

(Draft)

SECURITIZATION: POST FINANCIAL CRISIS RESPONSES OF THE BRICS' REGULATORS

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Abstract

Successful securitization in BRICS (Brazil, Russia, India, China, South Africa), the emerging markets spearhead, has been challenged by underdeveloped debt markets and improper legal frameworks. USA concluded its first deal in 1977 while they respectively contracted only in 1993, 2005, 1991, 1997 and 1989. After about 20 years of sporadic transactions, consistent growth started showing in the early 2000s when suddenly interrupted by the Global Financial Crisis. This paper focuses on how BRICS' regulators responded as securitization is fingered as a partial cause. Using the review of regulations, we first provide insights on the existing regulatory frameworks before the crisis and secondly analyse their evolution during/after the crisis. We found that domestically, BRICS carried out major reforms. Before, Brazil regulated each product differently under the general public offerings regulatory framework, but between 2008 and 2013 has aligned its reporting and accounting on securitization to international standards and introduced risk retention rules. Russia move from one law only on Mortgage Backed Securities, the use of mostly foreign Special Purpose Vehicles to a 2013 regulation that enlarges the assets base for securitization and establishes local Special Purpose Vehicles. In India securitization was limited to banks and financial Institutions but in 2007 a new regulation considered securitized instruments as securities and provided guidelines for best practices. China suspended the credit Assets Backed Securities and Asset Securitization of Securities Companies started in 2005, allowed their resumption in 2012/2013 with clear "administrative regulations" and added a new product, the Assets Backed Notes. South Africa enacted three Securitization Notices before and strengthened them with more regulations between 2007 and 2012 limiting banks involvement, précising the Special Purpose Vehicles status and integrating the Basel requirements regarding securitization. The implications are, even though to be perfected, these regulatory reforms have released participants' confidence and gave regulators more control.

Keywords: Securitization regulations; BRICS; Emerging markets; Global Financial Crisis

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Securitization is the process whereby an originator, the owner of assets (loans and other receivables), bundle them

Introduction

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into different tranches (senior, mezzanine and junior) and sell them to a special purpose entity or vehicle² (SPV) created only to acquire these assets³. The SPV in turn issues bonds on the secondary market destined to investors⁴ and use the proceeds to pay the originator. Investors are later on paid out of the cash flows from the assets securitized according to waterfall principle, from the least risky to the riskiest: the senior tranche first, then the mezzanine (if any) and the junior tranche. Types of securitization transactions include true sale which has just been presented, and synthetic which to the contrary do not entail the transfer of risks and rewards of ownership but only the credit risk using derivatives⁵. Among the benefits of securitization is obviously the commutation of illiquid assets (assets not immediately transformable into cash) into liquid assets (cash). It thus provides the originator with more liquidity to develop its business while transferring the credit risk⁶ to investors who will choose securities issued

2 A Special Vehicle Purpose is a legal entity created for the very purpose of a securitisation transaction in order to preserve the investors' interests in case the originator goes bankrupt.

3 with the purpose to reduce bankruptcy costs (Gorton & Souleles, 2007)

4 Such as banks, Insurance companies, finance companies, mutual fund, etc...

5 Examples: forward purchase, total return swap, purchased call or written put (IFRS, 2010)

6 However, a huge volume of commercial papers issued by special vehicle purpose and backed by some commercial banks' assets did not result in risk transfer during the financial crisis as evidenced by Asharya, Schnabl and Suarez. These Assets Backed Commercial Paper were sold to outside investors while guaranteed by commercial banks for regulatory arbitrage purpose and the latter experienced significant losses during the financial crisis as they had to pay maturing ones off at par (Acharya, Schnabl, & Suarez, 2013).

according to their level of risk aversion to diversify their portfolios. So it is a risk management tool. Also, for those originators, such as banks, subjected to prudential capital requirements, securitisation is an opportunity for regulatory arbitrage⁷ while at the same time diversifying their funding sources. Securitization is also a cheaper⁸ source of financing as what matters is the quality of cash flows expected from the underlying receivables not the overall credit rating of the originator. So it is a way to raise capital for undercapitalized or weakly rated originators (IOSCO, 2009). The reverse side is securitization carries some risks. A reputational risk for the originator if the underlying assets perform poorly, the risk that credit rating agencies fail in their assessment of the credit risk associated to these assets and the risk that investors do not evaluate properly their own exposure to these credits risks (Sabarwal, 2006).

As interesting as it can be, BRICS⁹, the world's largest emerging economies, only engaged in the securitization transactions almost twenty years after the first contract in the USA in 1977. One of the checks commonly cited is their bond markets deemed underdeveloped. Notably, they started increasing their volume of transactions when the 2007/2008 Global Financial Crisis (GFC) hit. While taking stock of the crisis, securitization has been regularly finger pointed as a partial cause. This paper focuses on how BRICS' regulators responded, by using the review of regulations to provide insights on the existing regulatory

7 The capital required by prudential regulators is a proportion of the available assets in the originator's balance sheet. So securitising part of the assets entails removing them from the balance sheet and transferring to the Special Purpose Vehicle. As a result, it alleviates the amount of capital required.

8 Even though in some country like South Africa the process is instead perceived as burdensome

9 BRIC is the acronym of Brazil, Russia, India and China, a group joined by South Africa in 2010. It was originated in 2001 by Jim O'Neill, a former economist/chairman at Goldman Sachs.

frameworks before the crisis and secondly analyse their evolution during/after the crisis.

This article is then organised as follow: section I provides the role of securitization in the GFC and how USA and Europe responded, section II the state of BRICS' bond markets and section III, a chronological overview of the existing legal frameworks for securitization before the crisis and BRICS regulators' responses during/after the crisis.

Role of securitization in the GFC and some International Responses

Securitization's role

The 2008 financial crisis had its origin in the subprime mortgage market expansion in the USA. Low interest rate, the increasing interest in the "originate to distribute" model¹⁰ within the banking sector boosted the housing market and fuelled the securitization of mortgage loans (Brunnermeier, 2009). In that environment, markets participants developed excessive risk taking behaviour that ended up being a triggering factor of crisis (BSD, 2008). Originators became less cautious while screening potential borrowers and the credit quality, on which depend the success of securitization settlement, lessened (Keys, Mukherjee, Seru, & Vig, 2010)(Maddaloni & Peydró, 2011) (Dell'Ariccia G., 2012). They pooled assets of low quality for sale knowing that the risk will be passed on to the another participant, this is called moral hazard (Jaffee, 2008). Also there was a lack of due diligence from the investors' part. Some, while pursuing higher returns, concentrated excessive securitised risks in their portfolio by borrowing short term loans to finance long term subprime mortgage backed securities¹¹ in such a way that the combination of disproportionate maturity mismatch and

10 Model where banks lend knowing that risk will be transfer to others

11 For instance Bear Stearns was an Investment bank as well as a key counterparty on the OTC interest rate, foreign exchange and credit default derivatives market. It went bankrupt because it combined high leverage and maturity mismatch without sufficient capital.

leverage became unsustainable (Jaffee, 2008) (Brunnermeier, 2009). Regulators are blamed as well. Basel II's provisions on capital requirements for instance, supposed to strengthen the safety, soundness and stability of the International banking system, did not prevent the financial crisis from occurring. Furthermore Credit rating agencies are pointed for using methods that ended up underestimating the risks associated to subprime mortgage backed securities and pursuing self interests instead of delivering accurate evaluation of subprime mortgage risks to Special Vehicle Purpose and to investors (Rao, 2011). In a nutshell, the combination of wrong incentives in the securitization value chain, inadequate risk management practices, over reliance on credit rating agencies and the gap and an imbalance of regulatory coverage among the participants where some were more regulated and other neglected like credit agencies was a catalyst to the GFC (IOSCO, 2009). Therefore, we joint Jaffee's view that securitization itself was not the major cause the financial crisis but its misuse.

International Regulators' and Boards responses to the GFC

After the crisis, regulators and other international organisations joined forces to develop recommendations and standards with the aim to restore the confidence and trust among the securitization participants by addressing the weaknesses revealed during the crisis¹². For instance, the G20 gathered in Pittsburgh in September 2009 and condemned the over riskier behaviour of Banks and Financial Institutions, the weakness of regulations and supervision that lead to the financial crisis. With regards to securitization, in order to promote prudent behaviour, the G20 recommended that sponsors or originators of securitization transactions retain part of the risk of the underlying assets(G20, 2009). The IMF (International Monetary Fund) recommended not to implement the risk retention on a one size fit all basis but for each securitization. The purpose is to align originators'

12 "Global Developments in Securitization Regulation"
OICU-IOSCO, Final Report of November 2012

incentives with the longer term performance of the securitized assets (IOSCO, 2009). IOSCO added two more recommendations which are transparency and standardisation¹³. The Basel Committee on Banking Supervision¹⁴ adjusted the re-securitizations¹⁵ exposures' risk-weights upward under Pillar 1, improved the disclosure requirements under Pillar 3 and enhance the Basel II norms by issuing Basel III with tighter capital requirements and new liquidity and leverage ratios. In the USA, the Dodd Frank Wall Street Reform and Consumer Protection Act of July 2010 for instance require standard risk retention of minimum 5% and the European Union Alternative Investment Fund Managers Directive also required from Alternative Investment Fund investing in securitization to retain a net economic interest of at least 5% in the securitization, in addition to other due diligence requirements.

BRICS' bond markets

For IOSCO¹⁶, the enabling conditions for securitization are a stable macroeconomic environment, a clear and robust legal framework, robust accounting principles, a neutral tax system and investors' education (IOSCO, 2009). Common obstacles to the development of securitization in the emerging economies include under developed institutional investors, weak rating agencies, lack of uniform transactions structures and common interest rates benchmarks (Jobst, 2006). The bond market globally was according to the Bank of International Settlement the largest investment market in the world in 2009 (\$82.2 trillion). A well developed local bond market presents a series of advantages. These benefits as pointed out by Jeanneau and Tovar include its key

13 See note 10

14 "Enhancements to the Basel II framework", BCBS, July 2009

15 examples of re-securitization are CDOs – collateralized debt obligation- of asset-backed securities

16 IOSCO is the International Organisation of Securities Commissions

contribution in the efficiency of a financial market as it provides the interest rates that help determine the appropriate opportunity cost of funds. It also strengthens the financial system by reducing maturity and currency mismatches through the offering of assets diversification. Furthermore, a well developed bond market is an alternative source of long term financing for investors as it lessens the over reliance on banks, scale down the concentration level and increase the competition with positive effect on intermediation costs. It is also a great medium for monetary policy transmission and macroeconomic forecasts. Finally, it serves as liquid underlying assets market (Jeanneau & Tovar, 2005) and risk diversification medium.

BRICS's bond markets are all under-developed compared to those of developed countries when we look at the volumes issued to GDP ratios. They are dominated by government bonds at the expenses of the private sector, but the gap is reduced over the years. The Brazilian government bond market was opened in 1964. Then followed in the 1980's and 90's a period of economic instability characterised by high inflation coupled with the uncertainties¹⁷ associated to the settlement of contracts in the Brazilian jurisdiction due to history of distortions in the execution of local long term contracts (Arida, Bacha, & Lara-Resende, 2005). These factors slowed down the development of the Brazilian financial market. As posit by Arida et al., in 2004 it was a still a fact that the long term credit market in Brazil does not exist but by the end of 2006 things changed.

In India, at the origin of the predominance of the Government Securities bond Market over the corporate bond market is the 1980's pre-eminence given to the public sector where public sector banks and financial institutions were dominated by the financial sector. Interest rates were administered and the government could easily fund its deficits at the Reserve Bank or via the issuance of bonds

17 They further defined jurisdictional uncertainty as the acts of the Prince changing the value of contracts before or at the moment of their execution, and as the risk of an unfavourable interpretation of the contracts in case of a court ruling.

destined to financial institutions as mandated investors (Mohan, 2007). The private sector was left to its fate. Among other points of reforms in the early 1990's was the government borrowing market subjected to market auction reinforced by the provision of the FRBM act, 2003, effective since April 2006 where the RBI (Reserve Bank of India) could no more be associated with the issuance of government securities in the primary market.

China's bond market is shared between the Inter-bank bond market where securities are traded over-the-counter through the China Foreign Exchange Trade System, the Exchange-traded bond market where securities are traded on the Shanghai Stock Exchange or the Shenzhen Stock Exchange and the commercial banks retail market. The Inter-bank bond market, by far the biggest and dominated by commercial banks is supervised by the People's Bank of China while the Exchange Bond Market, where corporate bonds are traded, is supervised by the China Securities Regulation Commission. The problem with the development of the China's bond market at the inception of the Chinese Stock Exchange was the lack of infrastructure and Centralized Securities Depository. Launching the Inter-bank Bond market in 1997 seems to have been the catalyst of the fast growth of the China's bond market is experiencing until today (Wang, 2010)¹⁸. Despite the remarkable growth, the China's bond market has not yet reached its full potential. Local authorities are fully aware of that and striving to expand it. For instance in 2011, the Notification and the Supplementary Notification on Supporting Commercial Banks to Further improve the Financial Services of Small and Micro Enterprises released by the CBRC encouraged commercial banks to issue special financial bonds to provide this category of enterprises with loans for their operational businesses. As a result, 169 Billions RMB were issued in one year following the Notification (CCDTC, 2012). Also, in 2014, the PBoC (the People's Bank of China) extended the issuers of financial bonds on the Inter-bank bond market to consumption

¹⁸ Mr Wang Pin is the Vice President of the China Central Depository & Clearing Co...Ltd

financing companies and insurance companies (PBoC, 2015).

South Africa bond market started in 1989 and has since been dominated by highly liquid government bonds. However improved macroeconomic conditions in the 2000's contracted government bonds financing needs in such a way that corporate bonds volume has increased from 13% to 48% between 2002 and 2008 (Hassan, 2013). But due to recession in 2009, the government increased its bonds issuance to 61% at March 2014, in order to boost the economy¹⁹.

BRICS' regulators responses to the GFC

Brazil

Before the crisis

The securitization market in Brazil is supervised and regulated by the National Monetary Council, the Central Bank and CVM²⁰, the Securities and Exchange Commission. Brazil's first securitization contract goes back to 1999. Its regulatory framework is quite fragmented with each sector its regulatory framework.

In 1991 the National Monetary Council (CMN) issued the Resolution 1834 regarding export securitization. Securities are backed by export receivables for foreign raised funds directly or through affiliated companies whether Special Purpose Company or not. The circular n0 3027 of 2001 by the Central Bank included even non export companies group indicating that they could buy export receivables and use as collateral as well to raise funds abroad.

The anchor legal framework for securitization backed by real estate credit receivables is derived from the Law 9514 enacted in November 20, 1997 establishing the real estate credit securitization company²¹ dedicated to real estate financing. This law also provided the second market

¹⁹ See Treasury.gov.za, "2013/2014 Debt Management Report"

²⁰ Comissão de Valores Mobiliários

²¹ (*companhia securitizadora de creditos imobiliarios*)

conditions and legal requirements (Republica, 1997) under the oversight of the National Monetary Council, the regulator of the Brazilian capital markets and financial system. The law designated banks, mortgage companies and real estate credit securitization companies as main securitization operators. This law also stated that securitization companies can establish trust schemes on real estate credits and send it to a trustee. It provided the conditions of the scheme and specified that the securitization of receivables in the scheme will then be separated from the securitization company's patrimony which preserved these assets from this company's insolvency.

As for bank receivables, the main regulation framework used at the beginning of securitization practice in Brazil was the CMN resolution n0 2026 Of 1993 where transactions were carried out without special vehicle purpose. Qualified as non financial institution, they were not allowed to purchase Financial Institutions receivables. The purpose was to protect public savings but at the same time this condition was limiting the development of securitization market in Brazil (Barbosa, Müssnich, & Aragão, 2001). Then in 1998, SPV were qualified and banks clearly designated as originators.

On the 26th of January 2000, the CMN by the resolution n0 2.686 authorised the securitization of financial receivables to be undertake through the financial credit securitization company²². Only Financial institutions could be involved but insurance companies were not mentioned in the list. This resolution also made reference to recourse and risk retention during the transfer when the SPV is controlled or affiliated to the originator (Art 2).

The next key step in the securitization market development in Brazil was the creation of FDIC²³, a receivables Investment Fund focused on credit rights, by the Central Bank resolution number 2907 of November 29, 2001 and further regulated by the CVM's, Securities and Exchange Commission, instruction n0 356 of 17 December 2001.

²² *companhia securitizadora de creditos financeiros*

²³ Fundo de Investimento em Direitos Creditórios

This resolution was intended to include the securitization transactions backed by other receivables than only real estate, from all categories of originators. FIDC is bankruptcy-remote special vehicle purpose. The Funds is administered only by financial institutions designated in the resolution. The FIDC's securitization transactions underlying assets comprises personal and vehicles loans, credit cards. These transactions now dominate the market at such level that Residential (RMBSs) and Commercial (CMBSs) mortgage-backed securities are still lagging behind. The certificate of real estate receivables (CRI), the securities backed by real estate receivables accounted for only 9% of structured transactions in 2006 (Scatigna & Tovar, 2007).

The agribusiness in Brazil accounts for more than 20% of its GDP. In 2004, the Federal law n0 11.076 of 30 December 2004 was enacted for the securitization of agribusiness receivables to be carried out, depending on the instrument, by financial institutions, agribusiness companies, or agribusiness credit rights securitization company²⁴.

After the Crisis

As response to the global financial crisis, Brazil undertook major reform specifically with the main purpose to mitigate regulatory arbitrage practice through the use of securitization. Referring to Rennhack' report (Rennhack, 2009), Brazil focused on two major aspects: the requirements of adequate capital charge for Special Purpose Vehicle and the alignment to the international accounting standard. Special Purpose vehicle are required to hold a capital charge up to the level of credit and market risks of the underlying assets. In order to avoid regulatory arbitrage

²⁴ (companhia securitizadora de direitos creditorios do agronegocio). See also "Securitisation of agribusiness financial instruments in Brazil: an expanding market I Global Securitisation and Structured Finance 2008", by Ronald Herscovici, Eduardo J Herszkowicz and Frederico M

Stacchini, http://www.globalsecuritisation.com/08_GBP/GBP_GSSF08_032_036_Brazil.pdf, accessed 8 August 2015

whether between on and off balance sheet positions or among portfolio classes, the assets sales as disclosed and classified in the books must also reflect the extent of transfer of risk, returns and control over the underlying assets. Moreover, until the latter are not definitely transferred the underlying assets remain in the originators balance sheets.

After the Crisis, the process of converging the national accounting standards to IFRS announced in 2006 by the Central Bank of Brazil (BRASIL, 2006) was accelerated in December 2007 and January 2008 when the amendments of the Brazilian corporate law (Law 6.404/76 and 11.638/07) required the Brazilian accounting standards to comply with IFRS.

After a transition period from 2008 to 2009 where some listed companies could still chose between the local GAAP²⁵ and the international IFRS²⁶ accounting rules, the full convergence to IFRS became compulsory for listed financial Institutions and the unlisted one for whom the audit committee is mandatory beginning with the financial year ending 31 December 2010. They must publish from there henceforth consolidated financial statements. Other financial Institutions are exempted unless they lead a conglomerate or Group including a listed entity (Rafael, Vinícius, André, & João, 2011)(IFRS, 2015a). Specifically with regards to Special Purpose Vehicle and other securities instruments, banking, securities and capital market regulations required respectively that supervised and unsupervised financial institutions²⁷ consolidate their financial statements including investments²⁸ under external

25 Generally Accepted Accounting Principles

26 International Financial Reporting Standards issued by The International Accounting Standards Board (IASB)

27 Specifically those deemed to be controlled *de facto* by a supervised financial institution

28 Under the conditions that the supervised financial institution has the power to elect or dismiss the management of the invested entity, exercise effective operational control, or exercise shareholder control directly

auditing; listed companies and the parents companies of a group of entities that include a listed company are required to consolidate their financial statements incorporating all the Special Purpose Vehicles controlled by the listed company. Here the consolidation of the investments will also be required at the discretion of the securities supervisor wether the entity is formerly controlled or not; lastly, listed companies are required to consolidate all their subsidiaries. With regards to off-balance sheet guarantees, Brazil adopted the Basel II simplified standardized approach type. It does not use rating agencies but the same factors for off-balance sheet guarantees and on-balance sheet credit transactions to determine risk weights (Rennhack, 2009).

Concerning export securitization, in 2010, circular n0 3491 simplified the registration on inbound and outbound financial transfer by not requiring the Central Bank specific approval. Replaced in 2013 by the circular 3691, however, these transactions must be carried out only by Institutions authorised by Central Bank in accordance with the laws and exchange regulations.

In 2011, the CVM's instruction 489 provided for the standards for preparation of the Investments Funds in credits Rights' (including FIDC) Financial Statements with the purpose to increase the level of information they convey to securities market and to align the Brazilian accounting practices to IFRS²⁹. Details were given for the measurement, classification³⁰, presentation and disclosure of financial instruments. Moreover, the registration of any

or indirectly even through mutual funds.

29 See explanatory note translated on [file:///C:/Users/Officeworks%20Glebe/Downloads/translate_c%20\(1\).htm](file:///C:/Users/Officeworks%20Glebe/Downloads/translate_c%20(1).htm), assessed 7 August 2015

30 Financial Instruments must be classified in three categories: measured at fair value through profit or loss; loans and receivables; held to maturity.

financial assets involved in a transfer transaction must include its retention of risks³¹ and benefits.

In 2015, the law n0 13097 laid down the conditions of functioning of real estate credit securitization companies.

Russia

Before the Crisis

On the 11 November 2003, the Law No 152-FZ was promulgated relative to domestic Mortgage Backed Securities backed by real estate assets only. It introduced the first special vehicle purpose, called the mortgage agent, and distinguished the mortgage backed bonds or covered bonds from the mortgage participation certificates. The mortgage agent's bankruptcy estate is separated from the mortgage pledge which can be transferred to another SPV. The first deal was made in 2005. However, others such as car loans, credit cards and other receivables were securitised via offshore Special Purpose, under the English law, thus making them foreign securities mostly accessible to foreign investors.

After the Crisis

In 2011, by an amendment, the 1995 Federal Law 208-FZ on "joint stock companies" adopted the consolidated financial statements for all banks and listed companies according to International Accounting Standards and was enforced in 2012 (IFRS, 2015c).

Regarding the securitisation process itself, a Federal law No 39-FZ of 22 April 1996 on "Securities Market" amended in 2012, simplified the trading of new shares process by allowing shares to be traded on the secondary market prior to the filing of the placement notification and registration of the registration report. The decision of the FSFM and the disclosure of necessary documents and information now suffice³².

More significantly, the seizing of the international securitisation markets in 2008 created a domestic pressure

³¹ The retention of risks here can be either by the existence of subordination or by repurchase/replacement of the defaulted assets by the transferor

on the Russian regulators in such a way that in 2013, they brought about a drastic change in the securitisation legal framework³³ (Kroll, 2015).

Since 2013, the Russian financial sector is oversight by one regulator. The Central Bank supervises banks, non-banking financial institutions and the securities markets, including securitisation market. After a long period of preparation following the financial crisis, the State Duma (the parliament) reformed the Russian Civil Code by the Federal Law No 367-FZ of 21 December 2013 under which a core Law No 379-FZ enacted several specialised laws including a Securitisation Act. Among the novelty is the implementation of Basel III requirements, the possibility for

³² See alert memo "Further Changes to Russian Securities Law aimed at Bringing Liquidity to the Local Market" by Clearly Gottlieb, February 2013, Available at www.clearlygottlieb.com, accessed the 12 Aug. 15.

³³ Several set of laws followed after the GFC including: Order No. 09-57/pz-n of the Federal Service for Financial Markets 'On approval of regulations on statements of managers of mortgage pool' dated 15 December 2009; Order No. 09-55/pz-n of the Federal Service for Financial Markets 'On approval of regulations on the requirements of the arranging, summoning and holding of the meetings of holders of mortgage participation certificates' dated 15 December 2009; Order No. 09-58/pz-n of the Federal Service for Financial Markets 'On approval of regulations on the redemption of mortgage participation certificates' dated 15 December 2009; Directive No. 3289-y of the Central Bank of Russia 'On accounting requirements of bonds collateral and funds debited on the pledge account' dated 20 June 2014; and Directive No. 3412-y of the Central Bank of Russia 'On list of management companies of SPVs' dated 6 October 2014. Some still to be approved include the draft Directive of the Central Bank of Russia 'On the list of other assets that could be pledged under the mortgage-backed bonds'; regulations on disclosure of information on assignment of receivables to the mortgage agents and SPVs, and on registration of holders of mortgage participation certificates. (Kroll, 2015).

special purpose vehicle to issue senior and subordinated bond. Moreover, the legislation enlarged the assets bases for securitisations by including the non-mortgage assets such as monetary claims and issue of bonds. In the first case, monetary claims are pooled into assets backed securities bonds and termed “securitization of financial assets”, in the second case bonds are issued from the implementation of long term project and termed ‘Infrastructural bonds’(Ernst & Young, 2013). Two new types of Special Purpose Vehicle besides the existing mortgage special purpose –the mortgage agent - where accordingly introduced: the Special Purpose Financial Company and the Special Purpose Project Finance Company. However, the law does not specify if these SPV are bankruptcy remote. The monetary claims involve in both forms of transactions serve as collateral, so adding to real estate assets and securities as eligible pledge (Prava, 2014). In terms of risk retention, the Securitization Act made provision that 20% of the total obligations secured by the pledge must be kept in the originator’s balance sheet and 10% for the infrastructure project (BBH, 2014).

As for credit rating agencies, Russia has completed it reform since 2010, according to the IOSCO recommendations on the registration, the oversight programs, the integrity and the management of conflicts of interest³⁴.

India

Before the Crisis

The main regulator on the Indian securitisation market is the Reserve Bank of India (RBI). Regulations clearly designate Non-bank financial Institutions as originators while most investors are banks.

In India, the gap between the increasing demand of loans and insufficient deposit has developed a real interest for

³⁴ See Financial Stability Board “ 2013 IMN Survey of National Progress in the Implementation of G20/FSB recommendations: Russia”

securitisation as a mean for banks to compensate the liquidity need. Securitisation was also found to act as a catalyst for Indian banks growth in performance, improvement of liquidity and a better risk management tool through asset quality improvement and loan portfolio enhancement (Roy, 2011).

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002 (SARFAESI Act, 2002) serves as the anchor legal framework for securitisation transactions in India following the Recovery of Debts due to Banks and Financial Institutions Act of 1993. This act defined securitisation as the acquisition of financial assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitisation company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise. Even though the originator in the Act is defined as the owner of the financial assets and thus may be including corporate, the rest of the provisions of the act with regard to securitisation seem to be referring mainly to banks and financial Institutions and their interests. Also there is no indication whether the securitisation company, referring to special purpose vehicle, is bankruptcy remote³⁵. But interestingly, it allows the securitization of banks’ non-performing assets via assets reconstruction companies.

In 2006 the RBI notified the “Guidelines on Securitisation of Standards Assets”, still applicable to banks, financial Institutions and non-banking financial companies only. The definition of securitisation is more specific. It says securitisation is a process by which a single performing asset or a pool of performing assets are sold to a bankruptcy remote Special Purpose Vehicle and transferred from the balance sheet of the originator to the Special Vehicle Purpose in return for an immediate cash payment. So a bankruptcy remote SPV was clearly referred to as well as its functioning criteria. But in terms of the transfer of assets, only true sale is mentioned as if partial sale,

³⁵ That is, assets sold are preserved if the originator or the SPV goes bankrupt.

financing, mix sale and financing are prohibited. It is necessary to say that synthetic securitisation has not been allowed before (Mohan, 2007). Securities issued by the SPV must be rated by a locally registered credit rating agency. Other provisions in the guidelines included the option for the originators to re-purchase the SPVs assets at the end of the securitisation scheme, the credit enhancement and the liquidities facilities, and the accounting rules.

After the Crisis

The Global Financial Crisis got no impact on the Indian banking sector due to its minor exposure to the USA sub-prime market (Mohan, 2008). Nevertheless, the RBI took tighter measures in the light of what was going on internationally and locally. In 2007, the Securities Contracts (Regulation) Act of 1956 as amended included “any certificate or instrument issued to an investor by any issuer being a special purpose...”, meaning securitized instruments were included in the definition of securities making them easily tradable.

After the Crisis also, the 2006 Guidelines on Securitization of Standards Assets issued to NBFCs were revised in order to address global and local concerns. In 2010, the draft was made public for comments. In 2012 the final guidelines were issued with three core objectives: addressing the ongoing unhealthy local practices where some origination of loans were carried out for the sole purpose of securitization, aligning the originators’ interest with that of the investors, and redistributing credit risk to a wide spectrum of investors. The revised format respectively requires a minimum lock-in period or Minimum Holding Period (MHP) from 3 to 12 months depending on the original maturity of the loan³⁶ before it can be securitized. This aimed at preventing the project implementation risk to be passed to the investors and to see the project demonstrating a minimum recovery performance before the securitization. For the second issue, NBFCs are now

³⁶ loan of up to 2 years must be kept for three months; 2 to 5, six months and more than 5 years, twelve months

subjected to a minimum retention requirement (MRR)³⁷ to ensure that they carry out proper due diligence of loans before securitization. The revised version of the guidelines prohibited the securitization of revolving credit facilities, assets purchased from other entities, securitization exposures such as Assets Backed or Mortgage backed Securities (ABS/MBS) continuing thus to exclude synthetic securitization and re-securitization. It further required appropriate stress testing regarding the NBFCs securitization positions and detailed the disclosures that must be made in the servicer/Investor/trustee report.

In terms of Basel III securitization framework, the Basel Committee of Banking Supervision after its assessment found India compliant with the risk based capital regulations (BCBS, 2015). However India has not adopted IFRS. Domestic companies whose securities are traded in a public market have option to use IFRS in their consolidated financial statements. But few have taken this advantage preferring the local Accounting Standards (IFRS, 2015b).

China

Before the Crisis

In China only banks that invested in the U.S sub-prime such as the Bank of China, who had to write down \$2 Billion out of \$9.7 Billion (Onaran, 2008), were affected during the financial crisis. The banking sector globally got limited impact (Xin, 2008) and the economic growth was still high at around 9.2 % in 2008 (Li, Willett, & Zhang, 2012).

People’s Bank of China (PBoC) and The China Securities Regulatory Commission (CSRC), the China Banking Regulatory Commission (CBRC) (and the National Association of Financial Market Institutional Investors (NAFMII)) are the oversight regulators of securitization transactions in China. Securitisation issuance in China is

³⁷ For Loans of up to 24 months, the MRR is 5% of the book value of the loans being securitized, more than 12 months, 10%. However, the total retained exposures of the originator must not exceed 20% under certain conditions or any excess would be risk weighted at 667%.

not regulated by a specific law but by a set of commercial laws and guidelines. Securitization transactions are carried out under: the Company Law of 1993 amended in 1999 and 2004 to protect the legitimate rights and interests of companies, shareholders and creditors; the Guaranty Law of 1995 meant to preserve creditors' rights and provide modes of guaranty such as suretyship, mortgage, pledge, lien and deposit for loans etc...; the Contract Law of 1999 preserve the legitimate rights and interests of parties to transactions such as loans, purchases and sales; The banking Supervision Law of 2003, amended in 2006 changed to Banking Supervision and Administration Law to reinforced the supervision activities of the Banking Supervision and Administration Institutions of the State Council and protect the rights and interests of depositors/clients; The securities law of 1998 amended in 2004 made provisions for the issuing and trading of shares, bonds and other securities, also the protections of the rights and interests of investors; The Trust law of 2001 regulate trust activities as well as the rights and interests of the parties involved. It precises that the Trust property shall not be part of the Trustee's property and shall remain segregated if the latter is declared bankrupt³⁸. This was later confirmed by the 2007 Rules Governing Trust Companies³⁹ indicating also securities underwriting and assets securitisation as part of Trust activities ; The 2006 Enterprise Bankruptcy Law is meant to settle claims and debts, preserve the interests and rights of creditors and debtors.

2005 marked a turning point in the securitization activities with the promulgation of an avalanche of regulations. In April 2005, the PBoC and the CBRC jointly promulgated the Administrative Rules for Pilot Securitization of Credit Assets⁴⁰ regulating the aforementioned program with the purpose to increase the liquidity of the credit assets and enrich securities assets. Eligible assets comprised

³⁸ All these laws can be founded on the following link:

http://www.npc.gov.cn/englishnpc/Law/2007-12/11/content_1383569.htm, accessed 1st August 2015

³⁹<http://www.cbrc.gov.cn/EngdocView.do?docID=200707318AEA4EB688AFCE58FFF8578DE9C3BE00>, accessed 1st August 2015

commercial MBS, residential MBS, auto loans receivables, Non-Performing loans, financial leases. The Rules indicated Trust Investment Company as Special Purpose Trust to be entrusted the assets and issue the securities to investors. Also, these securities are destined to the inter-banks bond market. Seven months later, in November 2005 the CBRC promulgated the "*Measures for the Supervision and Administration of the Pilot Securitization of the Credit Assets of Financial Institutions*"⁴¹. CBRC is the regulator of Financial Institutions (FI) here meaning local commercial and Policy banks, trust, investment and finance companies, urban and rural credit cooperatives. These measures unfold in detail the conditions of approval for the mentioned Institutions to carry out Credit Assets Backed securities securitization locally under the supervision of the CBRC as well as for other Special Vehicle Trusts, Credit enhancements, Loan Service, Capital custodians involved in the process. These conditions include each FI must be approved by the CBRC to engage at any level in the process of securitization, properly equipped in human resources, comply with all laws and prudential requirements, risk management, accounting procedures... etc. The credit assets to be securitised must be homogenous and the capital for the remaining risk after their transfer calculated based on the economic substance of the transaction and reserved. Financial Institutions are allowed to invest in the ABS but must be fully aware of the overall risks and dispose of risk concentration management tools. First loss liability is also permitted as well as the credit conversion factor (100%) and how to determine the risk weight for the risk exposure.

During/After the Crisis

With the inherent risks unveiled during the financial crisis, the CBRC issued the February 2008 Notice⁴² on "Further Improving the Management of Credit Assets Securitization Business". The Notice required from banking Institutions to

⁴⁰ <http://www.cbrc.gov.cn/EngdocView.do?docID=1340>, accessed 1st August 2015

⁴¹ <http://www.asianlii.org/cn/legis/cen/laws/mftsaaotpsocaofi1179/>, accessed 15th August 2015

carry out securitized activities in line with their business strategy and capacity management, to properly diversify credit and default risks with regards to non-performing assets, to make provisions of capital requirements and risk exposures, mitigate moral hazard, operational and legal risk via respectively the improvement of loan service, good appraisal of risk transfer and standardizing the procedures for transferring creditors' right. Banks were also designated responsible for educating the investors to securitization products. As the Crisis was continuing, the PBoC decided in 2009 to interrupt the 2005 pilot program. It is only in 2012 that the program was allowed to resumed by the NO 127[2012] *Notice on the Relevant Issues relating to the Expansion of the Pilot Programs for Securitisation of Credits Assets*⁴³ jointly issued by CBRC, MoF, PBoC. This notice was meant to improve rules, prevent risks and promote healthy and sustainable development of the credit securitization business in China. Within the program, underlying assets were expanded to loans for national major infrastructure projects, agriculture, small and medium enterprises...etc. However, re-securitization and synthetic securitization products were and still prohibited. In terms of risk retention, sponsors are required to hold a portion of the lowest grade ABS in each securitization which shall not be less than 5% of the scale of the issuance of each ABS and the holding period shall not be less than the existing period of the lowest grade ABS.

In 2013, CSRC promulgated the *Provisions on the Administration of Assets Securitization Services of Securities Firms* which replaced the *Guidance on Pilot Securities Companies Asset-Backed Securitization of (For Trial) of 2009*. It gave the opportunity to Securities

42 Notice can be found on:

<http://www.cbrc.gov.cn/EngdocView.do?docID=2008060427B4EF2C7E7F2E3EFF88EACD9963B800>, accessed 15th August 2015

43 See <http://www.lawinfochina.com/display.aspx?lib=law&id=10919&CGid=>, accessed on the 15th of August 2015

companies to securitize enterprises' assets via a special scheme and trade them on the Shanghai and Shenzhen stock Exchanges. Securities companies include Insurance companies, Trust and Fund management companies etc... Investors are Institutional Investors and eligible underlying assets are Enterprises' assets with stable cash flow such as rights to claim highway tolls, receivables from the acquisition of assets, proceeds from sales of electricity.... If the Enterprise goes bankrupt, these assets are excluded from the bankruptcy estate⁴⁴.

In 2014, *Administrative provisions on the asset securitization business of securities companies and the subsidiaries of fund management companies*, among the changes, include subsidiaries of fund management companies as securitizers. Eligible assets are property rights or assets belonging to the sellers such as account receivables, creditors' right over leases...

Despite the remarkable regulatory progress the volume of ABS issued is still low. Undoubtedly, limiting the issuers of ABS to financial institutions, the system of quotas of issuance and a bond market dominated by government and central bank bonds are problematic. Local authorities acknowledged the lack of sufficient liquidity on the secondary market and the insufficiency of information around the assets pooled that discourage investors (CCDTC, 2012). However, the market is evolving rapidly. After only Yuan 89.3 billion between 2005 and 2008, the break from 2009 to 2012, the volume of ABS issued in 2014 reached Yuan 282.3 Billion⁴⁵, from around Yuan 18 billion in 2013⁴⁶ and 19.26 Billion in 2012⁴⁷, the resuming year. The boost continues in 2015 as the People's Bank of China

44 Global Bulletin: "A brief on Securities Companies' Assets-Backed Securitization Business" by Wei QIN, June 2013, <http://www.globallawoffice.com.cn/userfiles/file/2.pdf>, accessed 15th August 2015.

45 Dominated by loans as collaterals: Yuan 269.1 billion in 2014, from 15.8 billion in 2013. See <http://www.bloomberg.com/news/articles/2015-04-03/china-eases-rules-for-selling-loans-as-asset-backed-securities>, accessed 31/07/2015

has decided that properly registered issuers do not need it approval on each deal anymore but can carry out ABS (look for the announcement on the website of PBoC and CBRC around the 3rd of April 2015 (see note 12).

Regarding IFRS, China has adopted national Accounting Standards that are substantially converged with IFRS. Only domestic companies whose securities are trade on the stock exchange of Hong Kong have this option (IFRS, 2014).

A- South Africa

Before the Crisis

The GFC had a limited impact on the South African (SA) financial system because SA banks did not invest in the USA subprime mortgages. The first securitization deal was issued in 1989⁴⁸ apparently just to acquire experience, not for liquidity or other purpose (Saayman & Styger, 2000). The expansion was since constrained by confusing regulations⁴⁹. The securitization process in South Africa is subjected to a set of regulations. A typical deal consists in selling the loan to a SPV, transferring the indemnity and other security agreements including the mortgage bond to a guarantee SPV. The bank then acts as servicer and in case of the customer's default, the guarantee SPV institutes a legal action by selling the bonded property and sending the

46 See "China's debt binge spawns Asset-backed bond boom" by Lianting Tu, <http://www.bloomberg.com/news/articles/2015-03-03/china-s-debt-binge-spawns-asset-backed-bond-boom-credit-markets>, accessed 31/07/2015

47 Chinadaily.com.cn

48 By the former United Building Society Ltd made of R250 Million of pooled mortgage listed as unsecured redeemable mortgage-backed floating rate debenture

49 See "The awakening of securitization in South Africa" by Neil Van Vuuren, December 2004, <http://www.sasf.co.za/aboutsecuritisation/The%20awakening%20of%20securitisation%20in%20South%20Africa.pdf>, accessed, 21 August 2015

proceeds to the SPV⁵⁰. Not a single regulation covers all the aspects of the transaction. The Companies Act 61 of 1973 applies if the Special Purpose Vehicle (SPV) is a company, and the Trust property Control Act, 1988 if the SPV is a trust.

Securitization Notice of 1992⁵¹ excluded securitization as part of banks activities. Originators were banks, they could act as servicer, provided third party credit enhancement at market price and subordinated loans to the SPV but not liquidity support to the scheme nor underwrite or guarantee the issue of securities by SPV, nor being involve in the SPV's shares and management. SPV's had not recourse against the originator in case of loss incurred by the transferred claims (Locke, 2008).

Commercial paper Notice of December 1994 applied to securitisation because assets backed securities have the characteristics of commercial paper (VanDenBerg, 1998). It was defined in this notice also as "debentures or any interest-bearing written acknowledgement of debt issued for a fixed term in accordance with the Companies Act, 1973, but does not include bankers' acceptances". The notice went on saying that the acceptance of money from the general public against the issue of commercial paper in accordance with the Companies Act is not part of the Business of banks. However according to Van Den Berg, this did not mean banks are excluded from these activities. Rather banks are not the only institutions to carry them out, finance companies are included also. This raised some confusion.

In order to align with international development and market needs, the Securitization Notice of 2001 was issued to repeal the 1992 Notice and the provisions of the Commercial Paper Notice of 1994. The new Notice cleared up the uncertainties that were prevailing in the former

50 See information note on "Securitization" on the Standard Bank of South Africa Limited website.

51 Notice on the Deposit-Taking Institution Act 94 of 1990 "Designation of an Activity not falling within the Meaning of "Business of a Deposit-taking Institution" (Securitisation Schemes)", referred to as "Securitisation Notice 1992"

commercial paper notice. Banks are allowed to act as originators, remote originators, sponsors or re-packagers and eligible assets are expanded to non-banking assets. Furthermore, banks could support the scheme with credit enhancement or liquidity facilities knowing however that this will impact their capital⁵².

The Bank Act, 1990, regulating banks activities in South Africa, defined what the “business of banks” stands for. By the Securitisation Scheme regulation of 2004 (Gazette, 2004), the registrar clearly specified that the Special Purpose Institutions’ activities were excluded from the aforementioned business of banks under certain conditions. Among others, the transfer of assets is total and the special purpose institutions have no right of recourse unless this right is agreed upon by the Institution. SPV could be a company or a trust, insolvency remote, incorporated or created solely for the purpose of the implementation or operation of a traditional or a synthetic scheme. So synthetic securitization were allowed with risk transferred through credit derivatives instruments, the assets base enlarged from monetary claims to other resources of the company, the conditions for securitization of revolving assets explicated and true sale clearly indicated.

During/After the Crisis

The BSD engaged its responsive action as early as in April 2008 by asking all participants to securitisation schemes a report on aspects such as accounting treatment, regulatory compliance, various risks (legal, liquidity, credit, operational, market) coordinated by an international auditing firm. The later delivered the report in November 2008 indicating that only 4% of participants funding derived from securitisation preventing them from overreliance and that in South Africa the scheme is used in its simplest form, unlike of those in the USA and Europe. The same report recommended actions in areas such as the

repurchase and replacement of assets, liquidity risk, the reporting methodologies... etc(BSD, 2008).

A bit before, in 2007, through the Banks Amendment Act 20 with effect in January 2008 and the Exemption Notice on the Securitisation schemes, the 2004 Notice was repealed but most of its provisions kept. Furthermore the provisions of Basel II on securitization were incorporated in the practice in SA. Securitisation Notice of 2008, Government Gazette N0 30628 of January 2008, also précised what the Bank Act, 1990, called activity excluded from the “business of a bank” in these terms: “the acceptance by special-purpose institution of money from the general public against the issue of commercial paper by aforementioned special-purpose, in respect of either a traditional or synthetic securitisation scheme”. Regarding risk retention, the South African regulations on securitization remain silent.

Directive 1/2011 dated 5 May 2011 stipulated that following the exposure of hidden risks in the securitisation transactions during the financial crisis, the BSD has decided to strengthen its understanding of these activities in South Africa by requiring from Banks, controlling companies and branches of foreign institutions to provide quarterly audited and certified information on issuer Special Purpose Institutions.

In the same line, Directive 1/2012 issued in term of section 6(6) of the Banks act, 1990, goes even further in the information required from securitisation market participants motivated by a BIS report recommending more transparency (BIS, 2011) and requiring from supervisors to shift from determining the capital treatment of a securitisation exposure based on its legal form to one based on its economic substance. Also, in 2011, by the new Companies Act Regulations, all domestic companies whose securities are trade in a public market are required to use IFRS in their consolidated financial statement (IFRS, 2015d).

In 2015, BIS found SA compliant with the Basel III requirements on securitization except the clean-call which serve as credit enhancement was not in the SA regulations disclosures requirements from banks(BIS, 2015).

⁵² See Chapter 4 “Developments related to banking legislation” <https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/4006/chapter4%5B1%5D.pdf>

Conclusion

In securitization, BRICS countries' regulators have actively responded soon after the 2007/2008 global financial crisis by engaging in tremendous legal and accounting reforms to be at par with international standards. The purpose was to gain more control on the complex process and inherent risks of securitization, educate, attract new participants and insure the return of previous investors' confidence. Obviously, these reforms need to be perfected and tested.

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