedback from industry, in that it:

- Makes observations about the role sound securitisation markets can play in supporting economic growth and the role regulation can play in reducing systemic risk and restoring investor trust and confidence;
- Provides a snapshot of the global securitisation markets;
- Summarises key themes, observations and issues coming out of the responses to the Consultation Paper in relation to approaches to risk retention, transparency and standardisation; and
- Makes recommendations in relation to risk retention, transparency and standardisation.
- Identifies other medium or longer-term priorities for policy consideration.

The recommendations take into account the fact that we are operating in an environment in which US rules are still being developed, and regulatory proposals are still evolving in Europe. On risk retention for instance, both the Consultation Paper and industry feedback were based on US proposals published jointly by the U.S. Department of the Treasury - Office of the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation, the U.S. Securities and Exchange Commission, the Federal Housing Finance Agency and the U.S. Department of Housing and Urban Development (**US Joint Agencies**) in 2011 (**Current US Proposals**)[1]. Meanwhile in Europe, CRD 2 has implemented some rules for investing banks. Rulemaking under the Alternative Investment Funds Management Directive and Solvency 2 will impact some other regulated investors, but are not yet finalised. These various uncertainties create difficulties at this stage in assessing the final implications of any possible differences between rules for cross-border securitisations markets.

II. Promoting Sustainable Securitisation Markets

Securitisation, when functioning properly, is a valuable financing technique contributing to economic growth and an efficient means of diversifying risk. Securitisation played this role in the past. As also acknowledged by the FSB SRC in its request, IOSCO believes that these benefits of securitisation remain unchanged.

However, the Crisis is recognised as having damaged investor interest and confidence in these markets.

This Project confirms, that despite some evidence of revival of investor appetite in some markets - particularly among US institutions looking to secure yield opportunities in their own and European markets – global activity continues at levels significantly below pre-credit

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1 Credit Risk Retention; Proposed Rule, 29 April 2011; http://www.gpo.gov/fdsys/pkg/FR-2011-04-29/pdf/2011-8364.pdf

bubble levels. The focus of regulatory initiatives should be on ensuring securitisation markets develop, but on a sound and sustainable basis.

Why are securitisation markets important?

IOSCO believes that securitisation markets can play a role in supporting economic growth. Securitisation offers financial institutions a market based alternative to existing sources of funding. Responses to the Consultation Paper supported these views.

Securitisation markets create opportunities for issuers to raise finance through alternative funding and by diversifying funding sources, potentially making bank lending less sensitive to abrupt changes to the cost of funds, ultimately affecting the availability of finance to economic growth. For that reason, access to these funding sources may be important to those economies experiencing slow growth. Industry responses to the Consultation Paper also advanced the view that securitisation represents a viable alternative source of funding for the banking sector at a time when funding diversification is needed.

IOSCO believes that these benefits can only be realised through the development of a sound market system in which market participants have confidence and trust. This in turn will depend on market participants having access to information that supports a comprehensive understanding of the features and risks associated with investments in securitisation and sound practices across the securitisation value chain. Without the trust and confidence which these measures may engender we do not expect investor appetite (influenced by negative perceptions) will be restored.

In addition to the various regulatory reforms discussed in this report that are generally intended to ensure global financial stability by strengthening oversight and regulation of the securitisation markets and more particularly to restore confidence and trust, industry has also begun a number of initiatives intended to assist in restoring confidence and trust in securitisation and addressing the stigma attached to it. These initiatives have included labelling and standardisation initiatives intended to encourage improvements in the quality of data provided to investors.

IOSCO recognises that the sustainability of securitisation and its adequate regulation depends on a range of complex factors. Increasingly critical factors include the capital requirements imposed on investors through various regulatory initiatives such as Solvency 2 in Europe and liquidity coverage ratios and new risk weights for securitised products under Basel 2.5 and Basel 3.

Importance of cross-border activity in securitisation markets

IOSCO recognises that securitisation markets are not purely domestic; their international components can be derived not only from securitised products being offered in different jurisdictions, but also from laws and rules of the different jurisdictions being applicable to the various parties to a securitisation transaction.

Before the Crisis, cross border activity was significant particularly in, and between, the US and Europe. This Project confirms that although there are currently reduced levels of such activity, there is evidence of investor interest in diversifying away from their home markets.

Cross border activity creates opportunities to broaden and deepen markets and amplify the economic benefits securitisation markets offer. Issuers have the opportunity to both explore and satisfy investor appetite outside their home markets. Investors can diversify their portfolios by gaining exposure to other jurisdictions.

Responses to the Consultation Paper acknowledged the significance of cross border activity in supporting recovery of securitisation markets[2].

Given the appeal of offshore pools of liquidity for issuers as well as diversification opportunities for investors, the potential impact of differences in regulatory requirements across jurisdictions in impeding cross border activity are issues of concern.

Role of regulation

In this context, IOSCO sees an important role for securities regulation. Specifically, regulation can contribute to a restoration of confidence and trust by setting standards market participants must meet to address issues that became apparent through the Crisis. Issues identified by IOSCO in previous work included securitisation practices and structures that created misaligned or wrong incentives and inadequate risk management practices.

IOSCO considers that risk retention requirements and enhanced disclosure requirements have an important role to play in addressing these issues. Risk retention requirements better align the incentives of the suppliers of securitisation products (e.g. originators/sponsors etc.) and, in particular, investors. While some degree of risk retention has already occurred in practice, formalising risk retention requirements has the potential to further incentivise originators, issuers and investors to properly conduct quality screenings, improve underwriting standards and adequately monitor for credit risk.

Enhanced disclosure requirements about the underlying assets, waterfall and performance of securitisation structures will help to inform investors, and have the potential to re-build investor confidence in the securitisation market. The greater availability of information would also help reduce the reliance on credit ratings agencies.

In making the recommendations in this report, IOSCO made three important observations that policy makers and regulators should consider in connection with securitisation reform.

The first is that securitisation markets are, and have been, institutional and professional markets in most jurisdictions. There has been little evidence of direct retail investor participation (although retail investors may have exposure through other means – particularly collective investments). Policy makers and regulators are, and will be, challenged to assess how the standards set should reflect the perceived sophistication of market participants (while noting the need for products to be understood by those making final investment decisions).

The second observation concerns the benefits of cross border activity. Cross border activity is an important component of global securitisation markets, and policy makers and regulators should be conscious of not adding to the cost of cross border activity through requirements that are duplicative of, or inconsistent with, requirements in other jurisdictions. Consideration, therefore, needs to be given to how domestic requirements (and conditions) may be implemented, while minimising any counterproductive impacts on cross border activity.

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2 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitisation Forum, August 2012, Global Financial Markets Association, August 2012, and Institute of International Finance, August 2012.

IOSCO recognises that securitisation markets are heterogeneous. There are differences between and within jurisdictions in underlying assets, the form of issuance (e.g. public vs. private), parties to the structures and the structures themselves. These differences together mean disclosure and risk retention requirements across jurisdictions may vary considerably even as they facilitate achieving the same objective of a sound securitisation environment. Aspiring to consistency or integration needs to be understood in the context of these differences.

The third observation relates to the range of, and differences in, structures and terminology used in securitisation markets (both within and between jurisdictions). Although there is significantly less complexity and fewer structures than before the Crisis, different structures and different terminology will continue to be a challenge for policy makers as they consider whether and how to develop consistent and harmonised approaches to regulating securitisation markets.

The aim of the Project

The Project – therefore – seeks to support increasing confidence in sustainable securitisation markets, assist in preventing a repeat of the creation of excessive leverage in the financial system and address possible differences in regulatory approach by surveying the standards that are being set in participating jurisdictions in respect to risk retention and improving transparency and information flows. In addition to analysing the various standards being implemented, the Project also considers the extent to which different approaches to regulatory reform might result in impediments to cross border activity and identifies a series of recommendations for consideration by regulators and policy makers.

III. Global Securitisation Markets

Survey responses and data from other sources[3] pointed to the slow recovery of global securitisation markets and to a number of features that are important to policy makers in considering policy initiatives[4].

- Parts of the securitisation market in the US appear to be recovering[5], while the securitisation market in Europe still appears to be depressed[6]. Some European issuers are therefore offering Asset Backed Securities (ASB) in the US. Market participants are

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3 Sources reviewed are listed in footnotes below as relevant for each jurisdiction. Industry input was also sought during a meeting on 17–18 April 1 2012 of the Working Group. Representatives from the Association for Financial Markets in Europe, European Financial Services Round Table and the American Securitization Forum attended this meeting as well as a representative of the European Central Bank. A representative of BNP Paribas also was present at the meeting.

4 This section illustrates recent trends in global securitisation markets. It is important to point out however that insofar as figures shown herein come from different sources, they may cover non comparable data and practices between jurisdictions (not only in terms of reference currency but also in terms of data gathering methodologies as well as the classification of products and placement type).

5 Mainly on the basis of federal mortgage agencies. OECD Outlook for the Securitization Market (Blommestein et al) - Financial Market Trends No. 100 Volume 2011/1; http://www.oecd.org/dataoecd/36/44/48620405.pdf

6 Ibid

concerned about the effect that CRD 4 and Solvency 2 will have on the European securitisation markets.

US[7]

New issuance totalled USD 124 bn in 2011, down from a 2006 peak of USD 753 bn. Roughly 50% of issuances are backed by auto loans, with student loans the largest other category. Industry participants in IOSCO's work pointed to anecdotal evidence of an increasing appetite among institutional investors in particular for investment in securitisation markets both in the US and in other markets (in particular Europe).

New issuances for the first half of 2012 already total USD 100 bn. As was the case in 2011, roughly 50% of issuances are backed by auto loans, however credit cards are now the largest other category with roughly 17%.

Europe[8]

New issuance totalled 228 bn Euros in 2011, down from a peak of over 700 bn Euros in 2008. Residential Mortgage Backed Securities (RMBS) accounted for 59% of issuance. In 2010 total global securitisation issuance out of Europe was still over 300 bn Euros.

The largest issuing jurisdictions are the Netherlands (accounting for 27% of issuance by value), the UK (accounting for 26%), Spain (accounting for 20%) and Italy (accounting for 13%).

Public placements are estimated by analysts to account for 38% of the value of deals with significant variation across asset classes. For instance, while 78% of all auto ABS and 74% of RMBS transactions in the UK are estimated to be public, only 35% of other ABS (excluding autos) and 5% of other RMBS (excluding UK and Dutch RMBS) were reported as being publicly placed.

A significant percentage of issues are ‘self-owned’ or ‘retained’. SIFMA estimates place the percentage at 76% of the value of all issues during 2011 (down from 78% in 2010 and 94% in 2009).[9]

Industry participants in IOSCO’s work pointed to an interest among banks and central banks in particular to see recovery in securitisation markets, primarily because they offer diversification in funding sources.

- Outside the US and the EU there has been little observed securitisation activity in recent years. In a number of jurisdictions, issuing is limited to either one or two firms and in a number of cases involves government sponsored entities.

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7 SIFMA U.S. Asset-Backed Securities Issuance:

http://www.sifma.org/uploadedFiles/Research/statistics/statisticsFiles/SF-US-ABS-SIFMA.xls.

8 European Structured Finance Annual Review, 2011-2012, Bank of America Merrill Lynch.

9 SIFMA, Securitization Issuance 2011. Data sourced from AFME & SIFMA Members, Bloomberg, Thomson Reuters, prospectus filings, Fitch Ratings, Moody's, S&P, AFME & SIFMA.

Latin America[10]

Brazil

Securitisation issuances rose from a total figure of 32 bn Reais in 2010 (23 bn Reais for contractual investment funds (**FIDC**) and almost 9 bn Reais for Commercial Mortgage Backed Securities (CMBS) and (RMBS) to more than 50 bn Reais in 2011 (37 bn Reais for contractual investment funds and almost 14 bn Reais for CMBS and RMBS).[11]

Private issuance included in the above numbers is thought to be substantial. The level of cross border activity is thought to be low.

Mexico

Securitisations in Mexico were down 26% in 2011 to USD 2.5 bn. RMBS account for 82% by value of Mexican securitisations. The market is dominated by two government related issuers (INFONAVIT and FOVISSSTE).

South Africa[12]

Issuance volumes dropped from ZAR 41 bn in 2007 to ZAR 3 bn in 2010. Volumes are expected to remain at this level with most activity understood to be refinancing.

RMBS accounts for 50% of rated public offers.

Japan[13]

Total issuances in Japan totalled JPY 34,063 bn in the fiscal year of 2011, up about 31% year on the previous year. RMBS accounted for the highest proportion, 76%, followed by CMBS (with 5%) and consumer credit ABS (with 5%).

Australia[14]

New issuance to November 2011 was AUD 26 bn – comparable to 2010 levels and down from the 2006 peak of over AUD 70 bn. RMBS remained the dominant asset class accounting for just under 80% of these transactions by value. Foreign interest in Australian issuances returned in 2011, with some interest from Japan. Foreign investors accounted for less than 5% of total issuance.

Canada[15]

As at January 2012, the total amount outstanding in the Canadian securitisation market was CAD 93.9 bn. In 2011, new issuances returned to levels seen prior to the

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[10] Moody's Latin America Securitization, 2012 Outlook.

[11] Year in Review Brazilian Real Estate and Structured Finance 2012, Uqbar.

[12] Fitch Ratings, Structured Finance, South African Outlook 2011.

[13] Data provided by Japan Securities Dealers Association.

[14] Australian Structured Finance Year Ahead 2012, Bank of America Merrill Lynch.

[15] Canadian Securitization Market Overview January 2012, DBRS. Canadian Structured Finance 2011 Year in Review and 2012 Outlook, DBRS.

2008 recession. The total volume of new ABS and Asset Backed Commercial Paper (ABCP) issuance throughout the year was CAD 23.4 bn, which represents an increase of 17% over the prior year and 7% over pre-recession levels of 2008.

In addition, the total amount of National Housing Association RMBS outstanding as of December 31, 2011 was CAD 368 bn and the total amount of Canada Mortgage Bonds outstanding was CAD 200.8 bn.

Other Jurisdictions

Based on the Survey responses, the number of reported deals in each of Hong Kong, Switzerland, Dubai and Egypt is understood to have been very small in recent years.

Survey responses also provided a number of additional insights:

Cross Border Offering is Limited Primarily to US and Europe

There is currently limited cross border activity outside Europe and the US. Issuers outside Europe and the US generally limit their offerings to their home jurisdiction. In Europe, cross border activity appears more significant as some sponsors/originators use offshore issuing vehicles. Prior to the Crisis issuers did engage in global offerings, however this activity has since contracted.

Differences in Regulatory Approach May Impede Certain Issuances

There are concerns, expressed by industry that differences in regulation may be hampering or inhibiting cross border activity. For instance there are differences with respect to risk retention and transparency requirements and the fact that some regulations apply only to certain categories of investors, so that not all investors equally benefit from such regulations.

No direct retail Market

In most jurisdictions, there is little or no direct retail presence in securitisation markets. Investors are generally institutional or wholesale investors. This is thought to be due to a range of factors influencing how securitisation markets have developed. In certain jurisdictions there are express restrictions on marketing securitised products to retail investors and in others there are additional compliance obligations when marketing to retail investors. The limited presence of retail investors as direct investors has important regulatory implications. In particular, offers to institutional and wholesale investors do not need to comply with public offer requirements in a number of jurisdictions (e.g. European Union and Canada) unless the offering is to be listed on a regulated market.

Securitisation Vehicles and Placements Vary between Jurisdictions

Vehicles used for securitisation products vary between jurisdictions. In most jurisdictions special purpose entities such as investment companies and trust vehicles are used. Vehicles are either a recognized or authorized schemes or are not subject to a form of legal recognition or regulatory authorization. However, in some jurisdictions this lack of recognition or authorisation is not considered an issue due to the extremely limited activities carried out by Special Purpose Vehicles (SPVs) and the fact that statistical data is collected on such entities.

A range of different methods are used to place securitised products. Respondents to the Survey indicated that offerings of these products are primarily conducted as private placements but when listing on a regulated market offers generally submit to a similar regime as that for public offers. Use is made of listed and unlisted markets, although on-market secondary trading is limited.

OTC Secondary Markets

Most trading of securitised products occurs OTC, even when such securities are listed. Where trading takes place via a regulated exchange, the usual transparency requirements on transactions apply. These might include post trade reporting on price, quantity and time of transaction. Where trading is OTC there is little or no post trade transparency. Due to the fact that there are no reporting requirements relating to OTC trading, it is difficult to state with certainty how much trading occurs on secondary markets.

IV. Observations and Findings

This section sets out observations and findings about regulatory and industry initiatives in the following areas:

- Risk retention;
- Improvements in disclosure;
- Standardising disclosure requirements; and
- Other issues (including in particular terminology, securitisation processes and information flows to CRAs).

These observations are based on Survey responses, the EC/SEC Staff Analysis, the industry Round Table and feedback on the Consultation Paper. They form the basis of recommendations set out in the next section. Our particular focus has been to understand differences in regulatory and industry approach between jurisdictions and the impact those differences may have. Our aim is to recommend regulatory approaches which address actual or potential frictions and so reduce the risk of what may be seen as potential barriers to viable securitisation markets while ensuring investor protection.

1. Risk Retention

Risk retention or 'skin in the game' requirements have been a key focus of regulatory responses since the Crisis[16]. These requirements have been and are being developed as a means of addressing misaligned incentives that may be embedded in the 'originate to distribute' model of some securitisation products with a view to encouraging prudent behaviour by issuers and sponsors.

In 2009, TFUMP recommended that a tailored approach to the introduction of retention requirements was necessary. The Report recommended that building on industry initiatives, any retention requirement should, at minimum:

- Be considered by financial market regulators in light of economic and regulatory features of the domestic securitisation market and include appropriate transitional provisions;

[16] The G20 Leaders' statement of the Pittsburgh Summit (September 2009) recommended that securitization sponsors or originators should retain a part of the risk of the underlying assets.

- Be risk sensitive and have regard to the underlying quality of the collateral backing a securitisation; and
- Consider the broad function of securitisation and the impact of increased capital charges, accounting de-recognition treatment and legal true sale issues in the relevant jurisdiction.

IOSCO surveyed risk retention requirements in a number of jurisdictions. IOSCO's analysis highlights differences in approach to risk retention. It also highlights differences in approach to these requirements between the EC and current US proposals. Feedback on the Consultation Paper suggests that in spite of the uncertainty still attached to the final outcome of current US proposed rules, these differences have the potential to be significant and could warrant some form of regulatory response.

IOSCO's analysis also points to few regulatory developments in other jurisdictions.

EC requirements and US proposals

IOSCO's analysis pointed to three types of differences between the EC requirements and US proposals –

1. Overall approach;
2. Forms of risk retention;
3. Scope – including exemptions.

Industry responses to the Consultation Paper flagged three sets of concerns about the frictions created by these differences.

1. Barriers to access: Concern that certain structures in one jurisdiction may be precluded by regulation from being offered into other jurisdictions;
2. Increased compliance cost: Concern about additional compliance costs because a structure must meet both sets of requirements; and
3. Loss of flexibility: Differences in approach to regulation may lead to fewer options for issuers in the design of structures. This could restrict innovation, create sub optimal outcomes, reduce liquidity and reduce the efficiency of securitisation markets.

In some cases these differences were said to have greater impact on issuances from the EU into the US. In other cases they were said to be more likely to have an impact on issuances from the US into the EU. This is discussed in more detail below.

In summary, industry responses to the Consultation Paper point to the risk of some transactions needing to be restructured to comply with EU requirements and requirements under current US proposals. This is particularly said to be the case in relation to transactions which are not well suited to retention through what some responses described as 'base case' holding options[17]. These responses highlighted concerns relating to a loss of flexibility and

[17] Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012.

increased compliance costs. Responses also claimed that at least one transaction would be precluded by regulatory requirements.[18]

Responses were unable to point to the actual costs associated with meeting both EU requirements and US proposals. The absence of detailed evidence about additional costs and the fact US (and some EU) requirements are yet to be finalized, limit the ability of IOSCO to assess whether significant unwarranted costs would actually arise and limit the recommendations TFUMP and IOSCO can make at this stage.

This section sets out IOSCO's analysis of the implications of differences in risk retention requirements.

Overall approach - Investor v Sponsor focus

The EC/SEC Staff Analysis noted that EU rules and the proposed US rules approach risk retention requirements from different perspectives.[19] Specifically:

- EU rules – which, for credit institutions, are set out in the CRD framework and technical guidelines by European Banking Authority[20] impose obligations on regulated institutional investors to address risk retention requirements. The CRD 2 prohibits EU credit institutions from investing in securitized instruments unless one of the relevant originating parties, originator (or sponsor or original lender) of the securitisation retains no less than 5% of the economic interest in the securitisation.[21]

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18 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitization Forum, August 2012.

19 The EC/SEC Staff Analysis focused on incompatibilities and differences in regulatory approach between the US and the EU and the impact and materiality of those incompatibilities and differences. It considered both risk retention and transparency requirements (focusing in more detail on the former). The EC/SEC Staff Analysis carefully outlined the status of developments in both jurisdictions noting that rules were in the process of being implemented or complementary rulemaking being adopted, on both sides of the Atlantic.

Whilst the intent of both regimes was similar, the EC/SEC Staff Analysis concluded that although there were differences in regulatory details and approach, those differences did not amount to material incompatibilities (that is, it was possible for market participants to comply with both regimes without conflict). The EC/SEC Staff Analysis acknowledged, however, that rules may subject "cross border market participants in certain limited situations to the additional regulatory burden required to comply with two similar but independent regulatory regimes".

20 Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management (**CRD 2**); EBA Guidelines to Article 122a of the Capital Requirements Directive, 31 Dec 2010, http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Application%20of%20Art.%20122a%20of%20the%20CRD/Guidelines.pdf; Q&A on Guidelines to Article 122a of the Capital Requirements, 29 Sep 2011; http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2010/Application%20of%20Art.%20122a%20of%20the%20CRD/Guidelines.pdf.

21 Similar requirements to those of CRD for credit institutions are being developed in the EU for investors in other sectors Alternative Investment Fund Managers (AIFM) and Solvency 2 Directives have provided similar requirements of general 5 % retention whose technical terms are currently awaiting rulemaking implementation by the EC for EU jurisdictions. For consistency across sectors, AIFM imposes general requirements that alternative investment and collective investment vehicle managers conduct thorough due diligence to ensure that originators comply with retention requirements when

- US statutory framework and proposed rules -- Section 15G of the Securities Exchange Act of 1934 (**Exchange Act**), as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (**Dodd-Frank Act**) requires the US Joint Agencies[22] to jointly prescribe rules for credit risk retention in ABS transactions (**US proposed rules**[23]) that require a sponsor to retain an economic interest equal to at least 5 percent of the credit risk of the assets collateralizing an issuance of ABS (other than synthetic ABS structures). Thus, as required by statute, the proposed rules directly impose the risk retention obligation on the sponsor.

The US approach requires that securitisers retain a meaningful exposure to credit risk and be so incentivised to conduct appropriate due diligence on and to monitor the underlying asset pool. The EU approach, by contrast and as a result of the concrete European experience during the Crisis, seeks to protect EU regulated investors, and ultimately European taxpayers, from exposures to securitisations originated anywhere in the world where the interests of issuers are insufficiently aligned with the interests of investors.

Responses to the Consultation Paper pointed to concerns with these differences. Some industry responses pointed to the European approach acting as a disincentive to investors in Europe. Submissions suggested that the indirect regime (i.e. where the investor bears the onus of monitoring compliance) causes legal uncertainty for investors, because it is difficult for investors to ascertain whether the originator or sponsor is complying with the risk retention requirement. In the event that the originator or sponsor no longer complies, the investor will be exposed to punitive capital charges on its ABS. A number of responses also indicated that the differences between a direct and indirect (i.e., sponsor- versus investor- focused) regime created an overall tension.

IOSCO considers that the indirect approach creates additional layers of complexity and sees some merit in working to reconcile these approaches[24]. IOSCO is also of the opinion that to the extent risk retention rules are adopted, these rules should achieve incentive alignment in the most efficient and cost-effective way.

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investing in securitization structures, and Solvency 2 introduces similar requirements for insurers when they invest in "repackaged loans". The technicalities of these retention requirements remain to be adopted by the EC.

22 Pursuant to the Dodd Frank Act, the OCC, Federal Reserve Board, FDIC, SEC, FHFA, and HUD are expected to jointly prescribe rules to implement the credit risk retention requirements of section 15G of the Exchange Act (15. U.S.C. § 78o-11).

23 Credit Risk Retention; Proposed Rule, 29 April 2011; http://www.gpo.gov/fdsys/pkg/FR-2011-04-29/pdf/2011-8364.pdf

24 For instance, in the EU, rules are fragmented. Article 122a of the CRD 2 in its current form, and the detailed EBA guidelines focus on investors and provide for an indirect control of risks retention practices of securitisers. However, they do not actually require that EU-based sponsors or originators retain risks. Other regulations apply a similar risk retention approach to other regulated investors such as fund managers, in that rules are focused on the investor, and not the securitisers. While its end goal is to ensure that European investors only invest in securitisation products subject to risk retention requirements, the merits of the EU's indirect approach are that it avoids imposing its requirements as extraterritorial rules to securitised products that could be offered in Europe but originated in jurisdictions that have not yet implemented risk retention requirements.

From the perspective of a country such as the US, which has implemented risk retention requirements to directly apply to securitisers (i.e. originators and sponsors), the overlap is not complete as EU-based securitisers are not always subject to the risk retention when issuing ABS to investors falling outside of the purview of CRD, Solvency and AIFM.

Forms of Risk Retention[25]

US proposed rules and those set out in the CRD 2 adopt different approaches to the form of risk retention.

- Current EU Rules[26] permit an originator to choose from a menu of the following four risk retention options:
  - Retention of no less than 5 percent of the nominal value of each of the tranches sold or transferred to the investors;
  - In the case of securitisations of revolving exposures, retention of no less than 5 percent of the nominal value of the securitised exposures;
  - Retention of randomly selected exposures, equivalent to no less than 5 percent of the nominal amount of the securitised exposures, where such exposures would otherwise have been securitised in the securitisation, provided that the number of potentially securitised exposures is no less than 100 at origination; and
  - Retention of the first loss tranche and, if necessary, other tranches having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total no less than 5 percent of the nominal value of the securitised exposures; and
- US proposed rules permit a sponsor to choose from a menu of the following five risk retention options:
  - A ‘vertical slice’ option whereby the sponsor retains not less than 5 percent of each class of ABS interests issued in the securitisation;
  - A ‘horizontal slice’ option whereby the sponsor retains a first-loss, last-pay residual interest in an amount equal to at least 5 percent of the par value of all ABS interests in the securitisation. As an alternative to actually retaining an ABS interest, this option also allows the sponsor to establish a cash reserve account valued in the same amount and structured to operate as a first-loss position;
  - An ‘L-shaped’ option whereby the sponsor holds at least half of the 5 percent retained interest using the vertical slice option and half in the form of the horizontal slice option;

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25 Those jurisdictions that had risk retention requirements generally did not permit hedging, transfer or financing of the risk.

Premium capture requirements were a proposed feature of regulation in the US. The EC/SEC Staff Analysis outlines the proposal by US regulators to include a ‘premium capture’ mechanism intended to ensure meaningful risk retention, whereby the premium received on the sale of tranches that monetise the excess spread would need to be kept in a separate account and used to cover losses, if certain conditions are met. These requirements were not in place in other jurisdictions.

Survey responses and the EC/SEC Staff Analysis also point to most jurisdictions having either regulatory requirements or industry practice about the disclosure of retained positions.

26 Currently under Article 122 a under CRD 2; and prospectively also declined under proposals for rulemaking under the AIFMD and Solvency 2 Directives.

- A representative sample option whereby the sponsor retains a randomly-selected, representative sample of the assets designated for securitisation in an amount equal to at least 5 percent of the unpaid principal balance of all the designated assets; and.
- A seller's interest option for revolving asset master trusts whereby the sponsor retains a seller's interest in an amount not less than 5 percent of the unpaid principal balance of the pool assets held by the issuer.

The US proposed rules also provide specific options for satisfying risk retention requirements for commercial mortgage backed securities, asset-backed commercial paper and US government sponsored entities while in conservatorship.

The EC/SEC Staff Analysis indicated that although not all options will be available for all transactions, a sponsor/originator could select an option that was available in both jurisdictions. For that reason, the analysis argued that there were no material incompatibilities between the regimes. Feedback on the consultation paper generally disagreed with this view.

In cross border transactions between the US and an EU jurisdiction, issuers would be expected to comply with risk retention requirements to access investors in both jurisdictions. Responses to the Consultation Paper acknowledged that some structures – particularly traditional securitisations such RMBS structures - could meet risk retention requirements in both jurisdictions without change[27].

Holding model options for structures or assets classes

A number of responses[28], however, noted that other structures or asset classes less suited to a classic base case retention holding model would need to be adapted to meet retention requirements incurring additional costs driven solely by compliance requirements. These responses[29] argued a loss of flexibility for issuers. Some responses[30] also pointed to regulatory requirements precluding certain structures. Responses did not set out the cost implications of adapting structures or meeting both sets of requirements.

Examples cited included Asset Backed Commercial Paper (**ABCP**), Commercial Mortgage Backed Securities (**CMBS**), and Managed Collateralised Loan Obligations (**Managed CLOs**) and Revolving Asset Pool Master Trust arrangements (in Europe). Policy makers in the US and Europe have set (or are proposing to set) risk retention requirements for these particular structures adapted to local conditions which are different. These are described in more detail below.

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27 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012.

28 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012

29 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitization Forum, August 2012

30 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitization Forum, August 2012

ABCP Programmes

Responses to the Consultation Paper described a mismatch between the main holding options set out in US proposals and the EU requirements for these programs.[31]

Under EU requirements, a sponsor of an ABCP Conduit will be able to meet its risk retention obligations by either providing a liquidity facility to its ABCP Conduit that ranks senior to other obligations in the waterfall and covers 100% of the credit risk of the underlying exposures or by providing for a stand-by letter of credit of an appropriate amount as program-wide credit enhancement for the ABCP Conduit.

Responses to the Consultation Paper indicated that these options are not available under current US proposed rules, given a very tight set of conditions that respondents considered would not work for most conduit arrangements (including those which fund US and/or EU originated assets).

Unless US final rules are different from the proposed rules, structures compliant with European requirements would need to be restructured to meet requirements in the US. Conversely, respondents also questioned whether the originator-seller holding option under US proposed rules would be compliant under the EU regime. Respondents argued that this would result in a loss of design flexibility and in additional (although unquantified) compliance costs.

CMBS

Responses to the Consultation Paper highlighted different approaches to risk retention in relation to some CMBS offerings. [32]

Regarding the statutorily required US rules as currently proposed, responses indicated that they should permit an originator of CMBS to meet its risk retention requirements by having a third party (a ‘B-piece buyer’) acquire an eligible horizontal residual interest in the issuing entity that, in addition to satisfying other conditions, complies with the risk retention rules that would have been applicable to the originator. They pointed out it was unclear whether these structures would satisfy EU requirements. These requirements provide that a subordinated investor which undertakes certain asset selection and structuring activities may retain the required interest, subject to certain conditions being satisfied, including that such investor is the most appropriate entity to retain the interest.

This potential mismatch was flagged as giving rise to possible difficulties in CMBS transactions which lack an involved originator(s) or a sponsor complying with both regimes. The implication was that costs could be incurred in the redesign of structures to meet requirements on both sides of the Atlantic.

Managed CLOs

Responses to the Consultation Paper highlighted possible differences in the treatment of these structures.[33] Responses suggested that in the EU, more flexibility is afforded to managed

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31 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitization Forum, August 2012 and Global Financial Markets Association, August 2012.

32 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitization Forum, August 2012 and Global Financial Markets Association, August 2012.

Collateralised Loan Obligations (CLOs) than the more prescriptive and limited US proposals. Under the EU regime, for instance, risk may be retained, in certain circumstances, by an anchor investor (rather than the CLO manager). This option is not available under current US proposed rules, where risk in these structures would need to be retained by CLO managers. Responses suggested that these differences may pose significant issues for EU offerings into the US – particularly as CLO managers may not be sufficiently capitalised to be able to retain the risk required under current US proposals. The implication was that restructuring these transactions to meet US requirements may not be possible.

Revolving asset pool master trust structures

Respondents highlighted concerns with the offer of EU master trusts into the US.

As regard those RMBS master trusts which securitize a revolving pool of non-revolving assets, a structure typically applicable to UK mortgage master trusts, respondents argued that a seller's holding interest option (available in the EU) would not be available under current US proposed rules. As such these structures could be precluded from being offered into the US under current US proposals.

Responses noted the importance of ensuring cross border market access remained available for such master trust structures as recent US placements levels for UK mortgage master trust transactions have been significant.

Analysis of responses to the Consultation Paper highlighted the complexity created by the range of structures developed between and within markets; the differences in nomenclature and the challenge this posed for developing policy responses.

IOSCO sees merit in policy makers also considering whether standard language or terminology can be developed which differentiates between different structures creating unique categories and terminology for different structures in order to assist in distinguishing between types of securitization transactions and the risks involved in transactions.

Scope of exemptions and safe harbour provisions

The Consultation Paper highlighted various exemptions from regulatory requirements under US proposals which might create further issues.

As outlined in the EC/SEC Staff Analysis the US proposed rules provide that a sponsor need not retain any portion of the credit risk in the securitisation if the ABS are collateralized by certain high quality assets that meet certain underwriting standards designed to ensure that the loans backing the ABS are of very low credit risk.

Proposed exemptions would include certain ABS with underlying assets deemed to be of high quality commercial loans, commercial real estate loans, automobile loans and residential loans. The EC/SEC Staff Analysis also indicates that US proposed rules would also exempt from the risk retention requirements certain other securitisations—for example, those backed by government-insured or guaranteed assets. Though EU rules do not provide for a similar exemption, they do exempt certain securitisations backed by specific public institutions.

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[33] Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitization Forum, August 2012 and Global Financial Markets Association, August 2012.

Beyond exemptions provided for by statute (e.g. Farm Credit System Institution and Federal programme such as the GSEs),[34] details of US proposed rules addressing precise conditions for exemptions that the US Joint Agencies could adopt - or must adopt in the case of QRMs- under Section 15G(e) of Exchange Act are set out in **Appendix Five.**

Through the Consultation Paper, IOSCO raised the question of whether such exemptions would have cost implications which could impede cross border issuance. Specifically, questions were raised about whether:

- US issuers benefiting from one of the safe-harbours, but who wished to access EU investors, would need to comply with CRD risk retention requirements (or other relevant EU standards) either for the whole transaction or try to bifurcate a transaction to both benefit from available US exemptions and comply with EU standards;[35] and

- EU issuers would be at a competitive disadvantage in accessing US markets as they could only benefit from limited safe harbours for foreign issuers and would therefore need to comply with home risk retention requirements, where US issuers of securitisations backed by similar assets would not.[36]

These issues were only lightly touched upon in responses[37] to the Consultation Paper. Most saw the issue of complying with requirements about risk retention in multiple jurisdictions as a bigger issue. However, responses[38] acknowledged that the differences in the scope of exemptions and safe harbour provisions between the EU and the US were potentially significant and if implemented as proposed could act as a particular impediment to EU investors being in a position to invest in US offers.

Responses[39] to the Consultation Paper also noted that the EU regulations may have a cross-border effect in that any transaction involving an EU investor, regardless of where the transaction occurs, will need to comply with the EU risk retention regulations in order for the EU investor to participate in the offering.

Responses[40] to the Consultation Paper also highlighted that a lack of consistency and coordination across jurisdictions on the scope of exemptions may lead to perverse policy and sub optimal commercial and economic outcomes. For instance, EU investors may be locked out of investing in more credit-worthy US securitised assets because of US exemptions.[41] As

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34 Section 15G(e)(3) of Exchange Act

35 Consultation Paper, pages 15 and 26

36 Consultation Paper, page 26

37 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012

38 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitisation Forum, August 2012

39 Response to Consultation Paper on Global Developments in Securitization Regulation, Institute of International Finance, August 2012

40 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitisation Forum, August 2012

41 Specifically, this would include Qualified Residential Mortgages (**QRM**), which the Joint Agencies proposed rules would ensure are very high credit quality consistent with their exemption from risk retention requirements. Please see proposed rule by the Department of Treasury, Federal Reserve

a consequence, to continue diversifying their portfolio, EU investors either may choose to access assets at home that are potentially less creditworthy, or seek exposure to US assets through more complex or synthetic instruments.[42] Similarly some responses indicated that by providing exemptions to certain government-backed ABS or public ABS, regulators were depriving their national investors of valuable investment opportunities.

IOSCO acknowledges that exemptions reflect different policy choices about how to achieve incentive alignment, and whether and how risks should be retained. In some instances, exemptions may result from situations where the securitisation vehicle's structure makes it more difficult for one of the originating parties to maintain a part of the risk on the balance sheet (typically non-banking securitisation, e.g. managed CLOs. In other cases, they may result from the fact that a standard risk retention level that does not distinguish between different types of securitised products may be unnecessary for products that achieve incentive alignment through other means. Certain exceptions to, or exemptions from, risk retention may be warranted where the objective of incentive alignment is met by alternative means.

IOSCO acknowledges that differences in the scope of the risk retention exemptions between different jurisdictions could have unintended consequences. These unintended consequences could undermine interoperability and impede cross border securitization transactions, and should not be underestimated. IOSCO considers it is worth reviewing this issue further.

Other jurisdictions

As for non-US and EU jurisdictions, some form of market practice regarding risk retention exists for certain asset classes.

Responses to the Survey indicate that outside of the US and the EU few jurisdictions have imposed or are considering imposing risk retention requirements. However, in a number of jurisdictions, market practice or industry standards have existed, or are developing, that provide for a similar outcome.

For instance in Brazil, the most common market practice is for the issue of senior and junior shares. Senior shares are taken up by investors and the junior shares are underwritten by the originator/sponsor.

In Canada, the structure of securitisation of standard asset classes is such that the originator of a pool of assets retains the risk of expected loss through mechanisms such as over-collateralisation, excess spread allocation to investors to offset losses, cash reserve accounts to cover debt service shortfalls and/or subordinated notes issued to originators.

In Japan, originators tend to hold subordinated tranches of RMBS.

It is also worth noting that the German response to the Survey made clear that the view of regulators in that jurisdiction is that an increased retention requirement of 10% would be necessary for a prudent ABS market based on the following considerations:

System, Federal Deposit Insurance Corporation, US Securities and Exchange Commission, Federal Housing Finance Agency and Department of Housing and Urban Development on "Credit Risk Retention" issued on March 30, 2011.

42 Response to Consultation Paper on Global Developments in Securitization Regulation, Institute of International Finance, August 2012

- The incentive effect of the various retention options (e.g. first loss, vertical slice) depends on the retention level in relation to the originator's loss expectations. A uniform retention level must be set sufficiently high to achieve a positive incentive effect for as many potential portfolio compositions and scenarios as possible;

- In various securitisation markets the retention levels required by investors have been well above 5%, even before the beginning of the Crisis. In order to be meaningful the regulatory minimum retention level should not be lower than the market participants' expectations; and

- A higher retention level leads to a corresponding increase in the alignment of interest between originators/sponsors and investors.

Some responses[43] to the Consultation Paper did not think it was feasible or desirable to develop a uniform global approach with respect to risk retention. It[44] was suggested that mutual recognition based on harmonised and equivalent rules and acceptance process (see details below) would be the most effective way to facilitate functioning global securitisation market. Another response suggested that it is more appropriate to provide a policy package that suits the actual situation of each jurisdiction to enhance prudence on the part of sponsors or originator, consisting of guidelines on disclosure, data availability and documentation especially regarding representations and warranties, and investors' due diligence.

Implications of Differences

Industry submissions called for IOSCO to take a proactive role in working towards global harmonisation of risk retention requirements to facilitate cross border transactions.

Industry submissions also admitted, however, that in finalising regulation, policy makers may choose approaches for domestic reasons that may impose additional compliance costs and deny issuers flexibility in structuring transactions. A number of submissions[45] urged that, if regional and national policy makers choose this approach, consideration be given to mutual recognition based on equivalent risk requirements that would allow some form of "passporting" arrangements between these equivalent jurisdictions.

Responses[46] proposed a number of options for dealing with these issues. They reflect a concern about both the cost of complying with two sets of rules and the effects of potentially significant impediments to the global market for securitisation. IOSCO includes here a number of suggestions by the industry that have been developed as examples for discussion as follows:

- ***Passporting mechanisms***: Examples included:

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43 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012and the Securitisation Forum of Japan, August 2012

44 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012.

45 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012 and American Securitisation Forum, August 2012

46 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitisation Forum, August 2012

- US Joint Agencies could make an affirmative declaration that EU rules are equivalent; and
- EU regulators could consider adopting some form of recognition for equivalent risk requirements in the US, so that an EU investor investing in a US issued securitised product can invest without a penalty capital charge; and

- ***Exemptions***: Examples included:
  - The provision of a safe harbour in the US for non-US securitizers that have already conducted risk retention in accordance with similar risk retention rules or practices to those of the US (which would include the EU), irrespective of the amount of their US offering; and
  - Jurisdictions granting relief to securitizers of foreign government-sponsored or guaranteed assets, such as ABS backed by US government guaranteed FFELP student loans in the case of European regulations, or ABS backed by governments or agencies of EU member states, in the case of US regulations.

Responses[47] also recognised the difficulties with mutual recognition processes and achieving equivalence where regulatory objectives may not be completely aligned. For instance, domestic policy considerations might inform the credit risk retention rules in some jurisdictions, resulting in a regulatory regime that does not accomplish all of the objectives of an investor's applicable regulators.

These responses point to the importance of jurisdictions clearly articulating their approach to incentive alignment, in particular risk retention, and doing so ideally in a globally coordinated manner. When adopting risk retention rules in a jurisdiction, any exceptions or exemptions should be warranted and to the extent possible be compatible with eventual convergence and harmonisation so as to avoid sub optimal commercial and economic outcomes. Such coordination will help to maintain a level playing field and global financial stability by avoiding any differentiated treatment of securitised products that have equivalent incentive alignment characteristics

Conclusion:

IOSCO acknowledges that several steps may need to be taken to achieve global harmonisation. Nonetheless, the issues raised by industry highlight the need for policy makers in the US, the EU and other jurisdictions to understand the particular cost implications of risk retention proposals. Policy initiatives should consider cross border impacts, balanced against local jurisdictional requirements and concerns. It is also incumbent on industry to work with policy makers to ensure a regime is developed which achieves the right policy outcomes without impeding efficient market solutions. It may be difficult in practice to pinpoint various costs and benefits for all types of structures and underlying asset classes across jurisdictions, yet it is important to consider any information industry can provide to policy makers in order for them to properly consider the real impact on cross border transactions of the changes being considered.

[47] Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitisation Forum, August 2012

IOSCO notes that jurisdictions are at different stages of implementing risk retention requirements. Jurisdictions are encouraged through this process to work to develop clear and consistent approaches to incentive alignment, including risk retention rules.

If jurisdictions adopt exemptions, IOSCO encourages them to explain how and why the exemptions achieve the outcomes of incentive alignment so that compliance can then be disclosed by issuers to investors in each particular transaction.

Once equivalent incentive alignment approaches, including risk retention requirements are in place, specific mechanisms should be put in place, consistent with a jurisdiction's laws and regulations, to recognise the equivalency of specific risk retention rules in other jurisdictions and to facilitate cross border ABS transactions. Consideration could be given to mutual recognition agreements, substituted compliance, passporting arrangements, safe harbours or exemptions consistent with a jurisdiction's laws and regulations which recognise equivalent regulatory outcomes in approaches at the national level.

2. **Disclosure requirements**[48]

The second part of the FSB's request was related to reviewing existing practices and national and regional measures to enhance transparency.

IOSCO's analysis points to well-developed regulatory requirements in a number of jurisdictions about disclosure in relation to public or listed offerings (both upfront and on an ongoing basis). Regulation, where it exists, points to similar outcomes being sought by regulation in participating jurisdictions and a general level of consistency in the information to be provided to investors.

There are, however, some differences which reflect differences in market conditions and practices. Certain information which IOSCO thought might be of significant interest to investors is also not required to be provided in most jurisdictions, such as information regarding stress testing and scenario analysis.

Given this perceived gap, the Consultation Paper sought industry views on whether it should consult with investors about their appetite for stress testing information, and whether it should make recommendations for future work in this area.

Current Regulatory Approach - Upfront Disclosure

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48 Analysis of disclosure regimes and development of principles for disclosure requirements have been the subject of recommendations in previous work conducted by IOSCO Committees, such as TFUMP, notably with the Final Report, *Unregulated Markets and Products,* Report of the Technical Committee of IOSCO, September 2009, (http://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf), . The aim of IOSCO's work has been to ensure that investors have access to information which enables them to make informed decisions about the benefits and risks associated with investing in securitisation products.

IOSCO also recently released *Disclosure Principles for Public Offerings and Listings,*Final Report, Report of the Technical Committee of IOSCO, April 2010, available at; http://www.iosco.org/library/pubdocs/pdf/ioscopd318.pdf, and it is now developing principles for on-going disclosure for public offerings and listings of ABS. Industry initiatives are also focused on improving disclosure through standardisation of documentation and greater transparency of granular data. Initiatives are in some cases jurisdiction specific (for instance in the US) and others were developed at a regional level (for instance in Europe)

IOSCO's analysis noted requirements which applied to both public offerings and private placements.

Public or listed Offerings

Although there is little direct retail participation in ABS markets, a number of jurisdictions have detailed disclosure requirements (both upfront and ongoing) that are specific to ABS public offerings or listed ABS.

For instance, in the US, Regulation AB, which was adopted in 2004, imposes detailed disclosure requirements (both upfront and ongoing) for ABS offerings.

EU countries are subject to the EU Prospectus Directive and Prospectus Regulation, which contain specific requirements for disclosure in relation to public offerings and/or listings of ABS on regulated markets as well as the general content of that disclosure.

In Canada, Mexico and Brazil, securities legislation also mandates general content requirements for public securities offerings as well as specific disclosure terms that are applicable to ABS offerings.

In Japan, under the Financial Instruments and Exchange Act, issuers must submit a Securities Registration Statement in respect of ABS public offerings that includes certain ABS specific disclosures, including on risk information. In addition, under the rules by the self-regulatory organization, distributors must disclose detailed information on risks when distributing securitised products, regardless of whether via a private placement or a public offering.

Other jurisdictions have only general disclosure requirements containing variations on the basic requirements that apply to any public offers for any type of security for a prospectus to contain sufficient or all material information to enable a reasonable investor to form an opinion about the company issuing the securities, e.g. Hong Kong and Australia.

The EC/SEC Staff Analysis also outlined requirements about the disclosure of waterfall analysis in the US and the EU.

- In the US, SEC rules require a prospectus to disclose the flow of funds for a transaction, including payment allocations, priorities and credit enhancement to facilitate timely payment to security holders. All fees and expenses payable out of cash flows must be disclosed on an ongoing basis. In April 2010, the SEC issued proposed revisions to the rules applicable to ABS transactions, which included a requirement that most ABS issuers file a computer program that gives effect to the flow of funds, or *waterfall*, provisions of the transaction. The proposal was designed to allow investors to analyse the ABS offering at the time of its initial investment decision and to monitor ongoing performance of the ABS. In July 2011, the SEC indicated its intent to re-propose this requirement. An ABS issuer would be required to file on the SEC website such a program for use by investors.[49]

- In the EU, the Prospectus Directive requires an explanation of the flow of funds including:

[49] For example, it would cover how cash collections are distributed to investors in the ABS, how losses or lack of payment will be divided among the investors, and when administrative expenses, such as loan servicing fees, are paid to service provider.

- How cash flows will meet an issuer's obligations to security holders;
- Credit enhancements and subordinated debt facilities; and
- Payment allocations and priorities.

The following themes also emerged from the Project:

- There is a degree of consistency in the type of information required to be provided upfront. Stress test outcomes on the underlying assets (whether for a static or dynamic pool with substitution rights) are generally not required, nor is disclosure about precisely how substitution rights impact risks through the life of the transaction;

- Few jurisdictions provide exemptions from the disclosure requirements for public offerings;

- There are generally no specific requirements about disclosing how the risk/reward profile of the ABS structure differs from a direct investment in the underlying assets, though investors may gain an understanding of these differences and associated risks from other information provided. Furthermore, although there is generally no requirement for an issuer to provide a concise overview of the factors which may impact on the risk profile of a structure, in many jurisdictions there is a general requirement to disclose all the risks associated with securities offered. That said, some investors[50] indicated a more formatted and standardised view of the risk of the potential investment positions might be useful; and

- In most jurisdictions there are regulatory requirements applicable to public offers or listed products on a regulated market which mandate the provision of up-to-date and material information intended to enable investors to understand how the issuer's investment objectives are to be achieved, how the risk of losses may materialize and to compare characteristics within the same asset class.

  In the EU, the Transparency Directive as transposed into national laws generally provides for some minimal periodic reporting providing a regular snapshot of certain quantitative and qualitative developments of the securitisation products, such as via issuer accounts and management reports. However, such reports do not provide loan level data and the data could be considered to be fairly limited, although many originators provide more detailed information to investors on a voluntary basis. Few jurisdictions required that this information be disclosed in a standardised format. Those that did not reported counterbalancing general disclosure requirements regarding investment objectives, risk of loss or asset comparison, seeking to ensure that investors still received comprehensive information.

Private Placements

Regulatory requirements about upfront disclosure in relation to private placements vary between jurisdictions. In most jurisdictions there are no specific requirements on the issuer. In these situations disclosure is, effectively, for negotiation between the various parties to the transaction and the information investors expect to receive.

[50] Response to Consultation Paper on Global Developments in Securitization Regulation, Bundesverband Investment und Asset Management (**BVI**), August 2012 and Morgij Analytics, August 2012

In some jurisdictions there was evidence of a developed industry practice within the jurisdiction regarding the level of disclosure for private placements.

In the EU, this is driven mainly by the need for regulated investors to satisfy due diligence requirements. As such, under the CRD 2, any EU investor credit institution may only become exposed to any securitisation transaction if they can demonstrate a comprehensive and thorough understanding of, amongst other factors, the risk characteristics of any ABS they invest in. Any issuer wishing to sell ABS to EU investors that are subject to the CRD would be asked to provide sufficient upfront disclosure to allow that investor to perform the due diligence necessary under the CRD 2 to form the relevant understanding.

Similar considerations apply to any issuer who wishes to sell to EU insurance companies and asset managers that are subject to Solvency 2 and Alternative Investment Fund Managers or AIFM Directive and their respective rules.

Disclosure to such EU investors may become even more relevant. Revisions are currently proposed to the AIFM Directive which would require investment managers not to rely solely and mechanically on external credit ratings. Revisions are also proposed to CRA Regulations,[51] with particular provisions on transparency of securitized products. These revisions are expected to require all information necessary for a comprehensive assessment of an EU securitisation product to be disclosed to the public by the issuer, originator or sponsor. The current proposals under negotiation suggest that this information should, for instance, be about credit quality and performance of the individual underlying assets, structure, cash flows and any collateral support, including all information necessary to conduct stress tests on the cash flows and collateral values supporting the underlying exposures. Technical specifications and further rulemaking for a standardised template and other practical features of reporting would be proposed by ESMA to the EC.

In Australia, the local industry body has developed standards for RMBS pre-issuance disclosure with further standards planned for ABS disclosure.

Meanwhile in the US, Reg AB II proposals also considered increasing transparency in the private ABS market by revising SEC safe harbours from offering registration to require ABS issuers to file a notice of ABS offerings conducted in reliance on the safe harbours; and to represent in their transaction agreement that they will make available to investors the same information about the securities that would be provided if the offering were publicly registered

Current Regulatory Approach - Ongoing Disclosure

In many jurisdictions ongoing disclosure requirements apply in relation to public offerings. The content and format of disclosure requirements varies between jurisdictions. Some jurisdictions require this information to be disclosed in a standard way, however most do not.

The Prospectus Directive applying in EU jurisdictions does not of itself mandate ongoing reporting for ABS transactions. There is no obligation to update or supplement a Prospectus if a significant change occurs during the life of a transaction (e.g. a modification to the terms and conditions, a material mistake or inaccuracy or any significant new factor). Nonetheless the Directive mandates that the issuer must specify whether or not they intend to provide

[51] Proposal for a Regulation, amending Regulation (EC) No 1060/2009 on credit rating agencies, Nov. 2011 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0747:FIN:EN:PDF (**CRA 3**)

post-issuance ongoing and permanent reporting relating to the securities and if so, where and when. Reporting is also mandatory and regulated if securities are admitted to trading on a regulated market and as such become subject to the Transparency and Market Abuse Directives for the life of the listing.

In EU jurisdictions, the CRD 2 due diligence requirements on investors in securitisation products apply on an ongoing basis. The practical effect of this is that ABS issuers provide ongoing reporting to CRD regulated investors to enable the investors to comply with their obligations. Comparable approaches have been recommended for EC's rulemaking for other entities under sector legislation (e.g. asset managers under the AIFM Directive and insurance companies under Solvency 2),[52] knowing though that these have not yet been finalised and come into effect.

In a number of jurisdictions it was reported to be industry practice for the issuer to provide ongoing reporting on key issues particularly relevant to the credit quality of the asset class/pool. This is particularly relevant where an ABS offering has been made by way of private placement that may not be subject to any regulatory requirements mandating initial or ongoing disclosure.

The EC/SEC Staff Analysis also addressed ongoing disclosure in the US. In the US, under revised Section 15(d) of the Exchange Act, ABS issuers must provide ongoing disclosure reports for the life of the security. In addition, the SEC has proposed rules requiring the filing of standardised information about the specific assets in the pool.

Outstanding Issues - Disclosure of stress testing

The Consultation Paper noted that while information regarding results of some testing (including stress testing) of the structure or outcomes of scenario analysis regarding underlying assets may be of significant interest to investors, such information is not required to be disclosed in most jurisdictions.

Disclosure of waterfall analysis is currently descriptive and static. When such disclosure is required for public or listed offerings investors generally do not have a comprehensive tool to test the performance of the ABS under economic stress. For private or non-listed placements, disclosure is determined by contractual and industry practice.

Investors' ability to conduct their own tests depends, among other things, on their capacity to model how the performance of underlying assets will impact the output of cash flow waterfall. Therefore investors need the tools and data to conduct both a proper credit analysis and cash flow analysis. When taken in combination, descriptions of how cash is applied through the waterfall given the priority of payments and the provision of loan level data (driven either by evolving market practices, public initiatives such as the European Central Banks or by mandatory requirements such as those of the SEC) have better equipped investors to run their own stress testing.

Nonetheless one outstanding issue is whether presentation of information that illustrates the performance and the risk profile of a securitisation structure in particular scenarios and under

52 Through Technical Advices to the EC by ESMA and CEIOPS/EIOPA (respectively "ESMA's technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive", Nov. 2011 and "CEIOPS Advice for Level 2 Implementing Measures on Solvency 2: Repackaged Loans Investment", Jan. 2010).

changing economic circumstances, (including potential default scenarios and scenarios of economic stress) could be improved so as to provide investors with an indication of the risk profile of not only the securitisation structure but also the underlying assets.

There are changing regulatory requirements in some jurisdictions, on testing of structures, ranging from jurisdictions and measures that focus on testing by investors (via thorough stress testing) to those requesting that focus on tools and information for such testing to be made available by the issuer:

- In the EU, as noted earlier, the CRD 2 requires credit institution sponsors/originators to make available to investors all materially relevant data information for them to perform 'comprehensive and well informed stress tests' both on cash flows and on collateral values. Beside, CRD 2 also require from credit institution investors to conduct regular stress tests and gather and analyse sufficient information (including risk characteristics of the exposures underlying the securitisation position) to be able to demonstrate to their regulator that they have a comprehensive and thorough understanding of the risk profile of securitisation positions and policies and procedures commensurate to the risk profile of the securitisation positions.

  Similarly, AIFM and Solvency 2 Directives once they come into force will require investing asset managers and insurance companies monitor on an on-going basis and, in a timely manner, performance information on the exposures underlying their securitisation positions.

- In addition, CRA 3 proposals have the broader aim to give investors the information to make an informed assessment of the creditworthiness of securitisation instruments and to help reduce investors' dependence on credit ratings. They would also require disclosure of information necessary to conduct comprehensive and well informed stress tests on the cash flows and collateral values supporting the underlying exposures by means of a standardised disclosure template that ESMA is expected to develop.

- In the US, the Reg AB II proposals would require issuers to file a computer program that gives effect to the flow of funds or 'waterfall' provisions which can then be tested by investors. The SEC indicated in 2011 that it would re-propose this requirement.

- Cash flow models are now also being required by the Bank of England starting with RMBS as an eligibility criterion to its collateral framework.

- Disclosure in relation to private placements (which account for almost all issuance outside EU and the US) appears to generally be determined by contractual and industry practice.

- Though disclosure in relation to private placements are generally not determined by mandatory requirement but rather by contractual and industry practice in the EU, the CRD 2 (for instance) imposes obligations on bank investors to ensure that that they receive adequate and comprehensive disclosure from originators and sponsors to satisfy their need for information irrespective of whether the transaction is public or private.

Given this perceived gap, IOSCO in its Consultation paper sought industry views at a very high level on whether it should consult with investors about their appetite for stress testing information, and make recommendations for future work in this area.

Consultation Paper Responses

To assist in reducing reliance on CRAs, the Consultation Paper proposed that IOSCO consult with investors about their appetite for stress testing information and, if appropriate, provide guidance on the disclosure issuers should be expected to make about stress testing and scenario analysis of pooled assets.

Responses to the Consultation Paper's proposal were mixed.

Industry feedback supported the need for timely and robust disclosure to investors in order for them to make informed investment decisions and to avoid over-reliance on CRAs. A number of submissions from investor groups welcomed the suggestions. Issuer stress testing was seen as supporting investors own due diligence of securitisation[53]. However, it was seen as imperative that issuers provide the detailed underlying data and other information necessary to allow investors to conduct their own due diligence and analysis[54]. This was because the submissions also recognised the potential for conflict for issuers between conducting their own stress testing and their interests in the successful placement of their issues. Therefore, the ability and tools to challenge and interrogate issuer stress testing were seen as key.

There were, however, submissions that expressed concerns about any proposals to mandate issuer disclosure of stress testing. A number of issues were raised:

- Results could be misunderstood and lead to investor overreaction or overreliance;
- Comparison of stress testing results would be unworkable because parameters are different and results depend on how stress tests are calculated;
- There may be incentives to carry out inadequate stress testing (this concern echoed the concern of investor groups); and
- Disclosure of stress testing will have different legal ramifications for issuers in different jurisdictions and in particular issuers will have liability concerns if they have to select the assumptions/parameters etc.

These submissions[55] also highlighted the need to provide to investors comprehensive data on the issuer, underlying assets and risks, which would allow them to conduct their own stress testing and scenario analysis.

Submissions[56] also recommended that issuers have input into any consultation process and be given the opportunity to be heard on issues regarding the costs of complying with such disclosures and the legal risks associated with it, especially in defining assumptions and

53 Response to Consultation Paper on Global Developments in Securitization Regulation, Bundesverband Investment und Asset Management e.V. August 2012 and AXA Investment Managers, August 2012

54 Response to Consultation Paper on Global Developments in Securitization Regulation, Institute of International Finance, August 2012

55 Response to Consultation Paper on Global Developments in Securitization Regulation, Bundesverband Investment und Asset Management e.V. August 2012.

56 Response to Consultation Paper on Global Developments in Securitization Regulation, International Banking Federation, August 2012, Institute of International Finance, August 2012.

parameters. They also raised the question of securities laws in some jurisdictions potentially deeming such analysis as forward looking statements.

Some submissions[57] urged IOSCO to consider that the introduction of any further disclosure requirements should involve a balancing of interests and a clear cost-benefit analysis. Any work here would need to confirm that any benefit to investors clearly justifies the corresponding costs to originators/sponsors.

The point was also made that issuer stress testing sits somewhat awkwardly with EU regulatory requirements that require investors to do their own due diligence and/or stress tests.

A number of submissions[58] on the Consultation Paper noted the many recent (and proposed) changes to regulation of disclosure and urged that further regulatory action not be taken until these measures had been finalised and their effects can be analysed. Some respondents[59] suggested that issuers should also be involved in any further consultation process and any cost-benefit analysis.

Conclusion:

IOSCO considers that investors should be able to test whether future cash flows generated from underlying pools and that go through the tranched capital structure, will pay investors in full and on time. This is consistent with the trend of current developments.

Further IOSCO is of the view that investors awareness of risks in the underlying loans within the pools of securitised assets will be raised if they are provided with the tools necessary to accurately assess those risks, or if they have adequate capability (either in-house or through external advice) to conduct their own credit analysis. They will otherwise rely on credit ratings assigned by rating agencies to evaluate the performance and test the structure. As noted above, there has generally been progress on the provision of loan-level data. However, to be able to test resistance to credit shocks thoroughly and impacts on expected maturities of the securities, investors need to access data on loan origination and historical performances of securitised assets such as those available to CRAs.

A question that arises is, therefore, whether investors should receive as part of mandatory information of legal documentation disclosure the risk/reward profile of the structure in simple, short and template format. As expressed by industry, IOSCO considers that it is essential to give investors the means to assess issuer disclosure, in particular by receiving comprehensive data on underlying assets from the issuer. It is similarly important that investors have the ability and adequate tools to challenge assumptions relative to the structure performance by conducting their own stress testing. In some cases, this could require that the issuer provide the investor with the necessary tools.

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57 Response to Consultation Paper on Global Developments in Securitization Regulation, Institute of International Finance, August 2012.

58 Response to Consultation Paper on Global Developments in Securitization Regulation, Institute of International Finance, August 2012.

59 Response to Consultation Paper on Global Developments in Securitization Regulation, International Banking Federation, August 2012, Institute of International Finance, August 2012.

First, issuers should provide investors some base indicators of the structure's most likely performance and/or some estimate scenarios for potential losses that could occur. At a minimum this should include disclosing a base case, expected loss coverage as well as in the case of pass through expected average life. Additional key indicators, including information about risk/reward profiles, fees and scenario analysis (including structuring assumptions) may also be provided.

Industry expressed concern that issuer’s stress testing could lead to investor overreaction or overreliance. IOSCO notes the aim here is not to request issuers to provide investors with the data from a series of advanced stress tests. IOSCO acknowledges that investors’ choices of assumptions will be specific to their investment profile and commensurate with their investment position. Therefore, IOSCO does not see it as appropriate to ask that issuers present investors with a series of thorough stress tests that could not realistically satisfy the needs of each and every investor.

IOSCO considers that indication of a base case in terms of loss and expected maturity of a securitisation product could be useful as the basic information investors need to assess the prospective stability of a structure. IOSCO envisages that investors would also be provided with simple indicators of the performance of a structure, such as presentation of simple limited scenarios under variation of a restricted number of parameters or minima of a base case (e.g. expected loss coverage as well as in the case of pass through expected average life). Subsequent comparison of scenarios could be facilitated if the parameters are limited.

IOSCO recognises that to the extent that criteria such as expected loss or expected life have a "forward-looking" component there may be no guarantee that any such forecasts or projections will come to pass, but such disclosure should nonetheless be consistent with realistic assumptions and predictions about initial individual assets that can be made with a high degree of confidence in light of historical performance. Provision of stress testing results under some extreme scenarios also may be useful.

In addition, issuers could provide investors with modelling tools to assist the investors conduct due diligence on an investment. The advantage of making dynamic modelling tools readily available to investors free of charge is that they can input their own assumptions as relevant to their particular situation or economic view into the modelling tool hence reducing their need of CRAs to provide such scenarios analysis. This provides investors with the tools to assess any scenarios that may have been provided by an issuer against different scenarios, circumstances or stress conditions chosen by the investor.

3. Disclosure Standardisation

The third issue raised by the FSB related to standardisation of disclosure. The Consultation Paper summarised regulation and industry initiatives based on responses to the Survey of members.

Responses to the Consultation Paper differentiated between the standardisation of ABS disclosure documentation generally and the harmonization of data at the asset level. The recommendations on standardisation reflect this differentiation.

Current Regulatory approach

Respondents to the Survey were asked whether standardised initial disclosure information was required which enabled investors to understand how issuers seek to achieve investment objectives, understand risk of loss to principal and interest and to allow comparison between securities in the same class. They were also asked whether standardised information was required on an ongoing basis about underlying credit risk, risk of loss and cash flows.

Responses to the Survey indicated that most jurisdictions did not specify any standardised disclosure formats. This was the case in relation to ongoing disclosure about underlying credit risk, risk of loss and cash flows and information intended to enable investors to understand how issuers seek to achieve investment objectives, understand risk of loss to principal and interest and to allow comparison between securities in the same class. There were some exceptions. In Japan a format for the Annual Securities Report was specified and in Brazil standardised quarterly information was required regarding various risks, cash flows and losses. In Portugal, Spain and South Africa there are also some standardised disclosure requirements.

Respondents were finally asked whether there was any certification or verification of information disclosed in offering documents or via ongoing reporting. Requirements for disclosure verification are in place in most jurisdictions. These requirements can be different in nature, including verification on the form of the disclosure (e.g. clarity and legibility), requirements about content (e.g. auditors' sign off on accounts), and self-certification or external verification requirements (e.g. senior management commitment or external verification in respect of representations and warranties or of custodial duties). Civil and in some cases criminal sanctions for misrepresentation and inaccuracy are in place in all jurisdictions.

Industry Initiatives on Disclosure Standardisation

Industry and other public sector initiatives have sought to encourage greater standardisation in documentation and greater data transparency at a granular level.

In Europe, initiatives have been advanced by public institutions such as the loan-level initiative of the European Central Bank (**ECB**) and a similar initiative of the Bank of England. Loan-level information disclosure and standardised monthly investor reporting under standard templates are in the process of being implemented. The ECB has adjusted templates to address specific asset classes (with first changes in relation to RMBS, CMBS, SMEs, and then for consumer finance, leasing and auto loans). The Bank of England has also been adjusting templates in relation to RMBS and mortgage Covered Bonds (and then later for CMBS, ABCP and SMEs CLOs).

Standard templates present some mandatory and other optional fields; ECB templates differentiate fields to be filled in by jurisdictions for those where such data might not exist or be relevant. These initiatives have been developed as criteria for those ABS products to be eligible to the collateral framework in the Central Banks' refinancing operations, no matter whether public, privately placed or unlisted issuance. As such they might develop into general market practices, with private initiatives such as Prime Collateralised Securities (**PCS**) already committed to cross-reference to these public initiatives. They have been driven by a need to gain standardised information on securitisation products for risk analysis as an investor and by the desire to restart the securitisation markets in Europe by the provision of additional transparency. The ECB has arranged for such loan-level data to be available publicly via a central repository (the “European Datawarehouse”). A provision for comparable mandatory disclosure is now currently being considered for all securitisation products in the revision of CRA Regulation in Europe as developed under Disclosure requirements section of this report.

In the Netherlands, Holland Financial Centre and a number of Dutch issuers of ABS have joined forces with the aim of standardising the disclosure relating to ABS in the Netherlands. It is the intention that this standard will be introduced in Q4 2012. Among other things, the standard will align the approximately 200 most used definitions in the prospectuses of all Dutch securitisation programmes as well as having all of these prospectuses using the same basic structure in order to aid investors in finding information in the prospectuses and help to compare different transactions. Additionally, standard monthly investor reports will be introduced that have been based on the input of market participants, such as credit rating agencies and investors. These monthly reports will provide investors and other third parties with more information than was previously available in a standard format across issuers. Parties participating in this initiative will also incorporate an independent association, named the Dutch Securitisation Association that will manage the standard.

In the US, the industry via The American Securitization Forum´s (**ASF**) Project RESTART has been identifying for private-label RMBS transactions detailed disclosure and reporting to be provided by issuers (regarding loan-level information to be disclosed prior to the initial offering and updated monthly by servicers throughout the transactions life). In Australia industry standards have been developed for reporting loan level data for RMBS transactions as well as standard pre-issuance disclosure. Similar ABS standards are being developed.[60]

The SEC has proposed to require that loan-level information would be provided at the time the asset is securitized and on an ongoing basis. The proposed rules would require loan-level or grouped account data about pool assets being filed with the SEC in computer readable, standardised format.

Consultation Paper Responses

The Consultation Paper proposed that IOSCO encourage industry to develop best practice templates and encourage industry bodies to work with their counterparts and other jurisdictions to ensure consistent and harmonised approaches. It also proposed that IOSCO consider developing principles to support harmonisation in these approaches.

The Consultation Paper argued that a standard approach to disclosure for both offer documentation and asset data within a jurisdiction, and potentially across jurisdictions, may assist investors to understand and compare the risk/reward profile of securitisation investments.

Respondents to the Consultation Paper expressed a range of views both on standardisation of asset data and on offer documentation.

Standardisation of asset data

Some respondents were supportive of the development of industry best practice templates for asset data, where possible. They recognised that any harmonisation between different jurisdictions and asset types/structures may be challenging as these differences must be taken

60 Australian Securitisation Forum: http://www.securitisation.com.au/standards

into account. Other respondents also referred to the need for coordination on the part of national regulators, considering this essential in the context of loan-level disclosure requirements.

Underlining that different jurisdictions also use different terms at the asset level which could prove to be difficult to reconcile, respondents viewed projects at a national level as appropriate in the context of local securitisation.

In that regard, submissions noted coordination of detailed work that was already conducted by Central Banks in Europe, whether the Bank of England (**BoE**) or the ECB, to achieve some asset-level reporting for various asset classes. They also noted the flexibility offered by these public sector initiatives, particularly the "comply or explain" approach where issuers cannot provide certain required information to investors. A principles based approach was favored as most appropriate. Others added that coordination of detailed work at the local level and mutual recognition based on equivalent rules might help overcome the difficulty of harmonising reporting standards and terms that reflect inherent differences in local assets.

Standardisation of ABS offer documentation

Submissions raised concerns about a proposal to standardise documentation, or at least felt that such efforts would be successful only in limited circumstances.[61]They indicated that the regulatory focus should be on ensuring that documentation is clear and understandable. Due to differences in the way information is presented in different jurisdictions, the differences in structures and asset classes, as well as the general complexity of ABS structures, the weight of industry opinion was that efforts to achieve standardisation in documentation practices and requirements would be very difficult with some very real drawbacks.[62]

Respondents also pointed out that a significant amount of work has already been undertaken in developing new disclosure requirements, such as Article 122a and implementation of Dodd Frank, further there are a number of industry led initiatives such as the Prime Collateralised Securities (PCS) and RESTART projects.[63] These have yet to be fully developed or implemented, and responses recommended reviewing the impact of these changes before pursuing further changes in relation to document standardisation.

Some submissions also argued that unduly standardising disclosure requirements can drive actual lending behaviour (for example, if all securitized loans had to have particular terms, this could restrict what loans are available to consumers by discouraging certain types of loan instruments). Even the standardization of definitions could force some products out of the market or limit their availability to investors, which would have a dampening effect without a clear benefit.[64] Further, disclosure should be appropriate for the risk issues arising from each type and structure of transaction and there would be little benefit in a minimum template that

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61 Response to Consultation Paper on Global Developments in Securitization Regulation, Institute of International Finance, August 2012 and International Banking Federation, August 201

62 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitisation Forum, August 2012 and the Japanese Bankers' Association, August 2012

63 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012

64 Response to Consultation Paper on Global Developments in Securitization Regulation, American Securitisation Forum, August 2012

might require disclosure of extraneous or less-relevant information over that appropriate to a specific issuance.[65]

Conclusion:

In light of current developments in the field of standardisation and of feedback regarding standardisation (both in terms of presentation of asset data and documentation), IOSCO sees standardisation as a useful way of enhancing transparency and facilitating disclosure.

First, IOSCO considers that initiatives for standardisation of asset-level disclosure underway in a number of jurisdictions, including Europe and the US, are a good starting point. As such IOSCO's view is not to impose new frameworks, but rather, to build on existing initiatives on standardisation. In Europe for instance, the EC and the relevant European Supervisory Authorities (ESA), and more specifically the European Securities and Markets Authority (ESMA), should work together with the ECB and the Bank of England, and possibly the industry, using detailed work that has already been carried out both at the level of asset data fields and on the issue of data protection and confidentiality when developing their new mandatory detailed reporting requirements on the provision of any asset level information.

Acknowledging that different jurisdictions have different approaches to asset level data, IOSCO considers that standardisation should first be sought at a national level to appropriately reflect the context of local securitisation for specific asset classes. Once this is achieved, IOSCO considers it might be useful to ensure the cross-border interoperability of such detailed transparency standards in order to facilitate cross-border transactions for the most common asset class. As a consequence, IOSCO sees merit in carrying out further work at a later stage to reconcile and harmonise these individual templates for detailed reporting as much as possible and to assist in achieving recognition of regulatory equivalence on this theme.

Secondly, IOSCO sees merits in standardisation of disclosure presentation to the extent it could enhance investors' ability to analyse and compare such raw information themselves.

As such, one option to assist in analysis and comparison might be to provide modelling tools as developed under the section on disclosure requirements in this report. An example could be to require issuers to provide cash flow models that incorporate key inputs of structures so as to test the cash flow output (e.g. into a format that present a pre-set table reflecting risk data and structural features relative to the transaction and the security as fixed and variable inputs so as to get corresponding cash flows for the expected life of the relevant bond as output).

Furthermore, IOSCO recognises that in some jurisdictions retail investors may come into possession of securitised products even without direct marketing through, for instance, repackaging of securities. With a view to further facilitating understanding of securitisation products, an additional option might be that issuers provide, consistent with a jurisdiction's disclosure framework, *the minima* key information about the risk/reward profile, fees and expenses of the securitisation structure under a simple and standardised format as a prominent part of disclosure documentation. In such cases, one aspect of a risk/reward could be illustrated by presenting scenarios on a base, positive and negative basis. This type of standard information can also be a useful tool to assist and facilitate understanding and

65 Response to Consultation Paper on Global Developments in Securitization Regulation, Institute of International Finance, August 2012

analysis of a securitisation product via indirect investments. Intermediaries repackaging a given securitisation product subsequently giving indirect access to new types of investors should thus be in a position to inform any investors - including retail investors in particular- that such key standardised information is available at the level of each individual securitisation product in the investment portfolio. Such disclosure should therefore be requested in any case, notwithstanding the offering regime or placement type so that it is available even where there has never been any public offer (or listing submitting products to a similar regime) for the securitisation product itself.

4. Other Issues

The Consultation Paper and comments received during the consultation process focused on a number of other issues falling beyond the FSB's request. In addition, this Project has also highlighted a number of essential factors or conditions for providing an adequate economic and regulatory environment necessary to grow confidence in sustainable securitisations markets.

These different issues are set out below.

(1) Securitisation processes

The Consultation Paper highlighted the importance of sound and effective risk management practices across the securitisation value chain in contributing to increased investor confidence in securitisation and thus possibly in supporting growth of sustainable securitisation markets. Key practices and processes for sound and effective risk management include underwriting and origination practices (such as procedures for accurate assessment of borrower's capacity to repay); the selection of underlying assets for the asset pool and investor due diligence.

The Consultation Paper outlined relevant parts of the EC/SEC Staff Analysis and outcomes of the Survey.

The EC/SEC Staff Analysis noted the following:

- Recently adopted SEC Rules are intended to drive and support initial due diligence.
    - This includes issuers of registered securitisation product offerings being required to conduct a review of the assets and disclose the nature of the review performed to satisfy the review requirements. Information that issuers are required to disclose includes: information about how the loans in the pool differ from the loan underwriting criteria disclosed in the prospectus; loans that did not meet the disclosed underwriting criteria but were nonetheless included in the pool; and the entity that made the determination that such loans should be included in the pool, despite not having met the disclosed underwriting standards. Current SEC rules also require substitution rights to be disclosed. Current ongoing disclosure rules require disclosure of pool asset changes resulting from substitutions and repurchases as well as any material changes to origination or pool selection criteria.
- EU rules approach the issue both directly and indirectly with comprehensive due diligence requirements imposed on investing institutions.
    - As a general principle, the CRD requires that any credit institution when acting as initiator or sponsor of a securitisation transaction shall apply the same sound and

well-defined criteria for credit-granting in accordance with the requirements of the directive to any exposures that are to be securitized as they apply to exposures to be held on their books. At the same time, there are also due diligence requirements on the credit institution and investment firms as investors which, as well as seeking to protect them as investors, also have an indirect impact on the quality of the securitisation.

In other jurisdictions participating in the Survey, there were varying approaches to regulatory requirements around securitisation processes. Survey responses pointed to other jurisdictions imposing prudent risk management practices on investors. In some jurisdictions there are specific limits on permitted investment exposure to securitisation instruments. In other jurisdictions there were regulatory requirements limiting the assets that could be selected for the pool at origination or during the life of the transaction. Selection criteria seem to be generally quite broad.

Responses to the Survey also suggested that in many cases the underwriter of the underlying assets is related to the sponsor or originator of the securitisation in some form of capitalistic way. This may provide the securitisation sponsor, or originator, with a degree of visibility to the underwriting practices used in respect of originating the underlying assets and some ability to control these practices.

The Survey also indicated the following:

- Selection criteria are generally set out in contractual agreements, disclosure documents or bylaws of the vehicles and can be reviewed by potential investors. Criteria in jurisdictions vary and can include nature of risks, quality of assets, governing law and currency;

- In most jurisdictions substitutions rights are not prohibited. Inclusion of such rights is a matter for industry practice and the specific structure of a transaction. Where substitution rights are present it appears that these rights generally would be disclosed. For instance in the EU the Prospectus Directive (to the extent that the product is offered to the public or listed on regulated market) requires disclosure of any substitution rights and a description of the manner in which and the type of assets which may be substituted. This information is mandatory at the time of issuance, and should be kept current on an ongoing basis;

- In some jurisdictions, it is a regulatory requirement or industry practice that the issuer or originator is obliged to repurchase/substitute assets that no longer meet eligibility criteria, or no longer meet the representations or warranties made in relation to the assets;

- In many jurisdictions, industry practice and external parties (e.g. CRAs or investors) influence the criteria applied to the asset selection at origination and on an ongoing basis. Where a rating is sought, an issuer would need to meet CRA requirements on asset pool selection and investors will have their own investment requirements regarding any assets they invest in regarding delinquencies and non-performing assets. An issuer seeking either a rating or targeting a particular investor or investor class would, in practice, need to meet the relevant requirements;

- Certain central banks and more generally “official or governmental investors” have become key investors for securitisation products after the Crisis, and as a consequence, they have imposed their own standards with regards to the nature and quality of underlying assets for securitisation products deemed to be acceptable or eligible for their investment portfolio. For instance in Australia the Australian Office of Financial

Management (**AOFM**) and the Reserve Bank of Australia will only invest in securitisation deals that meet their eligibility respective criteria, e.g. AOFM will only invest in RMBS backed by pools containing high quality Australian residential mortgages. In Europe, much securitisation activity is for the purpose of posting ABS collateral at the ECB, therefore ECB requirements are critical. The ECB has developed its own requirements for composition at loan level, with cash flow generating assets backing the ABS that lodged with the ECB having to fulfil a number of requirements,[66] and

- Some jurisdictions have key government related securitisation issuers in their markets. Those are for instance Japan Housing Finance Agency (**JHFA**) in Japan, and Infonavit and Fovissste in Mexico. Such issuers also have limitations on asset selection. The JHFA is restricted to loans for developing and purchasing houses; and Infonavit has self-imposed criteria reflecting its role as an agency providing housing credit to workers.

The Consultation Paper highlighted that initial due diligence and asset selection by originators or sponsors are key elements to ensuring the quality of securitized products. It indicated that it was therefore important to consider eligibility criteria for underlying assets. The Consultation Paper noted that in parallel, the FSB has conducted important work to identify sound practices for mortgage origination, with the development of an international principles-based framework for sound underwriting practices for residential mortgages (FSB's Principles).[67]

.The Consultation Paper suggested that it might be helpful to develop an integrated approach toward good governance. It suggested that this could be achieved, for instance, by helping investors through measures to identify securitisation products backed by asset pools originated in compliance with sound practices for underwriting of mortgages or loans more generally. Initiatives such as a credible and transparent labelling initiatives that promote standardised disclosure of underlying loans originated using sound loan origination practices might be needed in that regard.

Responses[68] to the Consultation Paper did not see work on this, at this stage, as a priority. They nonetheless noted that regulation of asset or mortgage regulation was a broader topic.

Mortgages may be financed through securitisation or other forms of finance, and sound origination and underwriting practices are key regardless of the source of finance. [69]

Conclusion:

IOSCO believes that investors may benefit from receiving information from issuers concerning the underwriting practices of originators. Proper origination can help to ensure the performance of underlying assets throughout the life of securitisation transaction. This

66 ECB, General Documentation on Eurosystem monetary policy instruments and procedures, Feb 2011; http://www.ecb.int/pub/pdf/other/gendoc2011en.pdf

67 FSB Thematic Review on Mortgage Underwriting and Origination Practices, March 2011 http://www.financialstabilityboard.org/publications/r_110318a.pdf and Principles for Sound Residential Mortgage Underwriting Practices, April 2012: http://www.financialstabilityboard.org/publications/r_120418.pdf

68 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012 and Amundi Asset Management, August 2012.

69 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012.

information provides an indication of the quality of the securitisation process that is relevant to investors when making their decision to buy the product.

This information provides an indication of the quality of the securitised product relevant to investors when making their investment decision. It may thus be useful in RMBS transactions, for example, that issuers disclose how initial asset underwriting was conducted and describe how underlying mortgages selected in the securitisation process will perform through time. In other words, that those mortgages (i) do not only correspond to disclosure of representations and warranties meant to guarantee their current quality, (ii) but more importantly that they are the fruit of sound, well documented and regulated process of underwriting.

In this regard, IOSCO recognises the essential role to be played by each prudential regulator in ensuring any originator of mortgage loans is regulated and has origination practices in line with the FSB's Principles.

IOSCO also sees merit in exploring with prudential regulators and industry how such practices could then be reflected into securitisation documentation in an informative and useful way of disclosure for RMBS investors.

(2) Credit Rating Agency related issues

This Project highlighted the fact that to perform their thorough testing and risk analysis of the products CRAs often have access to much more detail about rated securities than investors, whether for public or privately placed securities.

This Project highlighted the fact that to perform their thorough testing and risk analysis of the products CRAs often have access to much more detail about rated securities than investors whether for public or privately placed securities.

The Consultation Paper flagged that to help investors reduce their reliance on CRAs' analysis, and to help them conduct their own detailed due diligence and testing of their securitisation investment positions, there may be scope for investors to be given equal access to documents and data that are relevant to assess creditworthiness of a product and provided to CRAs at the time of the offering and on an ongoing basis thereafter.

Submissions[70] favoured transparency and disclosure to investors. There was concern, however, that if all information provided to a CRA were required to be disclosed to investors it may result in issuers being reluctant to provide as much information to CRAs, especially commercially sensitive information. The underlying argument was that this in turn would make the ratings process more difficult and ratings potentially unreliable.

Submissions[71] indicated that CRAs should be obliged to publish details and notify investors:

- When notified that a transaction is about to breach triggers of the transaction;
- When there has been a breach of the triggers of the transaction; and

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70 Response to Consultation Paper on Global Developments in Securitization Regulation, International Institute of Finance, August 2012.

71 Response to Consultation Paper on Global Developments in Securitization Regulation, Financial Services Board of South Africa, August 2012

- Of the proposed remedies documented in the transaction documents, the remedy chosen to rectify the transaction and the proposed completion date.

Conclusion:

CRAs usually benefit from a privileged position in the chain of information, which in the case of securitisation products can result in asymmetry of information with material consequences for investors. Hence investors should receive relevant information, documents and relevant data they need to assess the creditworthiness of a given securitisation product from the issuer, consistent with a jurisdiction's disclosure framework, rather than having to rely on second-hand information channelled through from the CRAs' analysis. IOSCO considers that, to assist in reducing overreliance on ratings prepared by CRAs, investors should be given equal access to any relevant documents and data provided by a securitisation issuer to the CRAs, subject to applicable privacy, confidentiality, and other laws.

IOSCO distinguishes two aspects, relating on the one hand (i) to structural information of the deal structure and on the other hand (ii) to detailed information in relation to the underlying assets.

IOSCO considers that providing information to CRAs that can reasonably be expected to affect the security's creditworthiness, such as a breach of triggers, before investors may put those investors at risk. This risk is especially prominent when investors only become aware of adverse developments in the creditworthiness of a securitisation transaction after they have materialised and have been made public through an impact on the rating (i.e. announcement of a downgrade of the rating attached to the securities). Investors should therefore be provided with equal and simultaneous access to such type of information without the intermediation of CRAs. Furthermore, such announcements should be made by a party to the transaction; CRAs should not be the announcing party.

IOSCO acknowledges that the detailed nature of information required to perform credit assessment of underlying assets of a securitisation products may give rise to privacy or confidentiality issues. Issuers may have legitimate reasons to rely on confidentiality agreements prior to disclosing certain information. Nonetheless, issuers should not invoke privacy or confidentiality concerns to withhold from investors information provided to CRAs that investors would otherwise need to make their assessments, absent a good faith and reasonable claim to privacy or confidentiality.

(3) Definitions and Terminology

This Project has highlighted the challenge of developing guidance on the regulation of a diverse range of practices and structures which though different in many respects have been collectively thought of as a single investment category or class.

A particular issue has been the different meaning which similar terms have developed in different markets and jurisdictions.[72] For instance, the primary definition of securitisation

[72] TFUMP used Asset Backed Securities (**ABS**) in the questionnaire to refer to securities that are primarily serviced by the cash flows of a discrete pool of receivables or other financial assets that, by their terms, convert into cash within a finite period of time. It explained that the questionnaire could cover RMBS (residential mortgage-backed securities), CMBS (commercial mortgage-backed securities), CLOs (Collateralised Loan Obligations), as well as <u>short-dated securitisation</u> such as ABCP (asset-backed commercial paper). It deliberately chose to exclude multisequential securitisation (e.g. Collateralized debt obligations (CDO) of ABS, CDO of CDOs), and non-cash securitisation (e.g. synthetic CDOs).

used in the EU specifically refers to a structuring technique based on the concept of tranching set out in banking prudential legislation to allow for calibration of capital risk weights reflecting the tranched structure. This specific definition is used as the basis for other regulatory requirements (such as provisions of CRA regulation on disclosures in the implementing rules of Solvency 2 or AIFM Directives in relation to risk retention). The definition also coexists with other definitions not necessarily encompassing each other. Examples are the definitions of Asset Backed Securities for the purpose of the transparency provision of Prospectus Directive; of Structured Finance Products for the purpose of post trade requirements of MIFID; of securitisation special purpose entity (**SSPE**) for the purpose of the scope exclusion of AIFM Directive. Definitions in the US refer to a principle based definition in combination with references to specific products types.

To address this issue, the Consultation Paper indicated that if policy guidance is to be developed by IOSCO, consideration may need to be given to developing standard definitions or a global taxonomy covering different types of securitisation products (which are consistent with other regulatory definitions such as under the Basel Framework) to which the guidance would apply.

The majority of submissions[73] addressing this issue did not see development of standard definitions as a material factor in the revival of securitisation. Some considered that it would be difficult to do so considering the divergence of terminology that has become embedded in securitisation practice and the differences in products and practice. Some submissions did call for IOSCO to consider developing standard definitions for the different types of securitisation products. However, these submissions encouraged IOSCO to ensure that standard definitions do not come at the expense of investor choice or sensible innovations.

Particular submissions[74] suggested exclusion of particular transactions (such as financial insurance guarantee transactions or banks' funding activities e.g. bank sponsored ABCP conduits) from the definition of "securitisation".

Submissions[75] also asked for a distinction to be made between multilateral and bilateral transactions, with a view to exclusion of bilateral transactions from any IOSCO approach. It was argued that in a bilateral transaction, it is up to the two parties to agree the level of risk retention – if any – and the information provided, and for the purchaser to satisfy themselves that they have enough information to make an effective judgement.

Conclusion:

IOSCO considers that in certain regulatory areas referring to a unique concept of "securitisation products" may pose a challenge for policy makers as they consider whether and how to develop consistent and harmonised approaches to regulating securitisation markets as a whole.

IOSCO sees merit in reflecting further on legal terminology so as to enable recognition that securitisation or asset-backed securities as a category encompasses not one but many

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[73] Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012.

[74] Response to Consultation Paper on Global Developments in Securitization Regulation, Association of Financial Guaranty Insurers, August 2012 and International Banking Federation, August 2012.

[75] Response to Consultation Paper on Global Developments in Securitization Regulation, Japanese Bankers' Association, August 2012.

different asset classes and structures. Acknowledging this complexity could facilitate harmonisation of rules while still allowing for development of more differentiated and nuanced approaches to reflect certain specificities of activities, forms and funding methods.

IOSCO believes that regulation and principles developed to address the activity of securitisation as a whole could be stronger if in addition to a single principle-based concept for "securitisation" technique in general it also allowed for certain regulatory approaches to take into account that this concept covers a variety of "structured finance products" with their own specific characteristics.[76]

(4) Liquidity : Standardisation and transparency

The Survey pointed to secondary markets being OTC, even when securitised products are listed on a regulated market.

The Consultation Paper noted that in 2010, IOSCO Committee 2 made recommendations based on the fact that pre-trade transparency (e.g. more standardised, more transparent products) and adequate post-trade transparency might help to develop liquidity for structured finance products, including securitisation products.

The Consultation Paper noted that, as is the case for derivatives, standardisation and transparency may help in the development of trading of securitisation products on secondary markets.

Responses[77] to the Consultation Paper did not see this issue as an immediate priority. Some respondents did nevertheless note the particular threat to liquidity of these markets posed by the treatment of ABS securities for liquidity coverage ratio purposes under current Basel III proposals and the need to monitor the impact of these developments. In that regard, submissions[78] noted that although there was no current clarity about whether ABS securities would be included as eligible assets for calculating the liquidity ratio, excluding ABS securities for liquidity ratio compliance would have detrimental effects on the trading of ABS securities by banks, resulting in even lower liquidity levels in the ABS market.

Conclusion:

IOSCO sees merits in product standardisation as a means of facilitating listing, secondary markets liquidity, and therefore the transparency of securitisation products.

IOSCO encourages industry to undertake work to develop less complex and more easily tradable securitisation products at the national and international level. This should be done alongside other more customised securitisation products.

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76 For instance, in conducting such reflections, legislators, regulators and standard setters could hence pay attention to the set of activities involving different types of activities and instruments (e.g. Residential Mortgage-Backed Securities, Commercial Mortgage-Backed Securities, securitisation of student loans, auto loans, credit loans, etc.) that can be carried out in different forms (trusts, funds, etc…) by different actors very different in natures (banking or non-banking securitisation); and result from different funding methods (e.g. Term securities, Asset-Backed Commercial Paper, Collateralised Debt Obligations, Master Trusts, etc.) in different jurisdictions.

77 Response to Consultation Paper on Global Developments in Securitization Regulation, Global Financial Markets Association, August 2012.

78 Response to Consultation Paper on Global Developments in Securitization Regulation, International Banking Federation, August 2012.

IOSCO therefore encourages industry's initiatives on product simplification and standardisation, and it will notably monitor how those can improve post trade transparency and liquidity on secondary markets.

(5) Other :

Asset-Backed Funding

During the Roundtable and during consultation, industry participants flagged concerns about differences between the regulation of certain types of collateralised securities, such as covered bonds, and securitisation.

Those expressing concerns indicated that, despite some structural differences, these products offered similar economic benefits to investors and – for that reason should be regulated in the same way. Some argued that the absence of a level regulatory playing field was hampering recovery of securitisation markets. Others expressed concern that what they saw as lighter touch regulation of covered bonds relative to securitisation products was creating incentives for financial institutions to use covered bonds as funding vehicles.

IOSCO recognises the issue and suggests that further work is needed to assess the differences between these products and the extent to which those differences warrant differences in treatment.

Accounting:

IOSCO also notes a current environment in which on the one hand, deleveraging is encouraged for individual financial entity at a micro level, while on the other hand consolidation is requested to ensure among other objectives that the systemic leverage in the financial system can be properly monitored to avoid any form of shadow financing.

Besides in a context where Basel III is going to phase in the introduction of a mandatory leverage ratio requirement for all Basel Committee on Banking Supervision member jurisdictions in the midterm, accounting, and differentiated impacts that may result from differences in accounting regimes, balance sheet presentation, and domestic regulatory adjustments can have significant impact. Accounting regimes and in particular, the use of International Financial Reporting Standards and the use of U.S. generally accepted accounting Principles can lead to large variations if a level playing field is not maintained. Thus IOSCO would urge standard setters and authorities to work closely together to ensure that from accounting and prudential perspectives that the combination of rules for consolidation of SPVs shown on the balance sheet and subsequent prudential treatment applied on this basis achieve consistent and similar outcomes.

V. Recommendations

The principles highlighted in the Report and these recommendations are intended as a toolbox for consideration and analysis by securities regulators that are developing or reviewing risk retention and other securitisation regulations. Some regulators may find it useful to incorporate all of the general principles into their requirements. Others may conclude that the relevance of specific principles in their jurisdictions may vary according to the characteristics of their specific regulatory framework, the characteristics of the parties or asset classes involved in securitizations, or the characteristics of the securities themselves, and may therefore wish to incorporate the principles on a more selective basis as part of their general regulatory regime. In this outcomes-focused approach, the suite of options chosen should aim to achieve the outcomes of incentive alignment, transparency and standardisation, and disclosure to investors described below.

I. Incentive Alignment and Risk Retention

To assist in achieving the objective of global harmonisation in aligning incentives of investors and securitisers along the securitisation value chain, IOSCO makes the following recommendations. The recommendations are intended to provide greater clarity, to reduce the risk that the emergence of potential barriers may pose to cross border securitisation markets and to improve the protection of investors.

Recommendation 1: Evaluation, Formulation and Implementation Deadline of Approaches to Align Incentives, including Risk Retention Requirements

All jurisdictions should evaluate, and formulate approaches to aligning incentives of investors and securitisers in the securitisation value chain, including where appropriate, through mandating retention of risk in securitisation products. Any exemptions to the risk retention requirements should be limited and warranted.

They should endeavour to take any necessary steps to implement such approaches to comply with the elements set out in Recommendation 2 by mid-2014.

Recommendation 2: Elements of the Incentive Alignment Approach and Risk Retention Requirements

In line with G 20 commitments and recommendations in IOSCO's 2009 Report on Unregulated Financial Markets and Products (IOSCO 2009 Report), jurisdictions should clearly set out the elements of their incentive alignment approach with risk retention being the preferred approach. Where risk retention is mandated, the applicable legislation, regulation and/or policy guidance should address the following elements:

1. The party on which obligations are imposed (i.e. direct and/or indirect regime, based on an assessment of the most efficient and effective way of achieving risk retention);
2. Permitted forms of risk retention requirements (e.g. vertical, horizontal, etc.);
3. Exceptions or exemptions from the risk retention requirements (i.e. exceptions and/or alternatives to maintaining a part of the risk in the balance sheet because of structural impediments, e.g. for managed CLOs, or because of risk alignment being achieved differently). These exemptions should be consistent with the objectives of incentive

alignment and achieve equivalent regulatory outcomes. National and regional policy makers and regulators should clearly explain the basis for these exceptions or exemptions, and how equivalence of outcomes is achieved.

Where a jurisdiction chooses not to mandate risk retention, national policy makers and regulators should explain to the Peer Review referred to in Recommendation 3.2:

1. Why measures taken by the jurisdiction are appropriate to achieve the objectives of aligning incentives of investors and securitisers; and
2. How this objective is otherwise achieved, taking into account prudential and securities regulation, as well as market practice.

All jurisdictions should ensure that domestic legislation, regulation and policy guidance require, that the method chosen for compliance with the incentive alignment approach, including any mandated risk retention requirements, is clearly disclosed for each particular transaction. Disclosure to investors of such risk retention information should be made in a manner consistent with a jurisdiction's disclosure framework for public or private securities, as appropriate.

Recommendation 3: Harmonised Alignment of Incentive and Risk Retention Approaches

Regulators should seek to minimize the potentially adverse effects to cross border securitization transactions resulting from differences in approaches to incentive alignment and risk retention.

To assist in harmonizing implementation IOSCO makes the following recommendations:

1. IOSCO encourages the establishment of a cross-sectoral work stream (comprising relevant responsible public bodies, and relevant international standard setting bodies, regulatory authorities and policy makers) to develop general principles on incentive alignment and risk retention and so assist jurisdictions in implementing Recommendation 1 in a globally harmonised way. These principles should address in particular i) forms of risk retention (e.g. with particular regards to specific asset classes) and ii) exemptions and/or adjustments as set out in Recommendation 2. This principles-based approach should allow for a wide range of application and adaptation by regulators. The work stream should be finalised by mid-2013.

2. In addition, once jurisdictions have finalised implementation of their approaches (and no later than mid-2014), the IOSCO Assessment Committee will conduct a Peer Review to assess implementation of incentive alignment approaches including risk retention requirements risk retention approaches in line with Recommendation 2 and the three elements that it sets out, make recommendations to address any differences in approach that may cause material adverse effects to cross-border transactions and to ensure convergence and harmonisation and monitor implementation of the recommendations.

II. Transparency and Standardisation

These recommendations build on recent developments on transparency and standardisation disclosure for securitisation products as set out in the present Report. They are intended to assist in achieving the objective of investors making informed investment decisions consistent with a jurisdiction's disclosure framework. National and regional policy measures should be consistent with the objectives of transparency and standardisation and achieve equivalent regulatory outcomes. Policy makers and regulators should set out and explain the basis for these measures, and how equivalence of outcomes is achieved with the Recommendations set out below.

Recommendation 4: Standardised Asset Level Templates

To further improve the detail of information to be made available to investors, IOSCO calls on members to work domestically (at the national level or regional level, where relevant), with other authorities involved in disclosure requirements or initiatives in their home jurisdictions (such as Central Banks) and industry to continue to standardize templates, as appropriate, for detailed reporting by asset classes by end 2013.

IOSCO should develop - in conjunction with the BCBS - general principles for policy makers and regulators to ensure as much convergence as possible of these templates across jurisdictions, consistent with a jurisdiction's laws and regulations, starting with RMBS templates by 2014.

Recommendation 5: Disclosure to assist investors making informed investment decisions

Regulators should consider ways issuers may be required to provide investors at the point of sale and on an ongoing basis, consistent with a jurisdiction's disclosure framework, information necessary to make an informed investment decision.

Specifically investors should:

1. Receive from issuers essential information to assess a securitisation product's performance. At a minimum, average expected loss coverage for bullet or pass through securities and average expected life of the asset pool for pass through securities should be provided in all circumstances. Additional key indicators including information about risk/reward profile, fees and scenario analysis including structuring assumptions may also be provided. The information should be included in disclosure documentation that is made available to investors. It will be insufficient for this information to be provided only in marketing materials;
2. Be provided, at no cost, with modelling tools that enable investors to conduct cash flow analyses of a given securitisation transaction through its life;
3. Receive equal access to all documents and data relevant to assess creditworthiness of a given securitisation product that are provided to credit rating agencies, consistent with applicable privacy, confidentiality, and other laws.

III. Further Issues to be Considered

IOSCO has observed that the impact of the recommendations set out above risks being potentially undermined if a number of other issues are not addressed. IOSCO makes the following recommendations on each of these issues.

IOSCO first observes that it will be beneficial if the impact of the recent legislative and regulatory changes in securitisation (almost all of which have been in effect for less than two years) are given time to have their impact assessed before any further (and potentially duplicative) additional regulations are introduced. IOSCO also recommends the following:

Recommendation 6: Prudential Treatment of Securitisation Products

IOSCO urges prudential standards setters and regulators to assess differences in the capital weight and liquidity treatment between securitisation products and other types of structured or collateralised financing and assess whether those differences are justified on the basis of their respective risks.

Recommendation 7: Accounting Issues

In order to ensure that risk retention requirements do not penalise originators under the relevant accounting rules, IOSCO urges the FSB in the context of its Shadow Banking Work (Work Stream 1) and in conjunction with International Accounting Standards Board (**IASB**) and Financial Accounting Standards Board (**FASB**) to work toward further harmonisation of approaches to consolidation of securitisation SPVs.

Recommendation 8: Guidance on Cross-border regulation

IOSCO should develop guidance on possible measures[79] that could eliminate or reduce the potentially negative effects of differences in securitisation regulation and terminology on cross-border transactions.

Recommendation 9: Standardisation and Secondary Markets

IOSCO supports industry efforts to develop less complex and standardised products and encourages more liquid securitisation products at the national and international level.

Recommendation 10: Sound Mortgage Underwriting Practices

IOSCO considers that the FSB's Principles for sound residential mortgage underwriting practices have the potential to improve the stability of the housing market, which is an essential part of the securitisation chain of RMBS. IOSCO therefore encourages all jurisdictions to implement these principles at the national level.

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[79] Without prejudice to any future guidance developed by IOSCO, such measures should take into account any range of regulatory approaches that serve to achieve the same outcome, that outcome being mitigating the risk to investors, sound markets and financial stability.

Appendix One

Previous IOSCO and Joint Forum Work

Both IOSCO and the Joint Forum have undertaken work since 2009 intended to support sustainable growth of securitisation markets. This work informed the request from the FSB Standing Committee on Supervisory and Regulatory Cooperation

IOSCO issued a report prepared by TFUMP in September 2009 (*TFUMP's First Final Report*)[80] which made recommendations about improvements in regulatory oversight of securitisation markets for financial market regulators to consider and implement as appropriate with respect to securitization. The recommendations were intended to assist in restoring investor confidence and market quality. These recommendations included:

- Considering requiring originators and sponsors to retain a long term exposure to securitisations;
- Enhanced transparency by issuers about verification and risk assessment practices;
- Regulatory support for improved disclosure about underlying asset performance;
- Review of investor suitability requirements;
- Developing tools to assist investor understanding of complex financial instruments; and
- Assessing the scope of regulatory powers to promote international coordination.

During 2010, TFUMP conducted a survey about the implementation of these recommendations in member jurisdictions. It reported the results of that survey to the Technical Committee in a report published in March 2011.[81]

Its report showed that these jurisdictions had at least one, if not multiple, initiatives in progress to implement the recommendations on disclosure, the retention of long term exposure, investor suitability and international coordination and regulatory cooperation. Its report also recognized that work remained to be done to improve disclosure standards for private and wholesale offerings of securitized products as well as to improve international cooperation towards convergence of national regulations, where desirable. TFUMP made recommendations to regulators in these two areas.

In July 2011, the Joint Forum published a report on *Asset Securitisation Incentives*.[82] The report was based on industry interviews in a number of jurisdictions and a literature review. The report reviewed developments in securitisation markets and explored reasons why there had yet to be a meaningful recovery in activity. It outlined a number of recommendations to

80 IOSCO *Unregulated Financial Markets and Products* – Final Report, Report of the Technical Committee of IOSCO, September 2009; http://www.iosco.org/library/pubdocs/pdf/IOSCOPD301.pdf

81 IOSCO *Unregulated Financial Markets and Products* – Implementation Report, Report of the Technical Committee of IOSCO March 2011: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD348.pdf

82 Joint Forum, *Report on asset securitization incentives*, July 2011; http://www.bis.org/publ/joint26.pdf

authorities on the tools and approaches they can employ to promote a sustainable and responsible securitisation framework. These included:

- Employing a broad suite of tools to address misaligned incentives, which may include measures to improve loan origination standards, and to align compensation arrangements with long-term performance and asset quality;
- Encouraging market participants to improve transparency to ensure that investors, other market participants, and supervisors have access to relevant and reliable information; and
- Encouraging greater document standardisation and less product complexity, which should assist in reducing information asymmetries and stimulating liquidity in secondary securitisation markets.

The report noted differences in approach to risk retention requirements between the US and Europe and highlighted the importance of consistent and aligned approaches in developing a regulatory framework for these issues. The report also urged authorities to strive for consistency across global markets and sectors (taking into consideration local market circumstances, business models and legal systems). It also urged relevant authorities to resolve uncertainty as to the development and implementation of regulations and guidance in a timely manner.

Appendix Two

Details of work undertaken on the Project

Methodology

As noted, the project was based primarily on an analysis of a survey of (the then) Technical Committee and Emerging Markets Committee members in March 2012 (**Survey**).

The Survey was based on a questionnaire designed by TFUMP to build on the approach and areas covered by the EC/SEC Staff Analysis. The core of the questionnaire dealt with upfront and ongoing disclosure about securitisation products and risk retention in securitisation transactions. It also included a number of other questions designed to assist in better understanding the structure and operation of markets in other jurisdictions and so provide a basis for better understanding the materiality of any differences in regulatory approach and opportunities for harmonisation. High level feedback on covered bond regulation was also sought. A total of 19 jurisdictions (drawn from Europe, the Asia-Pacific, Africa, the Middle East and the Americas) responded to the Survey.[83]

The questionnaire sought information about both regulatory requirements and industry standards and practice. Respondent jurisdictions were asked to seek information from industry (both sell and buy side) to support these responses.

The questionnaire sought information on the following:

- **Industry Environment**

Questions sought information about Asset Backed Securitisation activity, regulation of issuers, methods of initial offering and secondary trading for Asset Backed Securities (**ABS**) products.

By seeking to delineate the scope and framework of the regulation of ABS transactions, the primary purpose of these questions was to better understand the applicable regulatory framework and the similarities and differences between jurisdictions.

Questions were also intended to provide context around securitisation markets in different jurisdictions to assist in identifying regulatory tools that may be available to harmonise any differences in regulatory approach.

- **Transparency and Standardisation of Disclosure**

These questions were about upfront and ongoing disclosure requirements and practices. They also sought information about regulation and industry practice on matters which would be the subject of disclosure (in particular underwriting standards and due diligence).

[83] List of respondents: 1 Australia ; 2 Brazil ; 3 Canada (Ontario/Quebec); 4 Dubai ; 5 Egypt ; 6 France; 7 Germany; 8 Hong Kong , 9 Japan ; 10 Lithuania ; 11 Mexico ; 12 Netherlands ; 13 Portugal ; 14 Romania; 15 Slovenia; 16 South Africa ; 17 Spain ; 18 Switzerland ; 19 UK.

In relation to initial disclosure, questions were intended to provide an overview and specific details about what information was provided to investors for ABS offerings. The underlying theme of questions was whether and how regulation in respondent jurisdictions contributes to investor understanding of certain key aspects such as investment objectives and risk of loss, and how this is done (whether by way of requirements to disclose up-to-date information, all material information and/or in standardised formats).

In relation to ongoing disclosure**,** questions were intended to provide an understanding of what information is provided:

- During the life of the product, in relation to underlying assets, and credit risk reporting; and

- To enable investors to monitor general underlying risks, any breach of triggers, the structure of cash flows and evolution of risks.

The questionnaire also sought information in relation to both initial and ongoing disclosure about controls and sanctions in relation to the accuracy of information provided. This was intended to assist in assessing the comparability of the framework supporting the disclosure requirements in a jurisdiction.

- **Risk Retention**

These questions sought information about whether and how risk retention requirements were imposed by regulation (and relevant industry practice).

- **Other Issues**

These questions were about other aspects of the regulation of securitisation markets. These questions complemented earlier questions that were more about the requirements relating to securitisation incentives and obligations imposed on issuers of securitisation products. Specifically, the following were asked:

- Questions about whether and how investors are regulated.

- Questions about information flows between CRAs and ABS issuers and whether there are significant differences in disclosure practices for rated offerings.

- Questions about post-trade transparency. These were intended to assist in understanding what requirements exist in relation to transparency for secondary trading in different markets and to assess the development of these markets.

- Questions about the treatment of cross border activity. This was intended to assist in better understanding both the level of cross border activity and the regulatory treatment of offshore issuers and investors.

- High level information about the regulation of covered bonds markets in respondent jurisdictions. These questions were intended to provide a basis for any further work that may be considered on the regulation of these markets.

Respondents to the Survey were encouraged to discuss the Survey with market participants and industry groups in their jurisdictions. Responses from some national industry associations were sought directly.

Analysis of Survey responses was supported by discussions with industry at a meeting in Paris in mid-April. Industry representatives from Europe and the US outlined current industry initiatives[84] to support recovery of securitisation markets in Europe and the US (particularly in relation to measures to improve the information investors receive). The European Central Bank also outlined the disclosure framework it has developed to assist it in assessing the risks posed by securitisation instruments lodged with it as collateral.

[84] Such as the Prime Collateral Securities (PCS). See Appendix Four.

Appendix Three

List of respondents

1. American Securitization Forum
2. AMUNDI Asset management
3. Association Française des Investisseurs Institutionnels
4. Association of Financial Guaranty Insurers
5. Australian Securitization Forum
6. AXA Investment Managers
7. Beleggersverenigin
8. Bundesverband Investment und Asset Management
9. Financial Services Board of South Africa
10. Global Financial Markets Association
11. Institute of International Finance
12. International Banking Federation
13. Japanese Bankers' Association
14. Morgij Analytics
15. Securitization Forum Japan
16. True Sales International GmbH (TSI)

Appendix Four

September 2012

Prime Collateralised Securities

PCS goals

PCS is an independent, not for profit, industry-led initiative that is aimed at revitalising the securitisation industry in Europe by establishing "market best practice" standards. The key goals are to:

- Signal to policymakers that the European securitisation industry has proactively addressed concerns over quality, transparency, simplicity/standardisation that are pre-conditions to enhanced secondary market liquidity
- Evidence to policymakers and investors that PCS labelled bonds are a high quality investment, so that over time (i) policymakers may consider a favourable regulatory and capital treatment for them, as already exists for certain other fixed income asset classes in Europe and (ii) investors who have exited the market will consider returning.

Background of PCS

- In 2011, the Association for Financial Markets in Europe (AFME) and the European Financial Services Round Table (EFR) organised a cross-industry technical working group as well as a senior advisory group for PCS.
- The senior advisory group consisted of members of senior financial management (CFOs, Treasurers and CIOs) at European financial institutions. Bishopsfield Capital Partners is the independent consultant. ECB, EIB Group and the Bank of England were observers in 2011. Other associations also monitored progress.
  Eligible asset classes for PCS are European residential mortgages, auto loans, SMEs and leasing, and consumer loans/credit cards.

Key features of the PCS organisation

- "Not-for-profit" economic model
- Upfront funding intended to provide for start-up investment, operating losses for the first two years and a working capital reserve and guarantee its independence.

High level PCS principles agreed by the working group

- Not a credit rating
- Grandfathering/ retrospective eligibility
- Standardised reporting and disclosure
- Dynamic over time to accommodate evolving markets but also to assist the markets to more standardization and ever higher quality standards
- Recognises existing market practices provided they are consistent with investor needs
- Cross referencing for public term securities market to existing or soon to be implemented initiatives (e.g. ECB/BoE transparency)

Progress update and next steps

- PCS was launched at Global ABS on Tuesday, 12 June at Global ABS in Brussels

- A press release and fact sheet were distributed, with a focus on the appointment of Ian Bell as the newly-appointed Head of the PCS Secretariat, as well as the release of many other details
- ECB President Draghi provided a very helpful and public supporting note, and European Banking Authority (EBA) chair Andrea Enria also provided helpful remarks
- The launch achieved significant coverage with the European and global press
- Mark Lewis has now joined PCS as Managing Director, Head of PCS Operations
- PCS now has its own corporate existence, including offices, bank accounts and email addresses
- First PCS labeled issue targeted for Q4 2012.
- Funders have invited a group of non-funding observers to the implementation meetings, including European investors, ECB, EIB Group, Bank of England and the European Commission.
- Eligibility criteria are all but finalized.

<u>Appendix Five</u>

Proposed exemptions from US Risk Retention requirements

Under section 15G of the *Securities Exchange Act of 1934, as amended* (the **Exchange Act**) the risk retention regulations will include the exemptions from risk retention requirements ABS collateralised solely by qualifying Commercial Real Estate (CRE) loans, commercial loans or auto loans, and for ABS backed by Qualified Residential Mortgages (QRMs) as those terms are to be defined by US Joint Agencies rule making. The US Joint Agencies have proposed a list of defining criteria for these asset types in terms of underwriting standards and product features[85] meant to ensure that such underlying assets are of very high credit quality.

A summary of some of the key details of current proposals for each of these asset classes are set out below.

QRM loans

It is proposed that a QRM will be a transaction to purchase or refinance a one-to-four family property that meets the following key criteria:

- A Loan to Valuation Ratio ('LVR') no greater than 70% or 80% (depending on whether it is a refinance or purchase) with the borrower meeting initial transaction costs and making a 20% down payment for a purchase, from its own funds;
- First mortgage, loan maturity does not exceed 30 years, no deferral of principal or interest payments, limitations on how much the interest rate applicable to the mortgage transaction may increase by and appropriate debt mitigation terms in the mortgage; and
- The borrower must meet certain debt-to-income ratios and satisfy credit checks.

Commercial Loans

The proposed qualifying criteria for exemption for a commercial loan, being a secured or unsecured loan to a company or individual for business purposes, as currently proposed include:

- A first lien security (if secured), covenants regarding ongoing provision of financial statements, limits on granting future security, limits on changing business structure, location or operations, no reinvestment periods, full amortisation on a straight line basis within 5 years; and
- The borrower's ability to service the debt must be assessed and certain ratios maintained. For instance, during the previous 2 years and for the 2 years following closing (based on projections) the borrower must maintain a debt service coverage ratio of 1.5 or greater, leverage ratio of 3.0 or less and total liability ratio of 50% or less.

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85 In terms of borrower credit history, payment terms, LTV, down payment, qualifying appraisal of valuation, ability to repay, points and fees payable by the borrower, etc.

CRE Loans

For a CRE loan qualifying criteria are currently proposed to include:

- Similar assessments to those noted above about a borrower's ability to repay debt;
- A debt service coverage ratio for the previous 2 years and for the 2 years following closing (based on projections) of 1.5 or greater or 1.7 or greater (depending on loan type and rental income) and a CLTV of less than 60% or 65%; and
- Similar covenants as for a commercial loan, but loan term can be up to 20 years and interest rate is fixed, or if variable, the borrower enters into a derivative to swap to fixed.

Automobile Loans

Automobile loans will be exempted under current proposals where a number of criteria, including the following, are met:

- The borrower meets certain credit assessment checks. For instance, the borrower must not have been subject to bankruptcy proceedings, foreclosure or repossession action within the previous three years;
- The borrower meets a debt to income ratios of 36% or less and pays, out of their own funds, all fees and taxes on the purchase, as well as 20% of the purchase price; and
- Maximum loan term of 5 years (new cars), fixed rate loans and no deferral of principal or interest.

The EU does not provide any comparable exemption for ABS whose underlying assets might be deemed to be of very high credit quality. The main exemption applying to the EU states, as outlined in the EC/SEC Staff Analysis and confirmed in Survey responses, is that the risk retention rules do not apply where CRD regulated entities invest in securitized products with exposures that are claims on, or are fully, unconditionally and irrevocably guaranteed by, the following entities:

- Central governments or central banks;
- Regional governments, local authorities and public sector entities;
- Institutions to which a 50% risk weight or less is assigned under CRD; or
- Multilateral development banks.

IOSCO believes that it is unlikely that these exemptions will have as wide an impact as those being considered in the US. Furthermore, unlike the US proposed rules the EU retention rules are also applicable to synthetic ABS structures.

In addition to exemptions for ABS backed by qualifying assets (see above), the US Joint Agencies can adopt or issue additional exemptions, to the risk retention requirements on certain conditions under section 15G(e)(1) of the Exchange Act. Rules for a foreign transaction safe harbour have been proposed with the intention to exclude from risk retention requirements “transactions in which the effects on U.S. interests are sufficiently remote so as not to significantly impact underwriting standards and risk management practices in the

United States or the interests of US investors". The EC/SEC Staff Analysis outlines a proposed safe harbour for foreign transactions whereby the proposed US risk retention requirements would not apply to a securitisation transaction if all of the following conditions are satisfied at the time of issuance of the ABS:

- the securities are not required to be and are not registered under the Securities Act of 1933;
- no more than 10% of the dollar value by proceeds (or equivalent if sold in a foreign currency) of all classes of ABS interests are sold to US persons or for the account or benefit of US persons;
- neither the sponsor nor the issuing entity is:
    - o organized under the laws of the US or a US state or territory (US jurisdiction),
    - o an unincorporated branch or office (wherever located) of an entity incorporated under the laws of a U.S. jurisdiction, or

  (i) is an unincorporated branch or office located in the US of an entity incorporated under the laws of a jurisdiction other than a US jurisdiction; and
- if the sponsor or issuing entity is incorporated under a non-US jurisdiction, no more than 25% of the assets were acquired by the sponsor, directly or indirectly, from:
    - o any consolidated affiliate of the sponsor or issuing entity that is incorporated under the laws of a US jurisdiction, or
    - o an unincorporated branch or office of the sponsor or issuing entity that is located in a US jurisdiction.

There is no similar 'safe harbour' in the EU for foreign ABS transactions. For instance under the CRD legislative and regulatory framework the EU retention requirements apply to all-EU regulated credit-institutions that invest in any ABS transactions, regardless of the location or nationality of the originator, sponsor or underlying assets. This reflects the principle applied in the EU that the investor (bank or other credit-institution[86], asset manager or insurance company) effectively has the responsibility to check that an issuer retains the relevant interest, whereas the US has applied the principle that risk retention should generally apply to all sponsors regardless of what type of investor decides to invest in the securitisation.

[86] Similar retention requirements are being developed in the EU for investors in other sectors. AIFM and Solvency 2 have provided similar requirements and are awaiting technical rule making. AIFM imposes requirements on alternative investment and collective investment managers, Solvency 2 on insurers.

Appendix Six

Working Group Members

Australian Securities and Investments Commission (ASIC), Australia

Authority for the Financial Markets (AFM), The Netherlands

Autorité des marchés financiers (AMF), France

Autorité des marchés financiers (AMF), Quebec

Basel Committee on Banking Supervision (BCBS)

Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Germany

Comisión Nacional Bancaria y de Valores (CNBV), Mexico

Comisión Nacional del Mercado de Valores (CNMV), Spain

Comissão de Valores Mobiliários (CVM), Brazil

Commissione Nazionale per le Società e la Borsa (CONSOB), Italy

European Commission, Europe

Financial Services Agency (FSA), Japan

Financial Services Authority (FSA), United Kingdom

Financial Services Board (FSB), South Africa

Ontario Securities Commission (OSC), Ontario

Securities and Exchange Commission (SEC), United States

IOSCO General Secretariat