

**Peer Review of Implementation of Incentive  
Alignment Recommendations for Securitisation:  
Final Report**



**OICJ-IOSCO**

**THE BOARD  
OF THE  
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## 1. Executive Summary

This Report sets out the findings of an IOSCO Assessment Committee (AC) review (**Review**) of the implementation of IOSCO's recommendations in respect of incentive alignment in securitisation (**Incentive Alignment Recommendations**). The Incentive Alignment Recommendations were published in November 2012, along with other IOSCO recommendations relating to securitisation.

The Incentive Alignment Recommendations call for national authorities to:

- Evaluate incentives across the securitisation value chain, formulate and implement approaches to incentive alignment (Recommendation 1);
- Set out the elements of the incentive alignment approach, including risk retention (Recommendation 2); and
- Seek to minimise the potentially adverse effects to cross-border securitisation transactions resulting from differences in approaches to incentive alignment and risk retention (Recommendation 3). Measures in respect of this recommendation are not being formally reported as part of the Review.

### *Background*

The Review was an Adoption Monitoring Review, or Level 1 Review. It measured progress in implementation only and did not consider the consistency of adoption measures with the underlying Incentive Alignment Recommendations.

Implementation progress is reported in this Report as at 30 April 2015 (**Reporting Date**).

The Review reports progress only in relation to implementation of Recommendations 1 and 2. A review of implementation of Recommendation 3 is seen at this stage to be premature. This is because many jurisdictions are still in the process of implementing requirements, or are yet to commence doing so. An assessment of efforts to minimise cross border impacts would be more meaningful once requirements have been fully implemented.

25 jurisdictions participated in the Review, 24 of which are Financial Stability Board member jurisdictions.

### *Key Findings*

The Review finds that there has been significant but mixed progress in implementing the Incentive Alignment Recommendations.

Of the respondents, five<sup>1</sup> reported having completed implementation of all measures to implement Incentive Alignment Recommendations covered by this Report (**Adoption Measures**)<sup>2</sup> in respect of the whole securitisation market.

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<sup>1</sup> China, India, Indonesia, Japan and Turkey

<sup>2</sup> The recommendations covered are Recommendations 1 and 2. Adoption measures comprise a number of actions. They include: the assessment by jurisdictions of the nature of the incentives of issuers and investors in the securitisation value chain; the development of approaches to align incentives in the securitisation market; and the implementation of these approaches to align incentives.

In 11<sup>3</sup> jurisdictions, steps had been taken to implement all Adoption Measures, but those steps were either not yet complete or were not yet fully in force across the whole securitisation market.

In two jurisdictions, draft or final Adoption Measures had been published but did not apply to at least one part of the securitisation market.<sup>4</sup> In one jurisdiction,<sup>5</sup> measures reported as implementing Incentive Alignment Recommendations were not regarded as incentive alignment measures.

In six<sup>6</sup> jurisdictions, draft Adoption Measures had not been published in relation to any Incentive Alignment Recommendation covered by this Report.

European Union (EU) jurisdictions and the United States were generally further progressed in their implementation than many jurisdictions with smaller securitisation markets.

This Report also makes some general observations about the approaches taken by jurisdictions in implementing incentive alignment Adoption Measures. These include:

- The different approaches being taken in jurisdictions which impose requirements directly on issuers ('direct approach') and those which apply the requirements on investors ('indirect approach');
- The reliance by some jurisdictions on a disclosure-based approach to incentive alignment. The Review foreshadows that the consistency of this approach with Recommendation 2 will need to be considered further in any future Implementation Assessment, or 'Level 2', review;
- The limited use of tools to address cross border impacts such as equivalence or substituted compliance in regimes that have been implemented so far;
- While regimes in many jurisdictions have no exemptions to incentive alignment requirements, in others there are a wide variety of exemptions.

#### *Further Monitoring*

The IOSCO Board has accepted the following recommendation from the Review Team on further monitoring:

- A further **Adoption Monitoring Review** — comprising only jurisdictions that had not fully implemented measures at the time of this Review— should be undertaken in 2016; and
- An **Implementation Assessment**, or Level 2 Review, should be undertaken no earlier than mid-2016.

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<sup>3</sup> Argentina, Brazil, France, Germany, Ireland, Italy, Netherlands, Russia, Spain, United Kingdom and the United States

<sup>4</sup> Australia and Mexico

<sup>5</sup> Canada

<sup>6</sup> Hong Kong, Korea, Saudi Arabia, Singapore, South Africa and Switzerland

## 2. Introduction

### 2.1 About Securitisation

Securitisation is a process in which certain types of assets are pooled so that they can be repackaged into interest-bearing securities. The interest and principal payments from these assets are passed through to the purchasers of the securities.

In its most basic form, the process involves two steps. In step one, a company with loans or other income-producing assets — the originator — identifies the assets it wants to remove from its balance sheet and pools these assets. It then sells this asset pool to an issuer, such as a special purpose vehicle, which is an entity set up, usually by a financial institution, specifically to purchase the assets and realise off-balance-sheet treatment for legal and accounting purposes. In certain cases, originators sell, and issuers acquire, securitisation assets on the secondary market.

In step two, the issuer finances the acquisition of the pooled assets by issuing tradable, interest-bearing securities that are sold to capital market investors. These investors receive fixed or floating rate payments from a trustee account funded by the cash flows generated by the asset pool.

Securitisation received widespread attention during and after the financial crisis. In particular, there was concern that, where originators did not retain an interest in the asset pool, the so-called 'originate to distribute' model, they did not have sufficient incentive to ensure that lending standards, and by extension the asset pool, were of appropriate quality.

### 2.2 Incentive Alignment Measures

In July 2011, the Financial Stability Board (**FSB**) through its Standing Committee on Supervisory and Regulatory Co-operation requested that IOSCO, in coordination with the Basel Committee on Banking Supervision, conduct a stock-taking exercise to review current national and international regulatory initiatives on risk retention, transparency and standardisation of securitisation, and develop policy recommendations as necessary.

In response to this request, IOSCO, through its Taskforce on Unregulated Markets and Products (**TFUMP**), undertook a project to describe and analyse global regulatory and industry initiatives on risk retention, transparency and disclosure standardisation, and develop a series of recommendations. This work was driven, in part, by concerns about the extent of progress in addressing incentive alignment issues and, where progress had been made, by inconsistencies in approach.

The project involved a survey of IOSCO members, a public consultation paper and an industry roundtable. The Final Report (*Global Developments in Securitisation Regulation*) (**Final Report**) was published by IOSCO in November 2012 and, as requested, made a number of recommendations regarding risk retention, transparency and standardisation, and also in relation to further issues for consideration.

A summary of the Final Report's three incentive alignment recommendations (**Incentive Alignment Recommendations**) is set out below.

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

Jurisdictions should evaluate and formulate approaches to aligning the 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.

All jurisdictions 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*

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:

- 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);
- Permitted forms of risk retention requirements (e.g. vertical, horizontal, etc.); and
- Exceptions or exemptions from the risk retention requirements. (These exemptions should be consistent with the objectives of incentive alignment.)

All jurisdictions should ensure that domestic legislation, regulation and policy guidance require disclosure of the method chosen for compliance with the incentive alignment approach.

*Recommendation 3: Harmonised Alignment of Incentive and Risk Retention Approaches*

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

In addition, Recommendation 3 provided that the IOSCO AC will:

- Conduct a peer review to assess implementation of incentive alignment approaches, including risk retention requirements in line with Recommendation 2 of the Final Report and the three elements that it sets out; and
- Make recommendations to address any difference in approach that may cause material adverse effects to cross-border transactions and to ensure convergence and harmonisation and monitor implementation of the Recommendations.

## **2.3 Reasons for the Thematic Review**

A Thematic Review of the implementation of the Incentive Alignment Recommendations was undertaken to:

- Take forward Recommendation 3 of the Final Report;
- Identify the adoption measure (**Adoption Measures**)<sup>7</sup> that have been taken or planned, across jurisdictions, to adopt the Incentive Alignment Recommendations; and
- Identify any differences in the Adoption Measures that have been taken, with commentary on whether these differences warrant further policy consideration and implementation monitoring.

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<sup>7</sup> Adoption measures comprise a number of actions. They include: the assessment by jurisdictions of the nature of the incentives of issuers and investors in the securitisation value chain; the development of approaches to align incentives in the securitisation market; and the implementation of these approaches to align incentives.

Furthermore, in September 2013, the G20 Leaders in St Petersburg called for IOSCO to launch a peer review on the implementation of incentive alignment regimes (including risk retention requirements) and report its progress to the G20 in late 2014.<sup>8</sup>

In May 2014, Terms of Reference for this Review were circulated to the IOSCO Board and shared with the FSB Secretariat and the FSB Standing Committee on Standards Implementation.

The FSB noted the project in its Forward Work Plan. Preliminary results based on jurisdictions' self-assessments of implementation progress in respect of the first Incentive Alignment Recommendation were provided to the G20 Leaders, via the FSB, in the lead up to the Brisbane Leaders Summit in November 2014.

This Report describes how the Review was conducted, and sets out the Review Findings.

## **2.4 Methodology**

### **Nature of the Review and Objectives**

The objectives of this Review were to:

- Describe the Adoption Measures that have been taken, or are proposed to be taken, in line with the Incentive Alignment Recommendations;
- Chart the relative status of jurisdictions' progress in implementing the Adoption Measures against an agreed scale; and
- Explain how participating jurisdictions are implementing, or propose to implement, the Incentive Alignment Recommendations.

The Review was not a review of the consistency of the Adoption Measures taken against the Incentive Alignment Recommendations. Rather, it reviewed the status and timeliness of incentive alignment approaches implementing the Incentive Alignment Recommendations. This is referred to as an Adoption Monitoring or 'Level 1' Review, as opposed to an Implementation Assessment or 'Level 2' Review, which does assess consistency.

### **Review Team**

The Review was conducted by a Review Team that was chaired by Steven Bardy of ASIC and included Adam Coleman, also of ASIC, Gregory Frigo of the AFM Netherlands, José Manuel Portero Bujalance of CNMV Spain, Ana Duarte of the UK FCA, Elmarie Hamman (replacing Marius De Jong) of the FSB South Africa and Ken Nishimura of the JFSA. The Review Team was assisted by Raluca Tircoci-Craciu of the IOSCO Secretariat.

### **Jurisdictions Participating in the Review**

All IOSCO Members from FSB jurisdictions and IOSCO members from non-FSB jurisdictions with a significant securitisation sector were asked to participate in the Review. Other IOSCO Members were given the opportunity to participate in the Review.

In the absence of globally comparable data on the size of securitisation markets and activity at a national level, the Review Team agreed that a proxy for jurisdictions with a significant securitisation

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<sup>8</sup> See *G20 Roadmap Towards Strengthened Oversight and Regulation of Shadow Banking* (September 2013) <http://en.g20russia.ru/load/782788663>.



sector would be those jurisdictions which had actively participated in recent IOSCO policy work on securitisation (through TFUMP).

A list of jurisdictions invited to participate in the Review is contained in Appendix B to this Report.

24 IOSCO members<sup>9</sup> (including 23 members from FSB jurisdictions) submitted self assessments. Switzerland did not submit a self assessment on the basis it did not have an active domestic securitisation market. Swiss authorities did, however, contribute to and comment on the content of this Report, including on the status of implementation of Adoption Measures.

## Review Process

The Review was undertaken as a desk-based exercise based on responses provided by participating jurisdictions to a questionnaire designed and developed by the Review Team (**Questionnaire**). The Questionnaire was circulated on 14 August 2014, with initial responses due on 15 September 2014. The Questionnaire asked respondents to self-assess their adoption progress in implementing the Incentive Alignment Recommendations and provide supporting information.

In 2014, the Review Team agreed to produce two reports, one a high level summary for the FSB for inclusion in its report to the G20 (**FSB Interim Report**), and a separate, more detailed report of the key findings to the G20 (**G20 Interim Report**). On 4 November 2014, the approved FSB Interim Report was sent to the FSB. On 13 and 16 November 2014, the approved G20 Interim Report was published on the G20 and IOSCO<sup>10</sup> websites.

The FSB and G20 Interim Reports were based on the respondents' self-assessments only, that is, they were not subject to verification and challenge.

## Preparation of this Report

After the Interim Reports were presented to FSB and G20, the Review Team discussed and agreed on its approach to how adoption progress would be reported in this Review. It was agreed that the Review would report the progress of implementation of five elements of Incentive Alignment Recommendations 1 and 2. These were:

- The evaluation of the incentives of issuers and investors across the securitisation value chain;
- The formulation of approaches to incentive alignment;
- The implementation of the incentive alignment approach;
- The setting out of the incentive alignment approach in publicly available legislation, regulation or policy guidance; and
- Requiring that the method used to comply with the incentive alignment approach be disclosed.

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<sup>9</sup> Autorité des marchés financiers (France), Central Bank of Ireland, China Securities Regulatory Commission, Japan Financial Services Agency, Republic of Korea Financial Services Commission/Financial Supervisory Service, Mexico Comisión Nacional Bancaria y de Valores, Commissione Nazionale per le Società e la Borsa (Italy), USA Securities and Exchange Commission, Brazil Comissão de Valores Mobiliários, Securities and Exchange Board of India, Canada (Ontario Securities Commission and Quebec Autorité des marchés financiers), South Africa Financial Services Board, Australian Securities and Investments Commission, Germany Federal Financial Supervisory Authority, Hong Kong Securities and Futures Commission, Netherlands Authority for the Financial Markets, Central Bank of Russia, Saudi Arabia Capital Market Authority, Monetary Authority of Singapore, Spain Comisión Nacional del Mercado de Valores, Capital Markets Board of Turkey, UK Financial Conduct Authority, Comisión Nacional de Valores Argentina, and Otoritas Jasa Keuangan (Indonesia).

<sup>10</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD464.pdf>

It was also agreed that the Review would report progress in implementation as at 30 April 2015.

The Questionnaire also sought information from respondents about how they had sought to minimise adverse cross-border impacts in implementing incentive alignment requirements in line with Incentive Alignment Recommendation 3. However, the Review Team found that it was difficult to meaningfully report on how cross border impacts were being addressed, given the different stage jurisdictions were at in terms of implementation, with most jurisdictions still in the process of finalising requirements. As such, this Review has not rated the implementation of Adoption Measures in respect of this Incentive Alignment Recommendation.

It is anticipated that the implementation of Adoption Measures in respect of this Incentive Alignment Recommendation will be rated in any follow-up Implementation Assessment Review of incentive alignment.

### **Reporting Scale**

This Report tracks adoption of the Incentive Alignment Recommendations based on the following scale:

1. *Final Adoption Measures taken and, where relevant, in force;*
2. *Final Adoption Measures published but not taken or in force;*
3. *Draft Adoption Measures published;*
4. *Draft Adoption Measures not published; and*
5. *Not applicable.*

While the wording of the elements of the reporting scale in the Final Report is the same as that used in the original Questionnaire and in the Interim Reports to the G20 and FSB, the Review Team made some changes to how the scale was interpreted for the purposes of this Report. There were two key changes.

The first related to the *Not applicable* rating. This was originally intended to be used where a particular Adoption Measure was not needed because equivalent measures had been in place prior to the release of the Incentive Alignment Recommendations in November 2012. However, the Review Team decided that it would be more straightforward and useful to track adoption based on the current status of Adoption Measures. That is, where an Adoption Measure had been taken before November 2012, it was to be rated as *Final adoption measures taken and, where relevant, in force*.

Second, in their Questionnaire responses, a number of jurisdictions self-assessed particular Adoption Measures as *Not applicable*, not because they had equivalent measures in place before November 2012, but because they argued that the Adoption Measure was not relevant to their market. In response to this, the Review Team decided that it would consider accepting this where a respondent could convincingly make a case that an Adoption Measure was not relevant to their jurisdiction, essentially creating a new, different *Not applicable* rating.

Importantly, where Adoption Measures were being implemented sector-by-sector, or where requirements applied only to specific sectors — such as banks — the headline summary rating in Table 1 of this Report has been applied to the least advanced sector. These cases have been distinguished in the summary table with a triangle. Appendix A sets out in detail the implementation status among different sectors of each jurisdiction.

It should also be noted that the status *Draft adoption measures not published* was applied to the following situations:

- Where no action to implement incentive alignment had been taken or was being considered;
- Where measures were being considered but had not been published; and
- Where purported adoption measures had been published but were clearly not related to incentive alignment (as discussed in more detail under Challenging Self-assessments below).

### **Challenging Self-assessments**

The Review Team limited its challenges to respondents' self-assessments to the following situations:

- Where the rating scale had been misapplied, such as where respondents claimed particular Adoption Measures were *Not applicable* to their jurisdiction when that was not the case;
- Where the basis for the claimed adoption status was not clear;
- Where purported Adoption Measures were clearly not related to the Incentive Alignment Recommendations; and
- In order to apply the relevant rating (as mentioned above) to the least advanced market segment.

In all cases, respondents were provided with a copy of this Report in draft and given an opportunity to comment on the Review Team's ratings.

### **Rating Disclosure under Recommendation 2**

Incentive Alignment Recommendation 2, among other things, calls for jurisdictions to ensure that domestic legislation, regulation and policy guidance require that the method chosen for compliance with the incentive alignment approach be disclosed. As noted, this disclosure requirement was separately rated as part of this Review.

However, because of the nature of Recommendation 2 in respect of disclosure — which requires that the method chosen for compliance with the incentive alignment requirement be disclosed — respondents that had not implemented or proposed mandatory incentive alignment requirements were not reported as having or proposing disclosure requirements for the purpose of Recommendation 2. That is, merely requiring that information about incentive alignment mechanisms be disclosed, when such mechanisms were not required, does not constitute an Adoption Measure in relation to disclosure under Recommendation 2.

Because of this, jurisdictions which used disclosure-based models of incentive alignment were rated *Draft adoption measures not published* for this element.

### **Updates to Questionnaire Responses**

Prior to the completion of the Review, respondents were given the opportunity to update their Questionnaire submissions based on any further implementation progress up to 30 April 2015. In addition to this, in most cases the Review Team sought additional information to clarify or verify aspects of the Questionnaire responses.

It should be noted that the findings of the Review are based on information provided by IOSCO members in the respondent jurisdictions, in some cases with the assistance of other agencies, such as the European Commission (in the case of the EU), as well as central banks and other prudential

regulators. The information provided included copies of relevant legislation, regulations or guidance. Where necessary, the Review Team sought to verify and clarify the representations made by the respondents. In some cases, this included challenging and revising the respondents' self-assessments. However, the Review Team did not seek independent confirmation of the implementation of Adoption Measures from third parties.

### **Data about Activity in Participating Jurisdictions**

The Review Team collected data about the level of recent securitisation activity from participating jurisdictions. Most — but not all — participants responded. Where they did, the responses provided data for different periods and reported issuance level.

In deciding how to report jurisdiction-specific data and to ensure as much consistency as possible, the Review Team decided to report data collected by AFME covering Europe, the US and Australia supplemented by data reported by individual jurisdictions. Issuance in 2014 and outstanding balances in participating jurisdictions at the end of 2014 are reported in Table 1 below.

Complete data could not be sourced for Hong Kong, Korea, Russia, Saudi Arabia, South Africa and Switzerland.

## **3. Key Findings**

### **3.1 Market Size and Characteristics<sup>11</sup>**

#### **Global trends<sup>12</sup>**

The global issuance of securitised products experienced a spectacular rise from 2000 to 2006 reaching a peak of \$2.7 trillion. It then sharply dropped to \$475 billion in 2008. From 2009 to 2014, the issuance level has remained flat with securitised products issued to the end of 2014 equal to \$752 billion (Fig. 1).

The global issuance of collateralised debt obligations (**CDOs**) went from \$44 billion in 2000 to \$176 billion in 2006. Post-crisis, issuances had fallen to \$8 billion in 2010. Recent years have seen a significant recovery to \$102 billion in 2014 but still well below pre-crisis levels.

The mortgage backed securities (**MBS**) market showed the most impressive growth before the crisis, reaching \$1.5 trillion in 2006. It lost more than 80% of its value in 2007-2008 (\$247 billion issued in 2008) with issuance recovering to \$433 billion in 2014.

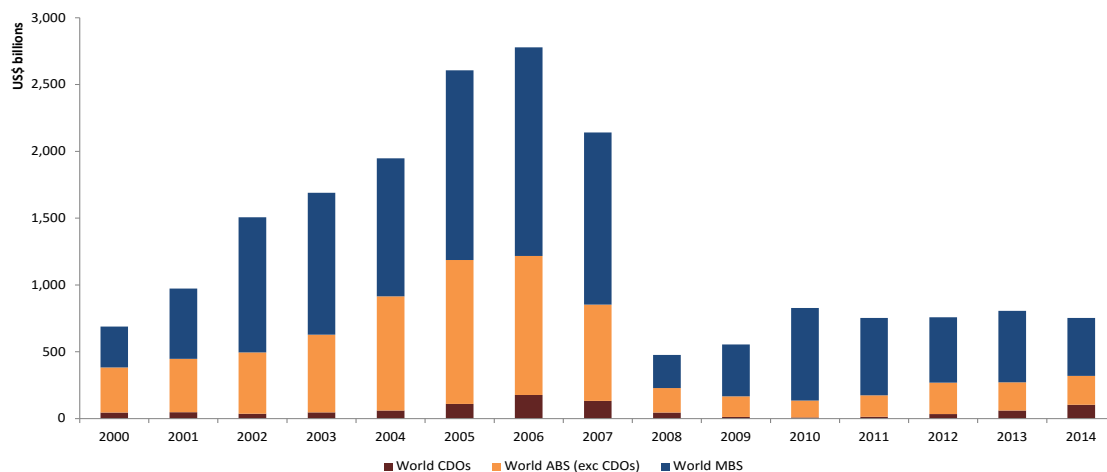
Asset backed securities (**ABS**) issuances have followed the same trend as the other securitised products, peaking in 2006 at \$1 trillion and then falling to \$125 billion in 2010. ABS issuances recovered to \$216 billion in 2014, well below the initial level of \$337 billion in 2000.

*Fig. 1: Total value of securitised product issuance (US\$ billion)*

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<sup>11</sup> The Review Team was unable to identify a single data source which provided a single consistent time series of securitisation activity across all participating jurisdictions. The IOSCO Research Department prepared a report in March 2015 based on data accessed through Dealogic. The report described trends in CDO, MBS and ABS activity globally and in regions. This report was used as the basis for the high level description of trends in this section. An alternative source of data identified by the Review Team is information reported on a quarterly basis by the Association of Financial Markets in Europe (AFME) AFME about securitization activity in the US, Europe and Australia. This data is drawn from a broader range of data sources, includes a broader range of securitisation instruments than the IOSCO Research Department report and provides a basis for jurisdictional comparability. This AFME data, supplemented by data provided by participating jurisdictions, was used as the basis for descriptions of market share referred to in Table 1 in Section 3.2 below.

<sup>12</sup> This analysis is based on analysis of Dealogic data provided by the IOSCO Secretariat.



Source: IOSCO analysis of Dealogic data

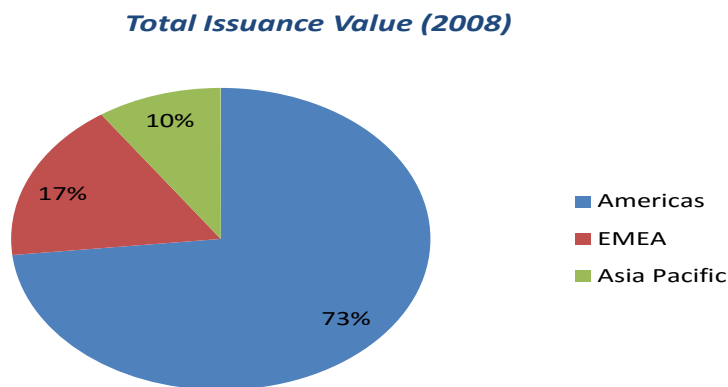
### Regional Trends<sup>13</sup>

Significant changes have been evident in regional shares of global securitisation activity since the crisis.

In 2000, the Americas accounted for almost 80% of the worldwide market, with EMEA accounting for 14% and Asia Pacific 7%.

In 2006-2007 the Americas' proportion of the market decreased to 73%, while EMEA and Asia Pacific increased, respectively, to 17% and 10%. At the end of 2014, the Americas accounted for 71% of total global issuances, EMEA 12% and Asia Pacific 17%.

Fig. 2: Securitisation market by region % (2008)

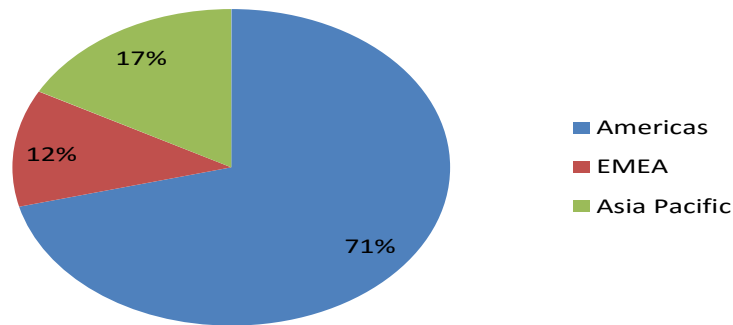


Source: IOSCO elaboration on Dealogic data

Fig. 3: Securitisation market by region % (2014)

<sup>13</sup> Ibid

### Total Issuances Value (2014)



Source: IOSCO analysis of Dealogic data

### Trends by product and region<sup>14</sup>

In EMEA, after a sharp decrease in total issuances at the onset of the financial crisis (from \$544 billion in 2006 to \$26 billion in 2009, that is, a fall of 95%) the deal value of securitised products stabilised at an average annual level of \$89 billion from 2010 to 2014, totaling about \$90 billion of issuance at the end of 2014.

In EMEA, ABS<sup>15</sup> issuance reached its maximum amount of \$111 billion in 2006. In 2009, there was a severe contraction of 88%, ending that year at a level of \$13 billion. After four years of a flat market (annual average of \$31 billion for 2010-2013) issuances rose in 2014, to \$37 billion. Meanwhile, the MBS market in EMEA saw \$54 billion issued in 2000. This peaked at \$376 billion in 2006 and then sharply slipped to \$9 billion at the end of 2009. It is only in the last few years that some signs of recovery have emerged, with \$39 billion issued in 2014. Meanwhile, the CDO market in EMEA went from \$7.7 billion issued in 2000 to \$56 billion issued in 2006 (a rise of 630%). This steadily shrank to \$1.8 billion in 2012 and rebounded to \$12.6 billion in 2014, a value far below the annual average issuances in the pre-crisis years.

### Americas

In the Americas, the total amount of securitised products issued (ABS, MBS and CDOs) climbed from \$543 billion in 2000 to \$2.1 trillion in 2006 (a rise of 292%). In the following three years (2007-2009) the annual issuances plunged progressively toward its lowest level of \$469 billion. In 2014 issuances accounted for \$534 billion, about the same level as in 2000.

In term of market composition, the MBS sector is the most important, with \$342 billion issued in 2014, compared to \$151 billion of ABS and \$48 billion of CDOs issued in the same year. The ABS market has experienced the most severe contraction during the aftermath of the financial crisis: it started in 2000 with a level of \$284 billion and peaked at \$915 billion in 2006. It has slipped to \$151 billion in 2014, well below the value in 2000 and more than 83% below the peak of 2006.

The MBS market has been steady in recent years (2008-2014) with the average annual level of issuances equal to \$387 billion, higher than the value in 2000 of \$237 billion, but far behind the exceptional peak reached in 2005-2006, which was \$1.1 trillion. CDO issuances represent the smallest sector of the securitisation market and they totaled only \$21 billion in 2000, which represented 4% of

<sup>14</sup> Ibid

<sup>15</sup> ABS excluding CDOs.

securitisation in the Americas. It experienced the same upward trend to 2006, with a jump to \$109 billion, then tumbled to \$40 billion by 2014.

### Asia Pacific

Asia Pacific has seen growth in the issuances of securitised financial products in recent years. From 2000 to 2006 the value of issuances increased by 120% (from \$46 to \$102 billion), then after a steep downturn to \$45 billion in 2008, it regained strength and totaled \$128 billion in 2014.

While in other regions many markets generally ended the year 2014 at lower levels of issuance than in 2000, all three segments in the Asia Pacific region — ABS, CDOs and MBS — showed a trend which in many cases outpaced even the level reached during the pre-crisis boom. The ABS issuance in 2014 was \$27 billion, higher than the boom level (\$19 billion in 2006) and the initial level (\$16 billion in 2000).

The MBS market recorded its maximum issuance in 2006 (\$78 billion) and has only slightly slowed since, with an annual average of MBS issuance of \$56 billion for the last three years. The Asia Pacific CDO market, by contrast, has shown a flat performance, with an average annual issuance of \$6.7 billion across the period from 2000-2014. In 2014 the value of issuances increased to nearly \$50 billion. This jump was mainly caused by a strong rise in issuance in China.

## 3.2 Thematic Overview of status of Adoption Measures

Overall, there had been significant, but mixed, progress in implementing Adoption Measures in respect of the Incentive Alignment Recommendations. In total, as of the reporting date of 30 April 2015:

- Five (5) jurisdictions<sup>16</sup> reported having taken all the Adoption Measures tested in this Review;
- Eleven (11) jurisdictions<sup>17</sup> had taken steps to implement all Adoption Measures, but those steps were either not yet complete or were not yet fully in force across the whole securitisation market;
- Two<sup>18</sup> (2) jurisdictions had published draft or final Adoption Measures but in at least one part of the securitisation market had taken no steps to implement Adoption Measures. One jurisdiction<sup>19</sup> reported measures implementing Incentive Alignment Recommendations, which were not regarded as incentive alignment measures; and
- Six (6)<sup>20</sup> jurisdictions had yet to publish draft Adoption Measures in relation to **any** Incentive Alignment Recommendation covered by this Report.

Of the 11 jurisdictions that had taken steps to implement the Incentive Alignment Recommendations, but had not yet completed the process of implementation:

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<sup>16</sup> China, India, Indonesia, Japan and Turkey. Note the Chinese requirements do not mandate risk retention. Under the Japanese regime, financial institutions are incentivised to invest in risk-retained products by additional deeper due diligence requirements otherwise imposed.

<sup>17</sup> Argentina, Brazil, France, Germany, Ireland, Italy, Netherlands, Russia, Spain, United Kingdom and the United States. Note: Argentina and Brazil have implemented incentive alignments models based significantly on disclosure, without mandating risk retention.

<sup>18</sup> Australia and Mexico

<sup>19</sup> Canada

<sup>20</sup> Hong Kong, Korea, Saudi Arabia, Singapore, South Africa and Switzerland.

- Seven were European Union jurisdictions, where incentive alignment was being implemented sector-by-sector, with not all sectors yet covered. This is discussed in more detail below;
- Argentina, Brazil and Russia had not implemented a requirement to disclose how the incentive alignment requirements are met by each transaction; and
- In the United States, all Adoption Measures had been taken but they were yet to come into force.

Table 1, below, shows implementation progress as of 30 April 2015.

The table reports implementation progress, based on the reporting scale described in Section 2.4. Each column shows the Review Team's review of the progress of implementation of Adoption Measures in respect of an element of the Incentive Alignment Recommendations. From left to right in the table, these are:

- Evaluation of the incentives of securitisers and investors through the securitisation value chain (Section A Question 1(i) of the Questionnaire);
- Formulation of approaches to align the incentives of investors and securitisers through the securitisation value chain (Section A Question 2(i) of the Questionnaire);
- The overall status of implementation of incentive alignment Adoption Measures (Section A Question 3(i) of the Questionnaire);
- The setting out of the incentive alignment requirements in publicly available legislation or regulation (Section B Question 1(ii) in the Questionnaire); and
- Implementing a requirement that issuers disclose how each securitisation transaction meets the incentive alignment requirements adopted (Section B Question 4(i) of the Questionnaire).

Again, where the Table below includes a triangle shape within a box, this denotes where the jurisdiction's implementation of that Adoption Measure was further progressed in at least one market segment when compared to the headline rating, which is based on the least progressed sector.

This particular reporting approach affected the headline reporting of implementation for jurisdictions within the EU. While incentive alignment requirements for banks (or, credit institutions and investment firms, as described in EU legislation) and alternative investment fund managers (**AIFMs**) had been implemented, an EU delegated regulation in respect of undertakings for the collective investment in transferable securities (**UCITS**) was still expected. However, in Germany, UCITS were already subject to incentive alignment requirements based on national legislation. Insurance undertakings will become subject to incentive alignment requirements from 1 January 2016 under EU legislation (Solvency II).

Likewise, draft adoption measures published in Australia will apply only to Australian authorised deposit taking institutions (**ADIs**), which include banks, credit unions and building societies. Non-ADI issuers will not be covered by the proposals. Mexico's requirements also apply only to bank investors in securitisations.

Detailed reporting of implementation by sector is in Appendix A to this Report.



Table 1 also provides an estimate of the share of each jurisdiction in securitisation activity of all jurisdictions participating in this review in 2014 and an estimate of the share of each jurisdiction of all balances outstanding in jurisdictions participating in this review at the end of 2014.<sup>21</sup>

*Table 1: Summary Dashboard of Implementation by Jurisdiction<sup>22</sup>*

	% of Securitisation Issuance in 2014 by jurisdictions participating in this review <sup>23</sup>	% of balances outstanding end 2014 in all jurisdictions participating in this review <sup>24</sup>	Evaluation of incentives across securitisation value chain	Formulation of approaches to incentive alignment	Implementation of incentive alignment regime	Setting out regime requirements	Disclosing regime requirements
Argentina	0.26%	No Information Provided					
Australia	1.58%	0.64%	Δ	Δ	Δ	Δ	
Brazil	0.72% <sup>25</sup>	0.34% <sup>26</sup>					
Canada	2.60%	0.67%					
China	0.28%	0.06%					
France	3.62%	0.78%			Δ	Δ	Δ
Germany	1.31%	0.77%			Δ	Δ	Δ
Hong Kong	0.00%	0.00%					
India	0.61% <sup>27</sup>	0.18%					
Indonesia	0.01%	0.00%					
Ireland	0.15%	0.39%			Δ	Δ	Δ
Italy	1.38%	1.73%			Δ	Δ	Δ
Japan	1.27%	1.23% <sup>28</sup>					
Korea	2.19%	No Information					

<sup>21</sup> A description of the data sources is in footnote 24.

<sup>22</sup> 'No Information Provided' in this Table means the public data sources used to determine jurisdictional share did not report data for the relevant jurisdiction **and** the jurisdiction was either unable or did not provide relevant data.

<sup>23</sup> Data for European jurisdictions, the US and Australia extracted from *AFME Securitisation Data Report, 4<sup>th</sup> Quarter 2014*, published March 31, 2015 applying exchange rate on December 31, 2014. Data for other jurisdictions provided by authorities covering periods and dates identified in the Table. AFME data reported for jurisdictions based on the location of collateral. Other data reported on the basis of issuances within the jurisdiction. Note commentary in Footnote 12 on differences between the data used to populate this Table and the data used to describe market trends and developments.

<sup>24</sup> Ibid.

<sup>25</sup> Data reported by Brazilian authorities for period May to December 2014.

<sup>26</sup> Data reported by Brazilian authorities as at February 2015.

<sup>27</sup> Data reported by Indian authorities for period April to December 2014.

<sup>28</sup> Data reported by Japanese authorities as at March 2015.

	% of Securitisation Issuance in 2014 by jurisdictions participating in this review <sup>23</sup>	% of balances outstanding end 2014 in all jurisdictions participating in this review <sup>24</sup>	Evaluation of incentives across securitisation value chain	Formulation of approaches to incentive alignment	Implementation of incentive alignment regime	Setting out regime requirements	Disclosing regime requirements
		Provided					
Mexico	0.43%	0.15%	Δ	Δ	Δ	Δ	Δ
Netherlands	1.72%	2.74%			Δ	Δ	Δ
Russia	No Information Provided	0.01%					
Saudi Arabia	No Information Provided	No Information Provided					
Singapore	0% <sup>29</sup>	0.07%					
South Africa	No Information Provided	0.06%					
Spain	1.94%	1.89%			Δ	Δ	Δ
Switzerland	0/00%	No Information <sup>30</sup>					
Turkey	0.01%	0.00%					
United Kingdom	3.51%	4.3%			Δ	Δ	Δ
United States <sup>31</sup>	76.37%	83.88%					

Source: AFME and supervisory data reported by regulators in the individual jurisdictions (see footnote 24).

### Key

1	Final adoption measures taken (and in force, where relevant)
2	Final adoption measures published but not taken or in force
3	Draft adoption measures published
4	Draft adoption measures not published
5	Not applicable

Note that a triangle (Δ) symbol has been used to denote instances where the implementation of incentive alignment approaches is more advanced in one or more sectors of the market than the overall rating. As explained above, jurisdictions have been rated based on the least advanced market segment in terms of incentive alignment implementation.

<sup>29</sup> Data based on returns submitted by lead manager or arranger of debt issuance. There was also no ABS retail offering in 2014.

<sup>30</sup> Switzerland is included in the 'Other' category in the AFME data. The AFME report states that: 'Other includes countries with outstanding securities that are too small to be displayed, such as Georgia, Iceland, Ukraine, Switzerland, Sweden, and Hungary'.

<sup>31</sup> US requirements enter into force on 24 December 2015 for RMBS and 24 December 2016 for other securitisation types.

### **3.3 Implementation issues**

#### **Jurisdictions with limited securitisation market activity**

The self-assessments of some respondents noted very little or no securitisation activity in their jurisdiction.

The Review Team decided to assess these jurisdictions' responses on the same basis as other jurisdictions

Some of the jurisdictions, which had not taken steps to implement Adoption Measures in respect of incentive alignment, argued that the scale of their securitisation markets and market practice did not warrant regulatory intervention. On the other hand, other markets with limited securitisation activity (such as Indonesia, Russia and Turkey) had implemented incentive alignment measures.

#### **Addressing Cross Border Impacts**

While the Review did not rate Adoption Measures in respect of Incentive Alignment Recommendation 3, on addressing cross border impacts, the Review Team did observe that there had been limited use of safe harbour or regulatory deference measures in implementing the incentive alignment approaches that had been adopted or proposed.

Once incentive alignment requirements are finalised and implemented globally, there may be greater scope for national authorities to discuss and consider, as appropriate, how to manage any cross border effects of incentive alignment regimes. However, there do appear to be some major differences in approach that could make such a process more difficult. These differences should be discussed in any future Implementation Assessment Review.

### **3.4 Emerging Differences in Approach to Incentive Alignment**

As an Adoption Monitoring Review, this Review did not seek to address the consistency of Adoption Measures with the Incentive Alignment Recommendations. However, in the course of the Review, the Review Team identified certain trends and issues which provide some insight into how incentive alignment is being addressed in different jurisdictions. They highlight the issues which may need to be addressed in any Implementation Assessment Review.

#### **Direct and Indirect Approaches**

The responses pointed to two approaches to mandating incentive alignment. The first approach is to directly apply risk retention (or other incentive alignment) requirements to the issuers of securitised products and/or other parties involved in originating and distributing securitised products. The direct approach has been implemented (or is proposed) in Australia, India, Russia, Turkey and the United States.

The approach taken by the European Union and Mexico, by contrast, has been to place an obligation on regulated investors to invest only in securitised products where the investor can establish that risk has been retained. The requirements in Japan are also indirect as they impose obligations on intermediaries and financial institutions as investors.

Both these approaches are intended to lead to the same outcome, the retention of risk by securitisation issuers, or to otherwise align incentives.

#### **Use of Risk Retention Requirements**

Most respondents that had implemented incentive alignment requirements (partially or fully) obliged issuers to (either directly or indirectly) retain a proportion of the credit risk related to that

securitisation. Most commonly, the proportion of risk to be retained was 5%,<sup>32</sup> with methods set out in the requirements as to how this must be calculated.

It appeared that, in these cases, risk retention was seen by the jurisdiction as the most effective way to address any incentive misalignments or agency problems that may arise from the 'originate to distribute' model of securitisation, where the original issuer is not exposed to the credit risk of the underlying assets. There was some variety in the mechanisms that could be used to retain risk under different models, with the general principle of retention of credit risk being a common feature of the models.

### **Use of Disclosure as an Incentive Alignment Approach**

In Argentina, the incentive alignment approach involves disclosure only, not mandated risk retention. Brazil argued that disclosure, in combination with prevailing market practices, characteristics and governance requirements, is a suitable incentive alignment strategy in that jurisdiction and that risk retention was not required.

Review Team members had some doubts as to whether a disclosure-based approach on its own can form the basis of Adoption Measures in respect of the Incentive Alignment Recommendations. Ultimately, because this was an Adoption Monitoring Review only, the Review Team chose not to challenge these types of Adoption Measures at this stage. The issue will be addressed as part of any subsequent Implementation Monitoring Review.

In other cases, such as Singapore, disclosure requirements are in place but were not represented as being Adoption Measures in respect of the Incentive Alignment Recommendations.<sup>33</sup>

### **Measures to Enhance Implementation of Incentive Alignment Rules under Indirect Regimes**

Some jurisdictions, which impose incentive alignment indirectly through obligations on investors, set out measures to enhance the implementation of incentive alignment rules.

In Japan, risk retention is regarded as the preferred incentive alignment measure under Supervisory Guidelines and financial institutions as investors are required to confirm whether part of the risk in securitisation is continuously retained by the originators. Should this risk not be retained, there are deeper due diligence requirements that apply to investors. Compliance with the additional requirements is under the supervision of the relevant authority.

Moreover, the European Union adopted specific measures to push forward the implementation of risk retention. If investors do not meet the risk retention requirements by reasons of negligence or omission, additional prudential risk weights are imposed on them.

### **Exemptions**

Under the EU and US regimes, there are exemptions to the incentive alignment requirements in certain circumstances. Under the EU regime, products that are guaranteed by governments and public institutions are exempt from the requirements. Furthermore, some securitised products guaranteed by some regulated, creditworthy financial institutions are exempt. However, in the latter case, this has

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<sup>32</sup> This is the case in the EU, India, Turkey and the United States.

<sup>33</sup> In Singapore, disclosure requirements are in place where ABS are offered to retail investors. In particular, Singapore MAS' prospectus disclosure requirements include a rule for issuers to disclose the nature, findings and conclusions of any form of due diligence (including any review, verification or assessment) in respect of the underlying assets that have been performed by the issuer, sponsor or originator, underwriter or any third party. This could be seen to encourage parties to conduct more careful due diligence and risk assessment, given that investors are less likely to purchase asset-backed securities where the disclosure shows inadequate due diligence.

the effect of placing the relevant obligation on the guarantor, rather than eliminating the requirements altogether.

In the United States, securitisations related to some government programs are also exempt from incentive alignment requirements, along with securitisations that meet high quality underwriting standards and encourage appropriate risk management practices, improve access to credit on reasonable terms, or are otherwise in the public interest and protect investors.

The different approach to exemptions between the European Union and the United States was mentioned in the Final Report, particularly in the context of cross-border transactions.

In other jurisdictions that had implemented or proposed incentive alignment requirements, there were generally no exemptions to the incentive alignment requirements.

Any future Implementation Assessment Review may wish to consider whether any exemptions are limited and warranted, as called for in Incentive Alignment Recommendation 1.

#### **4. Further Monitoring**

The Review Team noted the differences in progress in implementation. It also noted the limited scope of this Adoption Monitoring, or Level 1, Review, being concerned with the progress of implementation only, rather than the consistency of Adoption Measures with the Incentive Alignment Recommendations.

In light of this, the Review Team recommended, and the IOSCO Board agreed, that further reviews be undertaken, as follows:

- A further Adoption Monitoring Review, including only respondents that had not yet fully implemented Adoption Measures at the time of this Review;<sup>34</sup> and
- An Implementation Assessment Review, which would consider the consistency of Adoption Measures with the Incentive Alignment Recommendations.

The Review Team recommended that the Adoption Monitoring Review be conducted in 2016. The Implementation Assessment Review should commence no earlier than mid-2016.

The further Adoption Monitoring Review will provide an opportunity for jurisdictions to reflect on the progress being made on implementation internationally and benchmark their own progress against this. A timely Implementation Assessment Review is also warranted in light of some of the emerging differences in approach to incentive alignment which have been identified in this Review.

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<sup>34</sup> For the avoidance of doubt, the further adoption monitoring review would include all participants in this Review, with the exception of China, India, Indonesia, Japan and Turkey.

## Appendix A – Detailed Implementation Report

The table below sets out implementation status in detail by providing both the headline rating for each jurisdiction and the rating for each sector of the market. This distinction is relevant to Australia, Mexico and the European Union respondents.

The table uses terminology to denote relevant sectors based on the regulatory framework in the jurisdictions. These terms are defined as follows:

- **ADIs** means *authorised deposit-taking institutions*. These are regulated in Australia by the Australian Prudential Regulation Authority (**APRA**) and include banks, building societies and credit unions. The Discussion Paper on incentive alignment published by APRA in 29 April 2014 applies only to proposals covering ADIs.
- **AIFMs** means *alternative investment fund managers*. These institutions are subject to incentive alignment requirements under a delegated EU regulation.
- **UCITS** means *undertakings for the collective investment in transferable securities*. These fund management institutions are not subject to incentive alignment requirements as relevant delegated regulations have not yet been put in place.

It should also be noted that insurance undertakings in the European Union will become subject to incentive alignment requirements from 1 January 2016.

	Evaluation of incentives across securitisation value chain (Section A Q1(i))	Formulation of approaches to incentive alignment (Section A Q2(i))	Implementation of incentive alignment regime (Section A Q3(i))	Setting out of requirements (Section B Q1(ii))	Disclosure requirements for issuers (Section B Q4(i))
<b>Argentina</b>					
<b>Australia</b>	Δ	Δ	Δ	Δ	
<i>ADIs</i>					
<i>Non-ADIs</i>					
<b>Brazil</b>					
<b>Canada</b>					
<b>China</b>					
<b>France</b>			Δ	Δ	Δ
<i>Banks</i>					
<i>AIFMs</i>					
<i>UCITS</i>					
<i>Insurance</i>					
<b>Hong Kong</b>					
<b>Germany</b>			Δ	Δ	Δ

	Evaluation of incentives across securitisation value chain (Section A Q1(i))	Formulation of approaches to incentive alignment (Section A Q2(i))	Implementation of incentive alignment regime (Section A Q3(i))	Setting out of requirements (Section B Q1(ii))	Disclosure requirements for issuers (Section B Q4(i))
<i>Banks</i>					
<i>AIFMs</i>					
<i>UCITS</i>					
<i>Insurance</i>					
<b>India</b>					
<b>Indonesia</b>					
<b>Ireland</b>			Δ	Δ	Δ
<i>Banks</i>					
<i>AIFMs</i>					
<i>UCITS</i>					
<i>Insurance</i>					
<b>Italy</b>			Δ	Δ	Δ
<i>Banks</i>					
<i>AIFMs</i>					
<i>UCITS</i>					
<i>Insurance</i>					
<b>Japan</b>					
<b>Korea</b>					
<b>Mexico</b>	Δ	Δ	Δ	Δ	Δ
<i>Banks</i>					
<i>Non-banks</i>					
<b>Netherlands</b>			Δ	Δ	Δ
<i>Banks</i>					
<i>AIFMs</i>					
<i>UCITS</i>					
<i>Insurance</i>					
<b>Russia</b>					

	Evaluation of incentives across securitisation value chain (Section A Q1(i))	Formulation of approaches to incentive alignment (Section A Q2(i))	Implementation of incentive alignment regime (Section A Q3(i))	Setting out of requirements (Section B Q1(ii))	Disclosure requirements for issuers (Section B Q4(i))
<b>Saudi Arabia</b>					
<b>Singapore</b>					
<b>South Africa</b>					
<b>Spain</b>			Δ	Δ	Δ
<i>Banks</i>					
<i>AIFMs</i>					
<i>UCITS</i>					
<i>Insurance</i>					
<b>Switzerland</b>					
<b>Turkey</b>					
<b>United Kingdom</b>			Δ	Δ	Δ
<i>Banks</i>					
<i>AIFMs</i>					
<i>UCITS</i>					
<i>Insurance</i>					
<b>United States</b>					

### Key

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Note that a triangle (Δ) symbol has been used to denote instances where the implementation of incentive alignment approaches is more advanced in one or more sectors of the market than the overall rating. As explained above, jurisdictions have been rated based on the least advanced market segment in terms of incentive alignment implementation.



## **Appendix B – List of Jurisdictions Invited to participate in the Review**

The following jurisdictions were asked to respond to a Questionnaire as part of the Review.

### **FSB Members**

Argentina

Australia

Canada (Ontario and Quebec)

Brazil

China

France

Germany

Hong Kong

India

Indonesia

Italy

Japan

Korea

Mexico

Netherlands

Russia

Saudi Arabia

Singapore

South Africa

Spain

Switzerland

Turkey

United Kingdom

United States of America

**Non-FSB Members with Significant Securitisation Activity**

Ireland

Dubai

**Other IOSCO Members**

Mauritius

Nigeria