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of the Workshop
on Securitisation

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Mannato**

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Proceedings of the Workshop on Securitisation
Madrid, 27-28 May 2010

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ACKNOWLEDGEMENTS

This Statistics Working Paper, prepared by Michèle Chavoix-Mannato, Head of the Section '*Quarterly National Accounts and Financial Statistics*', Statistics Directorate, includes all documents presented during the various sessions of the Workshop on Securitisation of the Working Party on Financial Statistics (WPFS), which took place on 27-28 May 2010, and provides an overview of the outcomes of the Workshop.

Special thanks go to Beatriz Sanz, Statistics Department, Bank of Spain, and Chairperson of the WPFS, who actively organised this workshop in coordination with the OECD, and who made possible the hosting of the workshop at the headquarters of the Bank of Spain in Madrid; to her team in the statistics department of the Bank of Spain; and to Marie Viriat, OECD Statistics Directorate, for her excellent secretarial assistance.

The editor also wishes to thank the authors of the papers included in this document and all participants in the Workshop for their substantial contributions to the very fruitful discussions.

The opinions expressed in these papers are the sole responsibility of their author(s) and do not necessarily reflect those of the OECD or the governments of its member countries.

ABSTRACT

This Statistics Working Paper includes the documents that were presented during the various sessions of the Workshop on Securitisation, held in Madrid on 27-28 May 2010, as well as summaries at the beginning of each section.

The Workshop brought together regular members of the Working Party on Financial Statistics (WPFS), statisticians, analysts, supervisors, experts from accounting standard-setting institutions and from International Organisations, and representatives from the industry and from international associations. It aimed at exchanging views so as to better understand securitisation from various angles and to help improve the completeness and the usefulness of future statistics.

The first part of the Working Paper stresses the importance of statistical work in the field of securitisation against the background of the financial crisis, reviews recent progress by international organisations, in particular the relevant work of the OECD WPFS, and highlights both concerns about understanding the complexity of securitisation processes revealed by the outbreak of the financial crisis and the need to compile data on a country-comparable basis.

The second part refers to the past, present and future of securitisation from the standpoint of analysts, regulators and the industry. The presentations illustrate the reasons behind the significant surge in securitisation and its ensuing sharp decline, and the key role that certain securitisation processes have played in the financial crisis; they identify the main problems in the statistical field in the period of financial turbulence, and describe the steps taken to cope with the major deficiencies identified.

The third part addresses the role of statisticians in the production/dissemination of information on securitisation processes and highlights the difficulties in setting out a common methodology and compiling full information on securitisation operations. The papers aim at delimiting the securitisation phenomenon - definitions, agents (originators, SPVs or FVCs, administrators) and kinds of operations -, and at showing how to collect information on specific aspects of securitisation and to integrate the information collected into the financial accounts and other statistics.

The fourth part summarises the main discussions during a roundtable related to specific questions on needs for harmonisation, exchange of experiences and dissemination of information, addressed to four participants who also expressed their views on securitisation after the crisis.

The Concluding section points to a typical problem for statisticians, i.e. the lack of useful information when unexpected events occur. The securitisation process is a case in point. The three keywords repeatedly used during the sessions - harmonisation, transparency and cooperation - represent a very difficult but very rewarding challenge for financial statisticians. As regards securitisation, this means that statisticians have to produce good and comparable statistics on securitisation operations, understand and explain what these data are describing, and work through active and efficient cooperation with all countries' and international organisations' statisticians and analysts.

RÉSUMÉ

Ce document de travail statistique inclut les papiers qui ont été présentés lors des différentes sessions de l'Atelier sur la Titrisation, qui s'est tenu à Madrid les 27-28 mai 2010, ainsi que des résumés pour chacune des parties.

L'atelier a réuni les membres réguliers du Groupe de Travail sur les Statistiques Financières (WPFS), des statisticiens, des analystes, des superviseurs, des experts des institutions de normalisation comptable et des organisations internationales et des représentants de l'industrie et d'associations internationales. Il avait pour but d'échanger des points de vue afin de mieux comprendre la titrisation sous des angles différents et d'améliorer l'exhaustivité et l'utilité des statistiques futures.

La première partie du document de travail met l'accent sur l'importance des travaux statistiques dans le domaine de la titrisation dans le contexte de la crise financière, note les progrès récents des organisations internationales, en particulier les travaux pertinents du WPFS de l'OCDE, et souligne à la fois le souci de comprendre la complexité des processus de titrisation révélée par le déclenchement de la crise financière et la nécessité de compiler des données comparables entre pays.

La deuxième partie se réfère au passé, au présent et à l'avenir de la titrisation du point de vue des analystes, et des représentants de l'industrie. Les présentations illustrent les raisons sous-jacentes à la flambée importante de l'industrie de la titrisation et son fort déclin, et le rôle clé que certains processus de titrisation ont joué dans la crise financière ; elles identifient les principaux problèmes dans le domaine statistique en période de turbulences financières, et décrivent les mesures prises pour faire face aux principales lacunes identifiées.

La troisième partie aborde le rôle des statisticiens dans la production / la diffusion des informations sur les processus de titrisation et souligne les difficultés de formulation d'une méthodologie commune et de compilation d'informations complètes sur les opérations de titrisation. Les présentations visent à délimiter le phénomène de titrisation - définitions, agents qui interviennent (initiateurs, SPV ou sociétés-écrans, administrateurs) et types d'opérations -, et à montrer comment collecter des informations sur des aspects spécifiques de la titrisation et comment intégrer les informations recueillies dans les comptes financiers et d'autres statistiques.

La quatrième partie brosse un aperçu des principales discussions lors d'une table ronde portant sur des questions spécifiques sur les besoins d'harmonisation, d'échanges d'expériences et de diffusion de l'information, adressées à quatre participants qui ont également donné leur opinion sur la titrisation après la crise.

En conclusion, il est rappelé qu'un problème typique pour les statisticiens concerne le manque d'informations utiles chaque fois qu'un événement inattendu survient, ce qui est particulièrement le cas dans le contexte des procédés de titrisation. Les trois mots clés utilisés à plusieurs reprises au cours des sessions de l'Atelier - harmonisation, transparence et coopération - mènent à un défi très difficile mais très enrichissant pour les statisticiens financiers. Se référant à la titrisation, cela signifie que les statisticiens ont à produire des statistiques comparables de bonne qualité sur les opérations de titrisation, à comprendre et à expliquer ce que ces données décrivent et à travailler en coopération active et efficace avec des statisticiens et des analystes de tous les pays et des organisations internationales.

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**WORKING PARTY ON FINANCIAL STATISTICS (wpfs)
WORKSHOP ON SECURITISATION**

MADRID

27-28 May 2010

EXECUTIVE SUMMARY

Following the work conducted by the OECD Working Party on Financial Statistics (WPFS) since 2006 in the field of securitisation, a Workshop was held in late May 2010 with the active collaboration of the Banco de España. In addition to a broad representation of the regular members of the WP, the workshop was also attended by analysts, supervisors and expert practitioners in the industry. The aim was to exchange views so as to better understand securitisation from various angles and to improve the completeness and the usefulness of future statistics.

The Workshop was divided into four parts. The first began with some words of welcome by the Director of the Statistics Department of the Banco de España, who stressed the importance of statistical work in the field of securitisation against the current background of the ongoing financial crisis, and remarked on recent progress by international organisations (IOs), in particular the ECB. The work by the WPFS on this matter was then reviewed, and the main reasons for organising the Workshop were set out.

The second part comprised presentations from analysts, regulators/supervisors, the industry and international associations concerning the past, present and future of securitisation. The presentations addressed:

- a) The main factors that had triggered the current financial crisis and the key role that certain securitisation processes had played in it.
- b) The main problems identified in the statistical field in the current period of financial turbulence: the scant information, opaqueness and heterogeneity with respect to securitisation processes. On a positive note, however, the efforts that the industry, international associations and IOs have been making in recent years to provide useful information for analysts, investors and the public at large were acknowledged. Nonetheless, it was noted that since the production and dissemination of statistics is very costly, there is a potential risk of seeking to encompass the topic of securitisation with too broad a perspective. Accordingly, a balance must be struck between transparency and efficiency since, very often, providing extensive information does not necessarily entail having better information.
- c) Some points were made regarding the expected (or desirable) future of securitisation, suggesting that it will probably be easier than in the past, less prone to risk-transfer and more focused on the management of the financing of the originators.

The third part addressed the role of statisticians in the production and dissemination of information on securitisation processes. Some presentations described the efforts made in attempting to define what securitisation should encompass, seeking to encapsulate the agents who intervene and the operations that are undertaken. Account was given of the significant work undertaken recently to compile uniform and comprehensive information on securitisation. An example here is the ECB Regulation approved in late 2008, which has enabled to make available extensive and homogeneous information for euro area countries and some other EU members. Although the ECB has been receiving data from the countries subject to this new regulation since February 2010, the data are currently undergoing quality control and, once their

quality is considered acceptable, they will be disseminated. A second example is the Handbook on Securities that has been drafted following close cooperation between the IMF, the BIS and the ECB, which goes beyond securitisation.

In this part of the Workshop some countries explained specific aspects of securitisation processes that were being conducted in their respective countries. They highlighted the difficulty of defining the processes in the attempt to set out a uniform methodology and to compile full information on specific operations, especially when these extended beyond national borders. The necessary exchange of information between countries and the means of doing this are matters in which resolute future work will undoubtedly be needed.

The accounting aspects of securitisation in the balance sheets of credit institutions, the main originators of securitisation operations, were covered in the Workshop. The changes adopted recently by the US FASB in respect of accounting regulations and what this entails to achieve greater uniformity with European IASB rules were also presented.

Further, there was analysis of the integration of securitisation operations into the financial accounts, along with the information and scope-related difficulties still to be resolved so that such integration is sufficiently informative to analysts with different perspectives.

The fourth and final part of the Workshop was a roundtable. Four participants, one from a statistical institution, another from a central bank, and two from IOs, presented their views on five matters: i) the need to harmonise terms regarding operations, agents and practices, and whether any international organisation should take the lead on this; ii) the need to have harmonised legislation or at least a certain common methodology and uniform dissemination of statistics; iii) the need to exchange information among countries, in particular regarding difficulties encountered in collecting information, and how this exchange of information could take place, whether bilaterally or through IOs, such as the ECB for the euro area countries, and the corresponding IO for other regions; iv) the need for the OECD to collect/disseminate securitisation data for a selected group of countries along the lines set out by the ECB request; and, v) securitisation after the crisis.

Opinions on these points included most notably: the unavoidable need to produce comparable statistics, which entails the harmonisation of definitions and terms regarding operations, parties and agencies involved in securitisation. One way to work in this direction could be through the production of manuals and guidance notes with illustrative examples. On the method of work to put this into practice, rather than have just one IO take the lead, it would be preferable to have some form of collaboration. The Handbook on Securities drafted by three IOs is a good example in this respect.

The main points raised in this roundtable served as a basis for drawing the main conclusions of the Workshop from the statistical perspective. These conclusions can be structured around three recurring keywords during the sessions: transparency, harmonisation and cooperation. These terms plot a path for the future work of statisticians in this field. In the future, it will be necessary to define the production of data on securitisation processes since, and on the one hand, the need to analyse this phenomenon from different perspectives will lead to a more extensive demand for information, on the other, account should be taken of substantial production costs in terms of time and resources, especially when the processes extend beyond strictly national borders as they frequently do. Accordingly, joint work among statisticians, involving analysts, supervisors, accounting standard-setting institutions, IOs and representatives of the industry and international associations, will be unavoidable.

SOMMAIRE EXÉCUTIF

Suite aux travaux du Groupe de Travail sur les Statistiques Financières (WPFS) de l'OCDE depuis 2006 dans le domaine de la titrisation, un atelier a été organisé fin mai 2010 avec la participation active de la Banco de España. Outre une large représentation des membres réguliers du Groupe de Travail, de nombreux analystes, superviseurs et praticiens spécialisés de l'industrie ont également participé à cet atelier. L'objectif était d'échanger des vues afin de mieux comprendre la titrisation sous des angles différents et d'améliorer l'exhaustivité et l'utilité des statistiques futures.

L'atelier a été divisé en quatre parties. La première a commencé par quelques mots de bienvenue du Directeur du Département des Statistiques de la Banco de España, qui a souligné l'importance des travaux statistiques dans le domaine de la titrisation dans le contexte actuel de crise financière, et a noté les progrès récents des organisations internationales (OI), en particulier de la BCE. Le travail effectué par le WPFS sur cette question a ensuite été examiné, et les principales raisons pour l'organisation de l'atelier ont été exposées.

La deuxième partie comprenait la présentation des points de vue d'analystes, de régulateurs / contrôleurs, de l'industrie et d'associations internationales, concernant le passé, le présent et l'avenir de la titrisation. Les présentations ont porté sur:

- a) Les principales causes qui ont déclenché la crise financière actuelle et le rôle clé que certains processus de titrisation y ont joué.
- b) Les principaux problèmes identifiés dans le domaine statistique au cours de la période actuelle de turbulences financières: le peu d'informations, l'opacité et l'hétérogénéité en ce qui concerne les processus de titrisation. Sur une note positive, toutefois, les efforts que l'industrie, les associations internationales et les organisations internationales ont fait ces dernières années pour fournir des informations utiles pour les analystes, les investisseurs et le grand public ont été reconnues. Néanmoins, il a été noté que, étant donné le coût élevé de la production et de la diffusion de statistiques, il peut y avoir un risque de chercher à englober le sujet de la titrisation dans une trop large perspective. Par conséquent, un équilibre doit être trouvé entre la transparence et l'efficacité, car, très souvent, fournir des informations détaillées ne signifie pas nécessairement avoir une meilleure information.
- c) Certains traits quant à l'avenir attendu de la titrisation, suggérant qu'elle sera probablement plus facile que dans le passé, moins sujette à des risques de transfert et davantage axée sur la gestion du financement des créateurs.

La troisième partie portait sur le rôle des statisticiens dans la production et la diffusion d'informations sur les processus de titrisation. Certaines présentations ont décrit les efforts déployés pour tenter de définir ce qui doit être compris par titrisation, en cherchant à inclure à la fois les agents qui interviennent et les opérations qui sont menées. D'autres ont rendu compte de l'important travail entrepris récemment dans le but de compiler des informations uniformes et complètes sur la titrisation, comme, par exemple, le règlement de la BCE approuvé à la fin 2008, et qui a permis de rendre disponibles de nombreuses informations homogènes pour les pays de la zone euro et pour d'autres pays membres de l'UE. Bien que la BCE ait reçu des données en provenance des pays soumis à cette nouvelle réglementation depuis février 2010, les données sont actuellement en cours de contrôle de qualité et seront diffusées une fois que leur qualité sera jugée acceptable. Un deuxième exemple est le *Handbook on Securities Statistics* (Manuel sur les statistiques des valeurs mobilières) qui a été rédigé en coopération étroite entre le FMI, la BRI et la BCE, et qui va au-delà de la titrisation.

Au cours de cette session de l'atelier, certains pays ont expliqué certains aspects spécifiques des processus de titrisation menés dans leurs pays respectifs, ce qui leur a permis de souligner la difficulté à définir ces processus pour essayer d'établir une méthodologie uniforme et de compiler des renseignements complets sur des opérations spécifiques, surtout dans le cas où ces processus s'étendent au-delà des frontières nationales. Il est indéniable que des échanges d'informations entre les pays et les moyens d'y parvenir feront l'objet de travaux futurs résolument nécessaires.

Les aspects comptables de la titrisation dans les comptes de patrimoine des établissements de crédit, initiateurs principaux des opérations de titrisation, ont été couverts au cours de l'Atelier. Les modifications adoptées récemment par le FASB américain (*Financial Accounting Standards Board*) en ce qui concerne les règles comptables et les progrès que cela implique dans l'obtention d'une plus grande uniformité avec les règles européennes de l'IASB (*International Accounting Standards Board*) ont également été présentés.

En outre, ont également fait l'objet de présentations l'analyse de l'intégration des opérations de titrisation dans les comptes financiers, ainsi que les difficultés liées à l'information et à l'étendue du phénomène qui doivent encore être résolues afin que cette intégration soit suffisamment riche en renseignements pour les analystes selon différentes perspectives.

La quatrième et dernière partie de l'atelier a eu lieu sous forme de table ronde. Quatre participants, représentant l'un une institution statistique, un autre une banque centrale, et deux de Organisations Internationales (OI), ont exposé leurs points de vue sur les quatre questions suivantes: i) la nécessité d'harmoniser les termes concernant les opérations, les agents et les pratiques, et la question de savoir si une organisation internationale devrait en prendre l'initiative; ii) la nécessité d'avoir une législation harmonisée ou au moins une certaine méthodologie commune et une diffusion uniforme des statistiques; iii) la nécessité d'échanger des informations entre pays, en particulier concernant les difficultés rencontrées dans la collecte d'informations, et comment cet échange d'informations pourrait avoir lieu, soit au niveau bilatéral ou par l'intermédiaire d'OI, comme la BCE pour les pays de la zone euro, et d'autres IO pour les autres régions; iv) la nécessité pour l'OCDE de collecter / diffuser les données de titrisation pour un groupe sélectionné de pays de manière consistante avec la demande de la BCE. Des réflexions sur la titrisation après la crise ont clos le débat.

Parmi les opinions exprimées sur ces points a été incluse notamment la nécessité incontournable de produire des statistiques comparables, ce qui implique l'harmonisation des définitions et des termes concernant les opérations, les intervenants et les organismes impliqués dans la titrisation. Cela pourrait se traduire par la production de manuels et de guides pratiques avec des exemples illustratifs. Quant à la méthode de travail pour mettre cela en pratique, il serait préférable d'adopter une certaine forme de collaboration entre OI plutôt que de voir une seule OI jouer un rôle de premier plan. Le Manuel sur les valeurs mobilières rédigé par trois organisations internationales est un bon exemple à cet égard.

Les principaux points soulevés dans cette table ronde a servi de base à l'élaboration des principales conclusions de l'atelier du point de vue statistique. Ces conclusions peuvent être structurées autour de trois mots clés récurrents au cours des séances: la transparence, l'harmonisation et la coopération. Ces termes tracent un chemin pour les travaux futurs des statisticiens dans ce domaine. Dans la conduite de tels travaux à l'avenir, il sera nécessaire, d'un point de vue statistique, de définir la production de données sur les processus de titrisation, étant donné, d'une part, que la nécessité d'analyser ce phénomène à partir de perspectives différentes conduira à une demande plus importante d'informations, d'autre part, qu'il faut tenir compte des coûts les plus substantiels en termes de temps et de ressources que la production de statistiques implique, en particulier lorsque le processus s'étend au-delà des frontières nationales comme c'est le plus souvent le cas. En conséquence, le travail conjoint entre statisticiens, analystes, superviseurs, institutions de normalisation comptable, organisations internationales et représentants de l'industrie et d'associations internationales, sera inévitable.

OECD WORKSHOP ON SECURITISATION

OPENING REMARKS

The Workshop started with some words of welcome by *Eduardo Rodriguez-Tenés*, the Director of the Statistics Department of the Banco de España who noticed the significant importance of the securitisation phenomenon during the last few years in many countries and areas. Accordingly, central banks, other data compilers and international organisations have had to work intensively to develop their methodological framework to measure the economic and financial aspect of this activity.

For statisticians, the challenge involves providing relevant information on all the facets of the securitisation process including monetary analysis, transferor risk, financial intermediation and financial stability assessment. Moreover, in the global economy this information must be comparable across countries and areas. This calls for common definitions of instruments, participants and practices and, if possible, the collection of homogeneous information and the dissemination of common templates.

In this context, *Eduardo Rodriguez-Tenés* recognised the relevant work inducted by the OECD WPFS since 2006. The Banco de España has collaborated with the OECD actively in this task and this workshop is a further step in this direction. He also mentioned other important initiatives in this field by the European Central Bank (ECB) since 2004 when its Statistic Committee included this issue in its programme of work. As a result, a highly detailed statistical framework was set up to obtain data from financial vehicles that intermediate the securitisation process and from credit institutions as originators. The ECB has started to collect data according to this framework in 2010 and the result will be available in the very near future.

Eduardo Rodriguez-Tenés assessed this work in the ECB context as a very important step for providing information on securitisation that could serve as a basis for further international harmonisation. Among the initiatives in this field, there is the Handbook of Securities which has been drafted jointly by the IMF, the BIS and the ECB. In this workshop, the issue is tackled in a broader context. To produce relevant information, statisticians need to understand the phenomenon from every angle and exchanging views with data analysts, markets participants, supervisors and international organisations is crucial.

SESSION 1

**THE SECURITISATION PROCESS FROM THE STANDPOINT OF
ANALYSTS, REGULATORS AND THE INDUSTRY**

THE SECURITISATION MARKET IN SPAIN: PAST, PRESENT AND FUTURE

Roberto Blanco
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1. Introduction

The securitisation markets expanded at a high pace in industrialised countries between 2000 and the summer of 2007. The international financial crisis that broke in the summer of 2007 has hit these markets considerably. Despite some international public and private initiatives to re-establish securitisation, activity in these markets has not yet recovered significantly.

In Spain, the securitisation market expanded very rapidly during the first half of the 2000s. In mid-2007, before the start of the international financial crisis, the Spanish market ranked second in Europe (after the UK) in terms both of outstanding amounts and issuance volumes. During this period the covered bond market also exhibited very high growth, with the Spanish market the second largest in Europe (after the German market). Since the summer of 2007, both markets have been impacted by the international financial crisis, but to a different extent. The covered market has been used since then by financial institutions as a source of funding, whereas in the securitisation market activity has mainly been in the form of issuance retained by the loan originators with the aim of increasing their collateral.

Against this background, this paper focuses on the securitisation market in Spain covering the main developments before and during the crisis. In particular, the paper analyses the distinctive features of this market in Spain and compares them with the covered bond market. The paper also discusses the main factors behind these developments during both periods and the outlook for these markets.

The rest of the paper is organised as follows. Section 2 describes the main differences between asset-backed securities (ABSs¹) and covered bonds and the distinctive features of ABSs in Spain. Sections 3 and 4 analyse, respectively, the main developments during the pre-crisis period (2000-August 2007) and the crisis period (since August 2007). Section 5 discusses the outlook for the securitisation market and Section 6 concludes.

2. The main differences between ABSs and covered bonds and the distinctive features of ABSs in Spain

Before discussing developments in these markets and the main driving factors, it might be useful to analyse first the main differences between ABSs and covered bonds, and the distinctive features of the securitisation market in Spain.

Table 1 summarises the main differences between ABSs and covered bonds. Although both instruments tend to have a long maturity, ABSs had a much longer maturity (25.1 years) in comparison with covered bonds (10.5 years) during the expansionary period before the crisis. Other differences include

¹ In this paper the use of ABS include any securitised asset including mortgages.

characteristics such as the extent of maturity mismatch. In an ABS there is no maturity mismatch since the issuer transfers the cash flows to the bondholders, whereas in a covered bond there could be a maturity mismatch as in any other fixed-income security issued by a bank since the maturity of the bond is not necessarily the same as the maturity of the assets. Generally, banks issue bonds with a shorter duration than the duration of their assets, incurring refinancing risks. Another key difference is the extent of risk transfer. In an ABS, risks can be fully transferred from the originator of the securitised asset to the bondholder, although as will be seen later, the transfer of credit risks was in practice very small in the case of Spain. By contrast, in a covered bond the risk of the assets is retained by the issuer. The securitisation of assets normally results in the issuance of different classes of securities, referred to as tranches. The difference lies in their seniority. Normally, one tranche, referred to as equity, absorbs the first losses; then there are the so-called mezzanine tranches, which occupy an intermediate seniority role; and finally, the safest tranches, which tend to have a high rating. Covered bonds do not have these tranches, since all bonds have the same seniority. This feature of the ABS, is, in principle, attractive since the product can be designed to meet the demand of different kinds of investors. But this and other more flexible features of these products can sometimes result in complex structures such as ABSs that are securitised more than once (the so-called CDO squared), although this has not been the case in Spain, where securitisation structures have been relatively simple. Finally, in terms of the type of collateral, there are also some differences between ABSs and covered bonds. In Spain, the only collateral that can be used for covered bonds are mortgages and loans to government, whereas many other assets can be used for ABSs, such as loans to companies and consumer loans (see Chart 1).

The main distinctive features of securitisation products in Spain can be summarised in the following characteristics: i) simple products, ii) fewer conflicts of interests between originators and investors, and iii) comparatively higher transparency and investor protection. The simplicity of the products can be illustrated by the fact that there are no CDO or CDO squared. The only exception to CDO issuance is the securitisation of covered bonds by a group of saving banks. This technique was a way to increase size in ABS issuance with a product with similar characteristics to regular ABSs. The existence of fewer conflicts of interests between originators and investors results from the fact that originators of these products used to retain the equity tranches. Under Spanish regulations, securitised assets are only derecognised if the risk is transferred significantly from the originator to the investor. As can be seen in Chart 2, between 2004 and 2007 the proportion of securitised asset that were derecognised was less than 6%. In other words, this means that originators retained the bulk of the risks, mainly through the acquisition of the equity tranches. This means that the originators had the right incentives to undertake prudent policies. As regards transparency and investor protection, the mechanisms introduced in Spain include the obligation for the issuer to register with the Spanish securities regulator and supervisor (CNMV), and to publish a prospectus with very detailed information on the characteristics of the issuer, and the pool of securitised assets. Finally, in Spain there is a clear legal framework for mortgages, the main collateral class used in the securitisation market.

3. The pre-crisis period

Between 2000 and the summer of 2007 both the securitisation market and the covered bond market expanded significantly in Spain. As can be seen in Chart 3, the outstanding amount of ABSs and covered bonds issued by Spanish institutions rose from EUR 18 billion and EUR 12 billion in 2000 to EUR 298 billion and EUR 168 billion in the second quarter of 2007. The outstanding amount of other fixed-income securities issued by financial institutions also expanded rapidly, albeit to a lesser extent.

The growth of these markets in Spain was much faster than in other European countries. In terms of the gross issuance, between 2004 and the second quarter of 2007, the weight of the Spanish market for ABSs in Europe was 14%, the second largest after the UK. In the covered bond market, Spain had a share of 21% during the same period, again the second largest in Europe, although in this case the leading market was

Germany. In terms of outstanding amounts, as of June 2007 the picture was similar: a share of around 13% in both cases, with Spain ranked second (after the UK) in Europe in the securitisation market and third (after Germany and Denmark) in the covered bond market.

As previously shown, in Spain the originators of ABSs did not issue these securities as a means to transfer the credit risk of their loan portfolios to other investors. Instead, they issued these securities for funding purposes. As can be seen in Chart 4, between 2000 and 2007 the net flow of loans was persistently above the flow of deposits. Therefore, Spanish financial institutions relied on the bond markets as a way of funding this gap. As shown before, financial institutions relied not only on the securitisation market but also on other fixed-income markets for the same purpose, including notably the covered bond market.

4. The crisis period

After the summer of 2007, public issuance of ABSs fell everywhere. In Europe there has been some activity in the market since, but the bulk of this related to issues that have been retained by the originator as a way of increasing the collateral available for use in operations with the central bank (see Chart 5). Spain was no exception to this pattern. In the US, activity has fallen more dramatically, since the practice of retaining the issues by the originators was not so widespread. However, in this market some recovery in activity has been observed since 2009, linked initially to the Agency Mortgage-Backed Securities Purchase Program implemented by the Fed, although this pattern of greater dynamism has continued more recently despite the fact this programme has come to an end.

By contrast, the European covered bond market was more resilient to the crisis. Gross issuance volumes also fell in 2008, but they have recovered since 2009 (see Chart 6). The fall was more significant in the so-called jumbo segment, which includes all issuance over EUR 1 billion. Activity in this market was supported between May 2009 and June 2010 by the covered bond market programme implemented by the ECB, although this factor alone cannot explain the greater resilience of this market as compared to the ABS market. Again, the performance of the Spanish market for covered bonds during this period in terms of quantities was similar to the European market as a whole.

In terms of prices, the impact of the international financial crisis was also less strong for covered bonds in comparison with ABSs (see Chart 7), although the information available on prices has to be viewed with caution given the low liquidity of the secondary markets. In the covered bond market, one striking feature since the beginning of 2010 has been the higher discrimination of prices by countries and, in particular, the increase in spreads in countries most affected by the sovereign debt crisis, including Spain.

The main factors behind the comparatively worse performance in terms of both quantities and prices of ABSs at the international level are the following: i) the lack of investor confidence, ii) the exit of SIVs and ABCP conduits from these products, iii) thin market liquidity and iv) the uncertainty over the credit quality of the underlying portfolio.

The lack of investor confidence has ensued mainly in the wake of the unexpectedly large losses associated with some of these products (in particular ABSs based on subprime loans in the US). This event made international investors aware of the lack of transparency in the underlying assets of some of these products. Also, investors realised that the credit quality of the underlying assets was sometimes worse than anticipated, partly because of the conflicts of interests between originators and investors.

Another key factor driving the worse performance of ABSs in comparison with covered bonds is related to the fact that one major investor in ABSs were SIVs and ABCP conduits. These vehicles funded their acquisitions of ABSs by means of the issuance of short-term securities. Such vehicles, which played a

crucial role in transforming maturities in ABSs, were forced to liquidate their assets once investors in SIVs and ABCP securities stopped buying them.

Given the longer maturities of ABSs as compared to covered bonds, the degree of market liquidity in the secondary market is a more important characteristic for investors in those assets. Therefore, the evaporation of market liquidity has hit ABSs more strongly. Covered bond issuers have reacted to the lower liquidity of covered bonds by shortening the maturity of these products, a move that is not possible with ABSs since, as was shown previously, the maturity of these bonds is the same as the maturity of the underlying assets. In the past, the role of maturity transformation of ABSs was performed by SIVs and ABCP conduits, but the activity of these products practically disappeared.

Finally, the sharp downturn in the economic outlook as a consequence of the financial crisis meant a deterioration of the credit quality of financial institutions' portfolios, especially in the economies most hit by the crisis. The impact of this factor was stronger in the case of ABSs owing to the lower level of protection in comparison with covered bonds. In particular, covered bonds have dual protection against losses (the issuer and the underlying portfolio), a characteristic which is not present in the case of ABSs.

5. The outlook

The outlook for securitisation markets in Spain and elsewhere will depend on how supply and demand fare. From the standpoint of demand, a key factor is investor confidence in the products. This will only be restored if the problems that have been identified are successfully resolved. In particular, it is very important to increase the transparency of these products regarding their underlying assets and to tackle the issue of conflicts of interests. The recent private and public initiatives to re-establish securitisation on a sounder basis should help in this regard². Another important factor is the liquidity in secondary markets. Given the longer-term maturity of these products, market liquidity is an important attribute for these securities. Again, some initiatives are directed at this issue. Finally, a further factor that will affect the demand for these securities in the short term is uncertainty over the credit quality of the portfolios of the originators against a background of weak economic recovery in many industrialised countries, including Spain.

From the standpoint of supply, a key factor is the funding needs of the originators. In this regard, the deleveraging process that has been initiated during the recent crisis in the main industrialised countries, after a long period of very high growth of debt levels, means that financial institutions have less need to raise funds in the debt markets compared with the situation before the financial crisis. In the case of Spain, private-sector indebtedness increased markedly during the expansion period before the crisis, and the debt-to-GPD ratio currently stands above that of the euro area and the US, and close to that of the UK (see Chart 8). Against this backdrop, lending to the private sector has shown very low - and even negative - growth, implying that in 2009 and 2010 the financing gap of Spanish credit institutions was negative (see Chart 4). This means that the need to rely on wholesale markets is much lower than during the long expansionary period before the crisis.

6. Concluding remarks

Since the summer of 2007, public issuance of securitisation products worldwide has been very low compared to the levels before the crisis. Spain was no exception to this pattern. Pre-crisis levels will probably not be reached in the medium term due to a combination of lower supply and demand. Supply is lower because of the deleveraging process in financial and non-financial sectors. Lower demand can be explained by the disappearance of some investors such as SIVs and ABCP conduits, which played a key

² For more information on these initiatives, see IMF (2009) and FSB (2010).

role in supporting demand during the pre-crisis period. The disappearance of this type of investor is possibly a welcome development considering the destabilising role they played at the beginning of the crisis and, in this regard, pre-crisis volume levels should not be taken as the optimal target.

However, some recovery from the current low levels seems desirable since securitisation can perform some important economic roles not played by covered bonds, such as credit risk transfer (which may contribute to a better diversification of risks), the existence of tranches (which increase the availability of different instruments), and the wider collateral for these products (such as loans to SMEs, for example). Here, the main challenges for the industry are to restore investor confidence and improve market liquidity. In this connection, current private and public initiatives to re-establish securitisation on a sounder basis are welcome.

References

IMF (2009): Global Financial Stability Report.

FSB (2010): Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability. Report of the Financial Stability Board to G20 Leaders

ANNEX

ABS VS COVERED BONDS

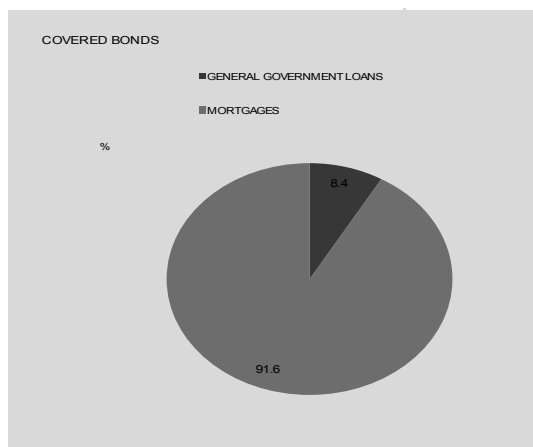
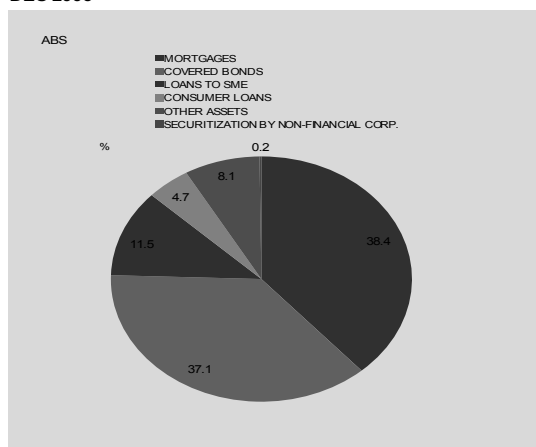
TABLE 1

	ABS	COVERED BONDS
AVERAGE MATURITY (YEARS, JUNE 2007)	25,1	10,5
MATURITY MISMATCH	NO	YES
RISK TRANSFER	YES (but in practice, small)	NO
TRANCHES	YES	NO
COLLATERAL	ANY ASSET	MORTGAGES LOANS TO GENERAL GOVERNMENT
STRUCTURE	COULD BE COMPLEX (but not in practice)	SIMPLE

SOURCE: Banco de España.

ABS AND COVERED BONDS. SPAIN. BREAKDOWN BY COLLATERAL. OUTSTANDING AMOUNTS DEC 2006

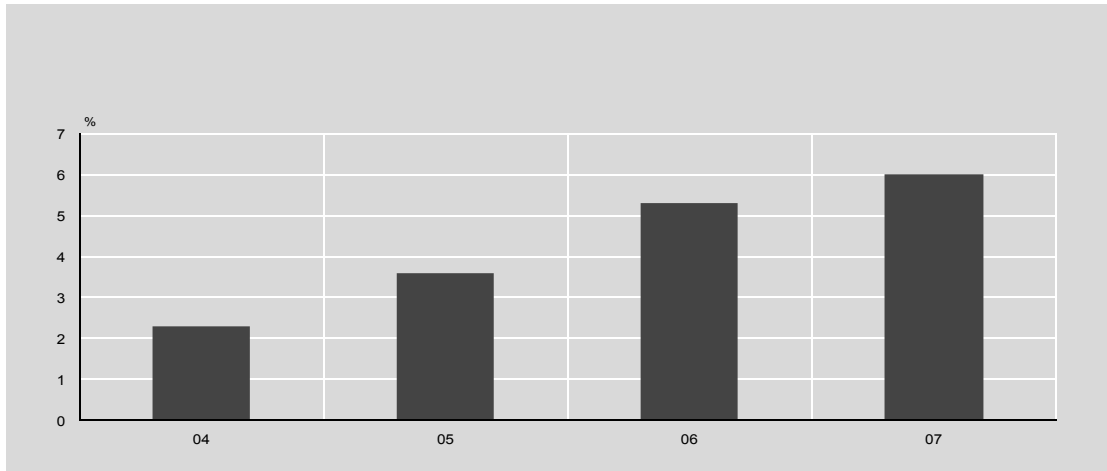
CHART 1



SOURCE: Banco de España.

PROPORTION OF SECURITISED ASSETS DERECOGNISED

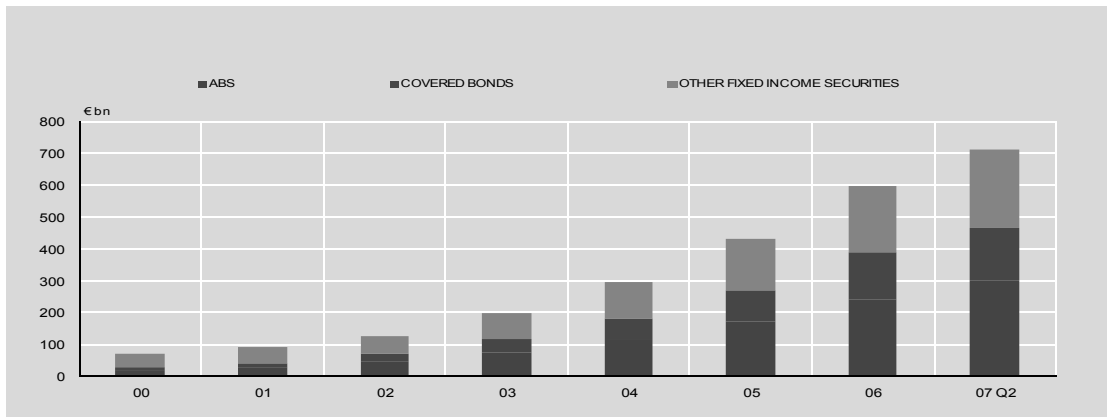
CHART 2



SOURCE: Banco de España.

ABS AND COVERED BONDS. OUTSTANDING AMOUNTS. FINANCIAL SECTOR. SPAIN

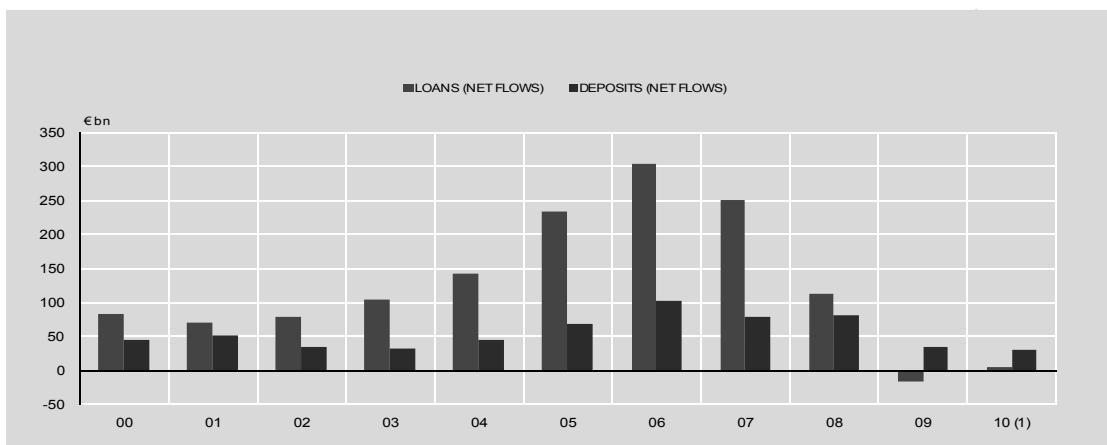
CHART 3



SOURCE: Banco de España.

FINANCING GAP OF SPANISH CREDIT INSTITUTIONS

CHART 4

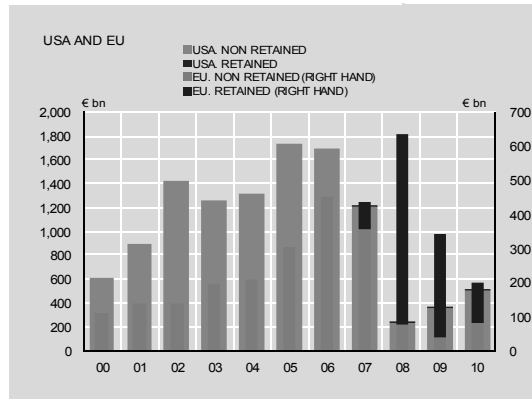
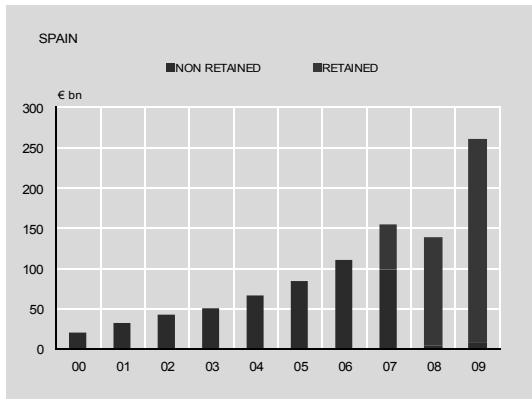


SOURCE: Banco de España.

(1) Up to the third quarter

ABS. GROSS ISSUANCE VOLUMES

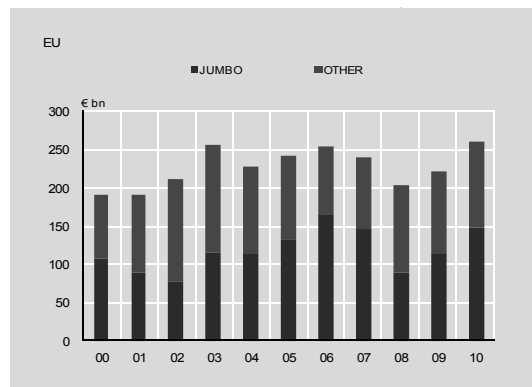
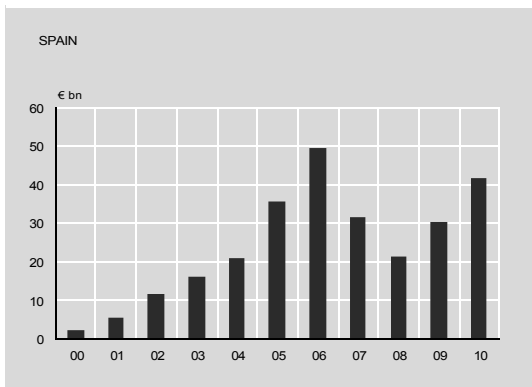
CHART 5



SOURCES: Banco de España and Dealogic.

COVERED BONDS. GROSS ISSUANCE VOLUMES

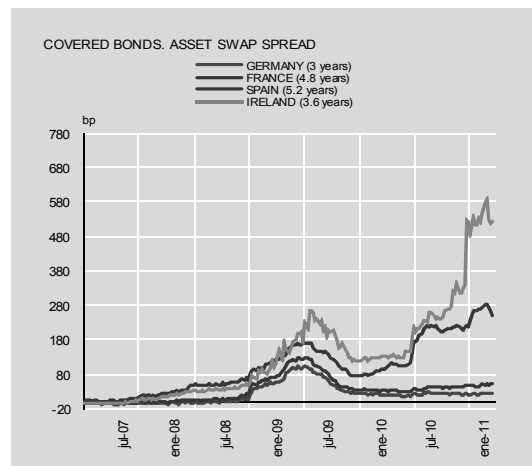
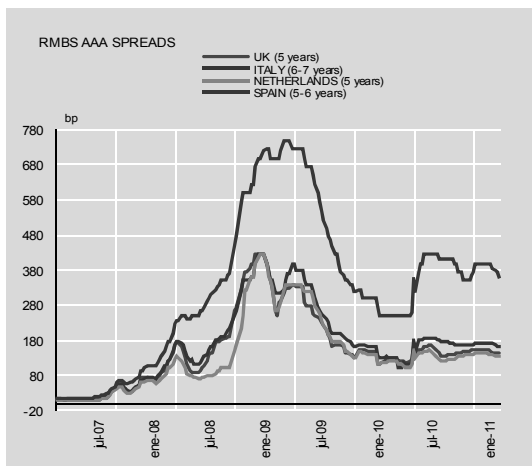
CHART 6



SOURCES: Banco de España and Dealogic.

RMBS AND COVERED BONDS SPREADS

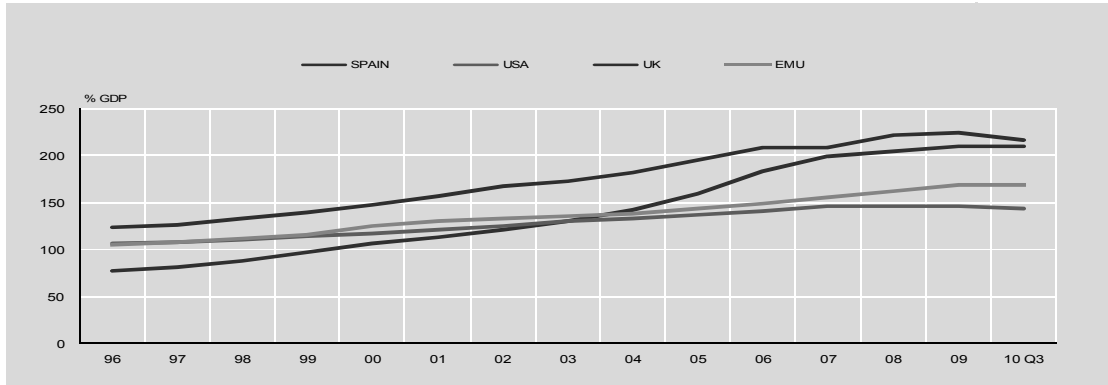
CHART 7



SOURCE: JP Morgan.

DEBT OF HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS

CHART 8



SECURITISATION MARKETS: PROPOSALS FOR REACTIVATION

Oscar Arce

Comisión Nacional del Mercado de Valores - CNMV³

1. Introduction

The mass securitisation of assets is among the most visible products of the financial innovation wave of the last decade. In advanced economies, this financial practice mobilised huge amounts of private credit in the years before the current crisis, by allowing the original owners of credit rights to amplify their traditional range of financing channels. In the years 2000 to 2007, the volume of asset-backed securities rose by 148% in the United States, 534% in Europe and almost 1300% in Spain, as we can see from figure 24 below. Such is the importance of securitisation for the Spanish market, of mortgage loans especially, that Spain is the second country in Europe by volume of asset-backed securities in circulation, surpassed only by the United Kingdom, with an estimated value (including securitised mortgage bonds) equivalent to 24.7% of last year's GDP.

Mass securitisation is among the most visible products of the intense financial innovation of the last decade.

Asset-backed securities outstanding
United States

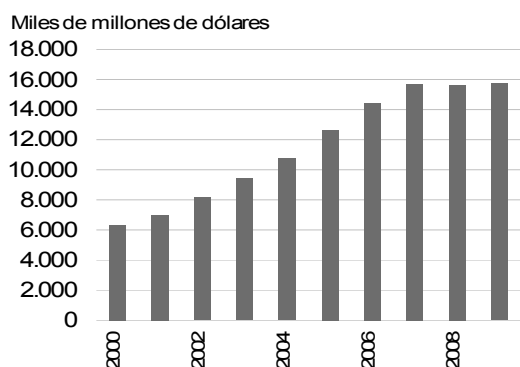
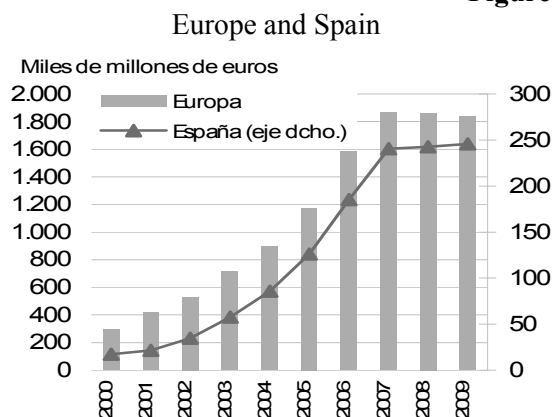


Figure 24



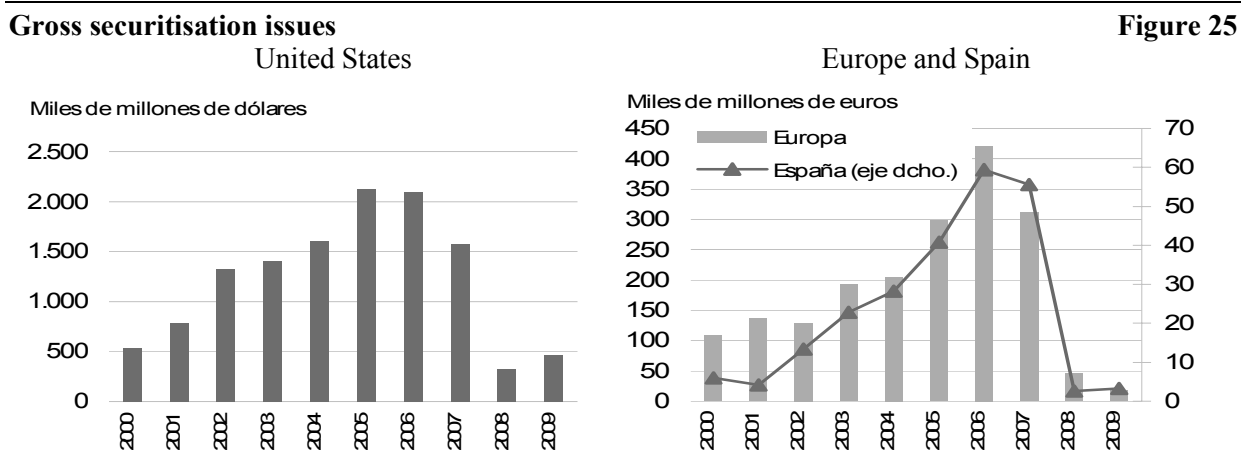
Source: Dealogic.

However a wave of defaults in the U.S. subprime mortgage sector starting in the first half of 2007 marked a turning point in what until then had seemed to be the unstoppable growth of the country's mortgage loan securitisation. Although the actual amount of subprime defaults was not that large compared to the size of the U.S. mortgage market, the fact that so many of these loans (around 75%) had been securitised caused a slump in investor confidence in this kind of structured product. Within a matter of months, this distrust had

³ This manuscript corresponds to section 5, chapter 1 of the CNMV Bulletin, 1st Quarter 2010, available on <http://www.cnmv.es/portal/Publicaciones/Mercados.aspx>

spread to practically all types of asset-backed securities, causing demand to simply cave in. As a direct result of this abrupt withdrawal of investor confidence, new securitisation issues have begun to dry up all over the world (see figure 25).

Defaults in U.S. subprime mortgages eroded investor confidence in structured products triggering a worldwide slump in demand.



Source: Dealogic.

In this context, it is not hard to understand what doubts have been sown about the whole future of securitisation. On the one hand, asset securitisation holds unquestioned potential as an enhancement tool for credit institution financing and risk management. On the other, the grave problems that the financial crisis has brought to light in the orbit of this practice dictate that any opportunity for its reactivation will depend on the ability of regulators and the industry itself to learn from the lessons of the past and lay the groundwork for a new securitisation framework that is simpler, more reliable and more transparent for the end investor.

The result has been to fuel doubts about the future of securitisation. Whether it can prosper once more will depend on the ability of regulators and the industry to come up with a simpler, more transparent development framework.

The aim of this chapter is, firstly, to identify the vulnerabilities surfacing in securitisation during its years of greatest triumph and, secondly, to describe some of the ideas recently put forward to reactivate the market. It is accordingly divided into four main sections: the problem of incentives in securitisation structures (section 2), the central role of rating agencies in valuing structured products (section 3), the need to progress in the transparency, simplification and standardisation of asset-backed securities (section 4) and ways to improve the functioning of secondary markets (section 5). Finally, section 6 offers some closing reflections.

2. Compatibility of incentives in the securitisation chain

The length and complexity of the chain of contracts in any securitisation process ensures that structured products are fertile ground for conflicts of interest between the parties. Two of these potential conflicts merit deeper discussion. The first is the possible existence of opposing interests within rating agencies, in their dual role as calibrators of risk and providers of investment advice, which we will leave until the next section. The second has to do with the lack of incentives for the originator of the securitised loan to act with sufficient care and diligence in assessing the credit quality of the securitised assets.

The length and complexity of the securitisation chain makes it an easy prey to conflicts of interest.

This problem of moral hazard, which arises in a wide variety of financial contracts and products, becomes especially relevant in the case of securitisations, because of the intrinsic difficulty investors face in deciding the quality of the product. In particular, the vast number of individual loans that may end up in a securitisation pool, and the complexity of the structuring techniques used in product design, stand as a major barrier to external validation of the real quality of the underlying assets. And this, together with burgeoning demand for high-quality assets during the last expansion phase, may have done much to exacerbate the problem of credit institution incentives.

One recent suggestion to align the originator's interests more closely with those of the end investor is to require all originators to retain a certain minimum proportion of the risk being transferred to investors. Variations on this idea have already received the blessing of the G20, the United States Government and the European Union.

One way to align the interests of originators and end investors would be for the former to retain a certain proportion of securitised exposures.

In the case of the G20, point 12 of the leaders statement issued after the Pittsburgh summit of September 2009⁴ calls for securitisation sponsors or originators to retain part of the risk of the underlying assets, though it does not specify how much.

This idea has received the backing of the G20,

In Europe, an amendment to the Capital Requirements Directive (article 122a) approved in May 2009 bars EU credit institutions from investing in securitisation issues in which the originator retains a net economic interest of less than 5% of the securitised exposures. The Directive also stipulates that this net economic interest must be retained on an ongoing basis without resorting to any form or mechanisms of credit risk mitigation. The new norm is scheduled to come into force in 2011.

...the European Union, which amended its Capital Requirements Directive accordingly in May 2009, and...

Meantime, the United States Government came up with a similar proposal⁵ last year in the frame of its financial regulatory reform plan, likewise targeting a minimum retention of 5%. However, the U.S. document contains two points of difference with respect to the European text. The first is that the obligation falls on the originator but not the purchaser. The second is the flexibility allowed in applying the minimum retention threshold, which is greater in the American case, since supervisors would be empowered to adjust it, upwards or downwards, in certain circumstances.

...the Government of the United States.

In any event, the imposing of minimum retention thresholds is undoubtedly an attempt, in spirit at least, to reconcile the interests of securitisation chain participants. Its implementation, however, will have to be balanced and flexible enough to ensure that retention requirements square with the real risk profile of each type of securitisation. In Europe, moreover, it is important to apply minimum retention thresholds similar to those envisaged in article 122a of the Capital Requirements Directive to the originators of securitised exposures on the balance sheets of entities other than credit institutions. Otherwise, we risk giving rise to

⁴ G-20 (2009): *Pittsburgh Summit Leaders Statement*, 24-25 September 2009. Available from http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf

⁵ United States Treasury Department (2009): *Financial Regulatory Reform. A New Foundation: Rebuilding Financial Supervision and Regulation*. Available from http://www.financialstability.gov/docs/regs/FinalReport_web.pdf

regulatory arbitrage opportunities that favour the build-up of asset-backed securities in the portfolios of institutions exempt from capital requirements.

To be effective, its implementation must be balanced and flexible enough to align retention requirements with the real risk of each type of securitisation.

3. The role of rating agencies

The complexity and, at times, opacity of securitisation transactions ensured rating agencies a key role in their valuation. But the slump in the value of asset-backed securities at the onset of the crisis has called into question the quality of their rating practices.

The complexity of securitisation transactions has put demands on rating agencies that they have been unable to fulfill.

Among the problems faced are the possible conflicts of interest deriving from agencies' dual role as providers of advisory or consultancy services to securitisation issuers, and as valuers of the resulting securities; the risk of strategic selection by issuers (rating shopping) to secure the best possible grade; agencies' limited experience in rating securitisations, especially complex issues for which there are no reliable performance records; and a lack of clarity regarding key factors like the valuation methodology used, the meaning of ratings or the depth and quality of the risk analyses run on underlying assets.

Among the problems detected are possible conflicts of interest arising from their dual role as advisors and valuers.

Regulators and supervisors have come across some of these problems before, and in fact had previously sponsored diverse initiatives based on self-regulation – the case of the IOSCO code of conduct for credit rating agencies (2008)⁶. However, deeper reflection in the wake of the crisis has persuaded them of the need to regulate rating agency activities. In Europe, this need is addressed in the recently published Regulation 1060/2009, which, for the first time, brings rating agencies under an authorisation and supervision system.

After due reflection, the authorities have opted to bring rating agency activities within the regulatory fold. This is the purpose of EU regulation 1060/2009.

Its principal measures with regard to structured financing are summarised below: It is prohibited to make proposals or recommendations on the design of structured finance instruments on which the agency is expected to issue a credit rating, i.e. they may not simultaneously provide advisory and rating services.

- Reporting of all assessments undertaken. In order to discourage the practice of rating shopping, agencies shall disclose, on an ongoing basis, information about all structured finance products submitted to them for preliminary rating, whether or not issuers contract with the agency for a final rating.
- Requirements regarding the rating of assets previously rated by another agency. Under the new regulation, agencies may not decline to rate a securitisation issue on the grounds that some of the assets have previously been rated by another agency.
- Organisational requirements. Most of the board members of rating agencies should have sufficient expertise in financial services, while at least two should be independent directors. When the agency

⁶ International Organisation of Securities Commissions (IOSCO), 2008: *Code of Conduct Fundamentals for Credit Rating Agencies*. Available from: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD271.pdf>.

issues credit ratings of structured finance instruments, at least one independent member and one other member of the board shall have in-depth knowledge and experience at a senior level of securitisation markets.

- Disclosure requirements. The new regulation specifies as follows: i) agencies shall provide full information about loss and cashflow analyses performed or relied upon and an indication of any expected change in the credit rating, ii) agencies should explain the models and methodologies used, incorporating simulations of stress scenarios undertaken when establishing the rating, iii) agencies should clearly differentiate between the ratings of structured products and those of more traditional instruments by displaying an additional symbol that distinguishes the former, iv) agencies should indicate the depth of their analysis of underlying assets, stating whether they have assessed them directly or relied on a third-party assessment, and v) when the lack of reliable data or the complexity of the structure of a securitisation raises serious questions about the reliability of any risk assessment, the agency should refrain from issuing a credit rating or withdraw an existing rating.

In sum, this new regulatory initiative tackles conflicts of interest within agencies, while imposing considerably stricter disclosure requirements. These two factors – incentives and disclosure – are essential if rating agencies are to fulfil their core function of mitigating information asymmetry between originators and investors. The challenge now is to ensure that they are rapidly and efficiently deployed.

The new Regulation seeks to mitigate conflicts of interest while imposing stricter disclosure requirements.

For the moment, the Regulation assigns the oversight of rating agencies to supervisors designated by Member States, though there is agreement that these powers should later be transferred to the European supervisory authority emerging from the transformation of the CESR.

4. Measures for the simplification, standardisation and transparency of securitisation

As we stress at the start of this chapter, the global implosion of securitisation markets can only be explained by a sudden collapse in investor confidence. And this collapse was largely due to the complexity and opacity that tend to surround products. Restoring confidence therefore calls for a greater degree of transparency, simplification and standardisation, and this is precisely the aim of the initiatives described below.

Simplification, standardisation and increased transparency are the keys to winning back investor confidence.

IOSCO recently issued a report⁷ with an exhaustive list of disclosure principles for asset-backed securities, focusing on those aspects where transparency is most clearly lacking: the identity, legal situation, functions and responsibilities of each participant in the securitisation chain, and the possible links between them; the securitisation experience of the originator and sponsor; the composition and characteristics of the assets making up the fund and details of individual performance by type (for instance, by cohort of mortgage loans entering the pool); concentration of exposure in a small number of receivables; transaction structure, including the flow of funds, fees and expenses, allocation of excess cashflow, contract termination or trigger clauses, etc.; credit enhancement; the use of derivative products to alter the payment characteristics of cashflows; the nature of risk factors material to the offering; the kind of markets on which the securities are to be traded and relevant tax information.

IOSCO has published an exhaustive list of disclosure principles for asset-backed securities.

⁷ International Organisation of Securities Commissions (IOSCO), 2010: *Disclosure Principles for Public Offerings and Listing of Asset-Backed Securities*. The consultation paper is available from <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD296.pdf>.

The issue of simplification was tackled by the Basel Committee on Banking Supervision (BCBS) in its recent review of weighting requirements for re-securitisation exposures in the Basel II framework⁸. On the evidence that re-securitisations are among the most complex types of structured products, and also among the most deteriorated on account of the crisis, the BCBS has sizably raised the corresponding risk weightings. Basel II will thus incorporate a separate weighting scale for these products, specifying increases at times of over one hundred percent, for application starting in the year 2011.

The Basel Committee on Banking Supervision has reviewed weighting requirements for re-securitisations.

A few months ago, the European Central Bank launched a public consultation paper with proposals on a structure for the gathering and upkeep of detailed intelligence on the loans entering securitisation pools, as part of the Eurosystem collateral framework. Its goals are, firstly, to provide rating agencies and investors operating in Europe with access to itemised information on this kind of product and, secondly, to work towards the establishment of a standard data gathering and reporting procedure in respect of euro area securitisations.

The European Central Bank has sent a proposal out to consultation on keeping detailed records of the loans entering securitisation pools.

Nationally, the CNMV has introduced pioneering new roles to strengthen the periodic reporting requirements of securitisation funds. Further to its Circular 2/2009 of 25 March on account standards, annual accounts, public financial statements, and reserved statistical statements of securitisation funds, all funds operating in Spain are obliged to file public and reserved statements with the Spanish regulator starting in early 2010.

The CNMV has taken a lead in Spain by imposing new disclosure requirements on securitisation funds.

Finally, the industry itself is leading a number of initiatives to boost the transparency and standardisation of key securitisation practices. One example is the set of ten initiatives drawn up by the Global Joint Initiative (2008), along with guidance on their implementation, tackling aspects like a standard definition for credit enhancement, the establishment of industry-wide due diligence standards, improvement in third-party valuation and audit practices, or training programmes specifically targeting directors and senior managers whose monitoring duties extend to securitisation products. But the most ambitious industry-led initiative to date is surely the RESTART project (Residential Securitisation Transparency and Reporting) launched by the American Securitisation Forum (ASF) in 2008 with a view to restoring investor confidence in mortgage-backed securities. This project is split into six phases. In July 2009, the Forum published the final blueprint for the first two, to be implemented in 2010, the aim in both cases being to increase and strengthen disclosure requirements. The first comprises a disclosure package whose purpose is, firstly, to provide substantially more critical data than has hereto be available to investors, rating agencies and other market participants and, secondly, to standardise the presentation of all data to allow investors to easily compare loans and transactions across all issuers. The second deliverable, known as the reporting package, comprises the enhanced and standardised monthly updating of critical pool and loan-level information.

And the industry itself has launched a number of initiatives to boost the transparency and standardisation of key securitisation practices.

⁸ Basel Committee on Banking Supervision (BCBS), 2009: *Enhancements to the Basel II Framework*. Available from <http://www.bis.org/publ/bcbs157.htm>.

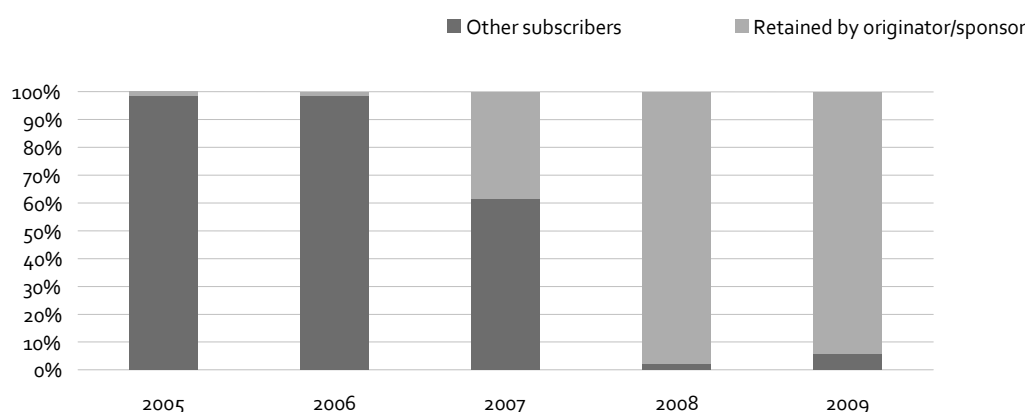
5. Proposals for secondary markets in asset-backed securities

The strong liquidity enjoyed by structured product markets evaporated when the crisis hit. According to IOSCO, for example, trading in residential mortgage-backed securities fell by 45% in the months following its onset. In Spain's case, although issuance of asset-backed securities held up reasonably strongly, most of the volumes issued since end- 2008 have been retained by originators and used as collateral for Eurosystem loans (see figure 26). Something similar has occurred in the rest of Europe and in the United States, whose Government launched a one-off initiative to revitalise the market at end-2008 specifying that asset-backed securities would be accepted as collateral in Federal Reserve refinancing operations⁹.

Structured product trading volumes fell substantially during the crisis, causing liquidity tensions in secondary markets...

**Nominal value of asset-backed securities in Spain
by type of subscriber¹**

Figure 26



Source: CNMV.

¹ According to prospectuses filed with the CNMV.

It must be said however, that the liquidity crunch in asset-backed securities markets, which in the midst of crisis left numerous investors without a counterparty for their trades, had more to do with concern over the quality of underlying assets than any failure of market functioning. Further, the climate of distrust brought on by the crisis was compounded by the narrowness of primary market spreads, denoting a miscalculation of risk at the point of issuance. And this has led to a situation where any increase in asking spreads would of necessity drive secondary market prices well below par.

...which had more to do with agent distrust than with possible failures in market operation.

Hence the search underway for mechanisms to boost the liquidity and efficiency of these markets, led by organisations like CESR and IOSCO. Their interest, for the moment, has focused on post-transparency regimes, i.e., the a posteriori disclosure of trading volumes and prices.

A series of international initiatives are focusing on ways to boost secondary market liquidity and efficiency.

⁹ Ashcraft, A.B., and T. Schuermann, 2008: "Understanding the Securitisation of Subprime Mortgage Credit," Federal Reserve Bank of New York, Staff Report n° 318.

A recent CESR report¹⁰ on the transparency of structured finance and credit derivative markets concluded that the lack of post-transparency was not to blame for current liquidity shortages in securitisation markets, while insisting on its important role in market operation as an aid to valuation. That said, it warns that pro transparency measures must be introduced with care to avoid unwanted pressures on liquidity. The best option, it concludes, would be the phased implementation of a harmonised pan-European regime for asset-backed securities of a comparable nature.

CESR underscores the importance of market transparency, but warns that care should be taken not to create renewed pressures on liquidity.

An IOSCO report drew similar conclusions regarding the relative importance of post-transparency¹¹. While admitting that deficient information on past transactions is not a prime cause of illiquidity, it contends that liquidity problems in part reflect a lack of reliable inputs for the valuation of structured products. The organisation has also sounded the views of market participants on the pros and cons of a mandatory post-transparency regime. Among the pros, respondents cited the mitigation of information asymmetry between market participants, more efficient pricing, and its usefulness to investors in valuing their portfolios. The main drawback, as they saw it, was that the complex, non standard, illiquid nature of many asset-backed securities would in any case impair price comparability. Also, as in many other cases, the disclosure of more post-trade information could prove a negative incentive for market participants, by forcing them to reveal data that could give away their strategies.

IOSCO arrives at similar conclusions.

On balance, however, it seems clear that some kind of enhanced post-transparency regime would be a step in the right direction, especially at times like these of heightened uncertainty. Any such move must of course bear in mind the idiosyncrasies of secondary securitisation markets, of which the following in particular spring to mind: the degree of liquidity or turnover of each kind of instrument, the original issue volume, whether placement was public or private, the size of the investor base, the extent of securities standardisation, the rollout cost of a post-transparency system, and the wisdom of introducing flexibility in disclosure requirements (for instance, delays in disclosure, reporting of data on an aggregate vs. transaction basis, making minimum trading volumes exempt from disclosure to preserve the anonymity of the trader, etc.)

On balance e, enhanced post-transparency requirements would seem to be a step in the right direction.

The next logical step after a reform of post-trade transparency in structured product markets would be to broach the possibility of standardising their trading rules, with thought to a common (or broadly similar) regime for at least the main regulated markets.

The next logical move would be to look at ways to increase standardisation in structured product trading rules.

6. Closing remarks

Both regulators and the industry itself are pursuing ways to revitalise struggling securitisation markets. A return to pre-crisis practices can be ruled out, given the greater caution investors will presumably exercise in future, and nor is it especially desirable given the numerous failures that the crisis has brought to light. In this article, we have considered some of the main problems the industry confronts and some recent

¹⁰ Committee of European Securities Regulators (2009): “Transparency of corporate bond, structured finance product and credit derivatives markets”. Available from <http://www.cesr-eu.org/popup2.php?id=5798>.

¹¹ International Organisation of Securities Commissions (IOSCO), 2009: Transparency of Structured Finance Products. Available from <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD306.pdf>.

initiatives to overcome them. Among the former, we have singled out conflicts of interest among securitisation participants, insufficiently robust valuations and incentive problems in rating agencies, the need for more transparent, simplified and standardised products and the lack of post-trade transparency in secondary markets.

Regulators and industry continue working to the goal of revitalising securitisation markets.

The goals of the industry's pursuit are clear enough: to achieve a sustainable recovery in securitisation markets, on the grounds that, despite the excesses of the recent past, there remains much to be gained from this financial technology, with its enormous potential as an instrument of bank financing and for the pooling of risk. To be successful, however, initiatives must rest on a balanced combination of new regulatory elements and more responsible practices on the part of the industry.

The success of these efforts will require a balanced combination of new regulatory elements and new industry practices.

SECURITISATION AND COVERED BONDS MARKETS: FUNDING AND RISK TRANSFER OBJECTIVES, INFORMATION AND DISCLOSURE ISSUES

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Abstract

The financial crisis has brought asset information to the centre of concern and controversy for market participants, supervisors and regulators. There is a wide agreement on the benefits of enhancing information and disclosure at all levels. However, there may be excessive expectations on the capacity of such enhancement to restore ABS markets, while some information related initiatives may not respond to a sound market necessity. The Spanish ABS market is well organised in what respects information and disclosure issues, but asset data at originator level may have a relatively poor quality. If banking institutions make an effort to enhance their loan information the Spanish SPVs management companies (Gestoras) are ready to provide the market with the highest standards of disclosure for ABS transactions. However, due to new regulation and changing market concerns, ABS is loosing attractive as funding tool when compared to alternative asset-based instruments, such as covered bonds, and the market may not resume with the level of activity previous to the crisis.

1. The importance of information

It is widely assumed that the opacity of certain financial instruments and markets, in particular those related with securitisation and derivatives, is to be blamed as one starter of the crisis and an obstacle to restore the confidence that markets require. With this in perspective, the ECB, BoE, SEC, IOSCO and CESR have launched initiatives to enhance the ABS market, formulating recommendations and proposing new regulation on loan information contents, disclosure requirements and credit rating related issues.

These initiatives have objectives such as: increase market transparency, reduce information asymmetry, restore investor confidence and, consequently, bring back previous investors and attract new participants to the ABS market. The latter is a necessary condition to restore levels of funding that allow Central Banks progressively reducing emergency liquidity facilities. The ECB initiative, officially launched last December, is the so called Proposal for ABS Loan-Level Information Requirements, which will constitute part of the eligibility criteria for asset discount at the ECB¹³. Closely related to this proposal is the BoE

¹² Prepared for The Working Party on Financial Statistics - Workshop on Securitisation, 27-28 May 2010, Bank of Spain, Madrid, Spain. The author thanks Carmen Barrenechea, Manuel Gonzalez and Borja Saez for their comments.

¹³ On 23 December 2009 the European Central Bank (ECB) launched a public consultation on loan-by-loan information requirements for asset-backed securities (ABSs) in the Eurosystem collateral framework.

initiative to define additional criteria for its own discount facility¹⁴. We comment on these proposals in the next section.

The SEC, more concerned than its European peers about the role played by Rating Agencies in this crisis, adds to the list of objectives the mitigation of conflicts of interest which may result from the rating industry procedures. The SEC new rule has given way to a reaction which is a notorious example on how regulations and new market requirements travel immediately across jurisdictions, typically in one direction: west to east. The recently published regulation, applicable to all structured products under the SEC jurisdiction, basically amounts to an obligation for the issuer to disclose, in real time, by means of a password protected web site, all documents and conversations concerning the rating process initiated with a hired rating agency. For the hired Rating Agency to start the rating process, the issuer must accept this requirement and the Agency will have to cease the process or cancel a given rating if the issuer does not satisfy the compromised agreement. All registered agencies recognised by the SEC must have access to the web at any time and without limitation. The consequence of this requirement, legally enforceable exclusively in the SEC jurisdiction, has been its immediate application world wide. Major Rating Agencies operating in Europe have already stated that they will require as soon as June 2010 the same standards of disclosure to European transactions¹⁵. The problems of implementation of this particular rule and the difficulty to estimate the consequences of the responsibilities assumed by issuers may drive some to abandon the ABS market or, at least, to postpone planned transactions. Probably this is also a good example of the damage that can be caused overreacting with regulations in a not sufficiently explored territory.

The European initiatives are focused on information for the market. It is hard to minimise the importance of information for the proper functioning of the financial markets, but we should always bear in mind that the real importance of information lies more within the banks themselves and for the purpose of risk control. Enhancement of information quality and improvement of organisation and data management systems, both for the internal control of risk and for the external supervision of the banks, should be the primary target of regulators, more than the problems of market malfunction, without minimising the relevance of the latter.

In this respect we could adventure the following hypothesis referring to the recent past. If loan information had been better in content and more accessible internally (in the banks) and externally (to the supervisors), alarms would have turned on at an earlier stage of the bubble, reducing the size of the consequent disaster. The unprecedented growth rates and high leverage of the banking industry, facilitated by securitisation techniques, developed in an ocean of liquidity and in an apparently unlimited capacity of the markets to absorb debt, at historically low spreads and without consideration for credit risk. That, in its turn, was a strong incentive to downgrade loan origination standards, which combined with poor loan information and deficient control systems ended up driving many banks to the edge of bankruptcy. Poor information, together with greed, is a necessary condition for bubbles to develop.

¹⁴ Bank of England consultative paper on extending the eligible collateral in the Discount Window Facility and information transparency for asset-backed securitisations.

¹⁵ The United States Securities and Exchange Commission (SEC) has adopted an amendment to Rule 17g-5 relating to rating agencies registered as Nationally Recognized Statistical Rating Organisations (NRSROs). The Amendment requires arrangers (defined as issuers, sponsors or underwriters) that hire an NRSRO to rate any new structured finance security to provide certain written representations to the NRSRO being hired obligating the arrangers to make available to any NRSRO, whether hired by the arranger or not, all information provided to the hired NRSRO both for determining the initial credit rating and for ongoing surveillance. The information must be made available by posting it on a password protected web site available to all NRSROs. Both Moody's, Standard & Poor's and Fitch have announced that they will apply the same standards in Europe for ABS, while they exclude covered bonds.

The difficulties of credit institutions to produce quality loan information and make it easily available to third parties (supervisors, rating agencies, markets), which still today is frequently the case, has to be taken as a clear indication that risk control was not as rigorous as it should have been. So, let this be the main target in the search of new information standards.

Among the elements that made the markets collapse, perhaps too much responsibility has been assigned to the lack of information on ABS. And now, unreasonable high expectations have been placed in restoring markets by means of simply enhancing information. Regulators and supervisors have over-reacted with an avalanche of proposals to increase the amount of information and facilitate its accessibility to all market participants. But a deficient diagnosis on where, for whom and what information was insufficient may lead to inadequate proposals with void results. There is a risk of introducing disclosure requirements and promote new market institutions for the broader accessibility of information, as it is the case of the ECB Proposal, that could end up being a fiasco.

Two different issues should be distinguished. On the one hand the importance of increasing the standards of information in the credit institutions themselves. On the other hand, the search of a balance between disclosure and efficiency across ABS market participants: issuers/originators, investors, servicers, analysts, supervisors, rating agencies, etc.

2. The ECB proposal

There is a wide consensus among all market participants that information on ABS requires enhancement if the market is to be restored. At least, this is considered by all a necessary if not a sufficient condition. It is also widely recognised that differences among assets have to be considered, because not all assets demand the same levels of information. And, finally, within the EU, it is now widely accepted that an effort on data standardisation and homogenisation is required to overcome differences between jurisdictions in the search of a more unified market.

The ECB proposal is an initiative in this direction. Initially the proposal is addressed exclusively to RMBS, but the plan is to extend it to other ABS in the future. It has two basic elements:

- a) A very extensive asset/debtor and bond information data template, with static and dynamic fields, to be implemented by originators, loan servicers and SPV cash-flow servicers. The template is a worthy effort to homogenise terminology and consider the differences among jurisdictions.
- b) The obligation to disclose information to all market participants, at loan by loan level and on an ongoing basis during the life span of the ABS. The question of how to implement this disclosure, either by a unified data portal or by several, remains open.

The ECB plans to introduce these two elements in the ABS market by making them a requisite for bond eligibility in the Eurosystem collateral framework. Taking into account the crucial role of the discount facility in today's financial system, this new requisite to be applied exclusively to ABS should not be underestimated. It is going to become very important, in particular in those jurisdictions where securitisation is more used compared to covered bond issuance.

According to the ECB, the initial response to the proposal gathered from the industry is positive. The provision of more detailed information is considered that would help the market to assess the risks associated with ABS. It is also considered that the reporting of data to the broader market on an ongoing basis would contribute to restoring investor confidence. It is also reported that investors think that loan-level information would unquestionably benefit all types of investors, as well as the general level of liquidity in the market, plus potentially attracting new investors. According to some investors, all those benefits that could be attained, by far outweigh the cost of providing loan level data. Finally, we are also

told, that one respondent to the consultation has calculated the cost for the availability of loan-level daily performance data at five basis points of the principal amount of the securitised loans, annually. High expected benefits and what seems to be interpreted as low cost, give no reason to the ECB to reconsider the proposal. Preparatory work is expected to be completed by September 2010 and issuers would have 12 months prior to provision of data becoming mandatory.

The proposal to enhance and standardise asset information across jurisdictions by means of a unified data template is without any doubt a very positive initiative. All efforts in that direction should be welcomed. No matter the type of underlying asset we refer to (residential mortgages, commercial mortgages, small and mid-size enterprises, consumer loans, credit cards, students loans, etc.) this is an important objective to attain across the EU and it constitutes the first step to eventually approximate, if not unify markets. It could be said that such an agreement across jurisdictions on the information required for each type of asset, to guarantee the proper assessment of risk, is much more important than deciding now on the particulars of market information disclosure, which to some point could be left for the market to decide. As it has been stated before, the importance of loan information quality goes beyond securitisation and it should be more a concern for the banking supervision regulation than an ABS requirement for ECB discount eligibility.

However, a different consideration deserves the ECB requirement of a broad distribution of loan-level information. The availability of loan-level information at, say, an extra cost of five basis points may look as reasonable for some, in particular if it is not clear how and who is going to pay in the first place and by whom the cost is finally absorbed¹⁶. But, costs aside, the main concern about this part of the proposal is that it may be unnecessary to attain the benefits envisaged by investors, if there are attainable at all. The point is to what extent those market benefits depend on information issues and, if reachable, to what extent they could not be reached simply by:

- Requiring better information at the originator's and cash-flow servicer's levels, which is the objective of the template,
- Standardising and enhancing reporting obligations with some level of aggregation, and
- Facilitating access to information on a decentralised basis.

That is, the proposal should encounter a balance between disclosure benefits and the cost (not only immediate monetary cost) of imposing requirements and creating centralised market institutions which may not respond to a real today's market demand. Contrary to what has been suggested by some, the costs of centralising loan level data for its broad disclosure may outweigh its benefits and induce a reduction in market size. In fact, it could be the case that the proposal retreats potential ABS issuers unwilling to assume administrative costs and to disclose data on a broad basis and to a level of detail which may unveil confidential internal policies beyond the performance of a particular portfolio. The point is not if the market information platforms (Bloomberg, Reuters, etc.) shouldn't have more and better information on ABS, which certainly would be positive for the market. What we maintain is that going from information on bonds, which is what the platforms now have, to loan-level data of the underlying portfolios, is probably an excessive and unnecessary jump or, at least, premature.

A different question is that ABS generates specific issues of information asymmetry which could generate problems of privileged information that should be taken into consideration. For most ABS and in particular

¹⁶ In Spain an average ABS transaction of 500 million Euros is charged with ongoing annual costs in the range of 2-3 bp. Costs include trustee (Sociedad Gestora), payment agent, rating surveillance and SPV annual audit. Loan servicing, typically done by the originator/issuer is not included. Note also that the average spread of residential mortgage loans in Spain is approximately 75 basis points.

for MBS, loan-level information is required for a proper credit risk assessment. Therefore, as it happens now, at least in the case of Spain, Credit Rating Agencies (CRA) demand and receive loan-level data, and it is very unlikely and undesirable that the industry retreats in that aspect. In addition, probably it is the case that in some jurisdictions privileged investors are having access to loan-level data on demand, which creates an unacceptable asymmetry in the market. So, there is a real problem to be solved: establishing the limits of disclosure.

The ECB justifies the requisite of public availability of loan-level information as a means to have it available to assess the risks of the bonds taken in guaranty. To some point, taking into account that another requisite for ABS discount is having triple-A rating by at least two CRA, it seems that the new requisite is somewhat excessive. Standard & Poor's has recently published data showing that no European ABS, CMBS or Covered Bond rated above investment grade (BBB) by S&P has defaulted in the period from mid 2007 to the end of 2009. In the same period no RMBS rated above A has made default and the cumulative default rate of those rated A was 0.04% in that period. Defaults concentrate in ratings below investment grade and in CDO's (1.51% in total for all ratings). However, it could be a surprise for many to now that, according to S&P, overall rating levels and overall those mentioned European bonds, the cumulative default rate was only 0.39% over the period. That figure was 4.29% in the US¹⁷. With that information available, the question of why the ECB is so concerned with ABS credit risk to require two triple-A ratings in the discount facility seems more than relevant. The question is even more relevant if we consider that the information refers to defaults, which means that the data on loss has to be even more favourable. What is the reason for the ECB to require double triple-A in ABS and not in other type of bonds? Is it a matter of some kind of discipline for that market? Probably it is time to start reconsidering the meaning of triple-A ratings.¹⁸

Maybe the ECB plans to use loan-level information to assess risk and start excluding ratings from regulations; an initiative that many would applaud. The extended inclusion of CRA ratings in regulations affecting the financial system is one of the reasons for the questionable drift the rating industry has taken in the recent past and perhaps also the cause for the misuse of ratings by investors. Data shows that the refinement of CRA analysis in the upper part of the rating scale is no more than an illusion and the product of models that produce thin results out of gross hypothesis. The formal consistency of the rating models applied by the Agencies is confused with the coherence of the analysis. Ratings, as opinions on future situations determined by human behaviour, have an arrogant and pretentious accuracy. Hence, establishing legal requisites, such as triple-A rating, that affects banks and markets in a decisive manner, may benefit some players, redistributing resources in their favour, but damages all by introducing instability. The latter because Triple-A is a thin and blurred line, understood but by a few, that in the financial world separates heaven from hell. Such a line should not be used as an instrument for regulatory discrimination neither among assets nor for credit entities, neither should it be used for blind investment decisions.

As it has been mentioned above, the BoE has its own initiative on information requisites for eligible collateral in the Discount Window Facility. It is under consultation a proposal to extend the Facility beyond structured bonds and directly accept for discount portfolios of eligible retail loans. The rating of the portfolio would not be required in that case, and the credit risk assessment would be the exclusive responsibility of the BoE. This is an interesting proposal, obviously not free of implementation problems, but which could be taken as a first step to limit the power of CRA, that in many cases we may discover aren't necessary. If rating is to play for the BoE exclusively a role of risk comfort provider, it may be

¹⁷ European Structured Finance: Rating Transitions 2007 – 2009, Roberto Paciotti, Standard & Poor's, May, 2010. Data remain basically the same at the end of Q1-2010, as reported by S&P.

¹⁸ ABS-Asset-backed securities. SME-Small and medium-sized enterprise. CDO-Collateralized debt obligation. CMBS-Commercial mortgage-backed securities. RMBS-Residential mortgage-backed securities.

simpler, more transparent and reliable to define a set of eligibility criteria for assets and portfolios, than to be dependent on the mysteries of rating models and the voluble opinions of CRA on ABS.

Going back to the ECB, its proposal seems to be missing the importance and complexity of providing the broad market with the SPV cash-flow structuring models which are behind each ABS. The nature of ABS tells us that loan-level data is not enough information for the assessment of credit risk and to price the ABS. The model that redistributes the SPV cash flows is necessary for that purpose. The assessment of the underlying portfolio credit risk doesn't give necessarily the best assessment for the bonds. Moreover, it is a common mistake to infer the quality of a particular ABS strictly from the quality of the underlying portfolio and vice versa. But centralising loan-level data-bases with broad accessibility, which include the SPV structuring models, is neither free of problems, as it has been properly pointed out by respondents to the BoE consultation. Again, an efficient alternative could be that the cash-flow models and the loan-level data are located at some intermediate level, at a third specialised independent party. The latter would have the obligation to provide the CRA with loan-level data, but the market would receive exclusively aggregated-level enhanced information. That role is played in the Spanish ABS market by the SPV management companies (Sociedades Gestoras), which represent the SPV and act as cash-flow controllers at loan-level.

We are reported by the Bank of England that the industry considers that covered bonds (CB) shouldn't be subject to the same requisites of loan-level information than ABS¹⁹. The reason given is that the analysis of the underlying loan portfolio in the case of a CB is not part of its risk and pricing analysis. We are told that detailed stratification tables, loan-level data and cash flow models are relevant for the risk and pricing of ABS, but are rarely used for the risk and pricing analysis of CB. We think that this is a fact, but it suggests the following issue: in a triple-A scenario, a consistent analysis requires to assume that the CB issuer is in default, while simultaneously the cover pool and whatever other guaranties, if any, have to be sufficient to rate the CB as triple-A. Therefore, for a triple-A rated CB and exclusively from the point of view of credit risk assessment, theoretically, the underlying portfolio is also important. So, to be coherent with its own concerns about the risk of the discounted bonds, the ECB should extend the loan-level data requirement to CB. That should not be considered a proposal.

If loan-level data is considered necessary for triple-A ABS investors but not for triple-A CB investors, being important for credit risk assessment in both cases, it is because the relevance of loan-level data is not for credit risk analysis. In fact, except for non-granular portfolios where individual risk assessment may be relevant, loan-level data is not essential to analyse credit risk; it should be sufficient with the standard aggregate-level information available in the market. Loan-level data is justified if investors want to make their own cash flow analysis under alternative prepayment assumptions. That is, pricing analysis beyond credit risk. This is obviously important for investors, but it is a relatively less important issue in the case of floating rate ABS, more extended in Europe than the fixed rate alternative. The question is to what extent is it possible to provide the market with sufficient information for market risk analysis without having to provide loan-level data on a regular basis during the life span of the ABS. Perhaps the necessities of investors for this matter, at least for the European market environment, have been overstated, and it is possible to give sufficient information without descending to loan-level. The information provided by cash-flow servicers on alternative prepayment scenarios, as it is currently done for Spanish ABS, may be a reasonable second best.

At the end, for credit risk analysis purposes, granularity reduces the relevance of loan-level data, in particular for high rated tranches. Therefore, for the most common and potentially liquid ABS, broad availability of loan-level data may be irrelevant. On the contrary, as the number of loans in the portfolio

¹⁹ We refer to the joint response to the BoE consultative paper by the European Securitisation Forum and other financial market associations.

reduces, as it is the case in many CMBS, loan-level data becomes crucial, while broad disclosure concerns grow in importance for the issuers.

3. The Spanish ABS information framework

The ABS market started in Spain in 1993 and it is regulated by law²⁰. Each ABS has to be structured by means of a regulated SPV, named “Fondo de Titulización” (FT). These play the role of trusts, an inexistent piece in our legal system. The FTs are represented and administrated by management companies, named “Sociedades Gestoras de Fondos de Titulización” (SGFT). These companies are regulated to exclusively perform this activity and are supervised by the CNMV. They play the functions of a trustee plus some additional responsibilities, in particular related to cash-flow and loan servicing control. As of today, there are seven active SGFTs in the Spanish market, which have control of all the ABS transactions issued under Spanish legislation since the origin of the market in 1993. This type of management companies exist in other jurisdictions, such as France, Italy and Portugal, but do not always perform the same duties in respect to the SPV. In the case of Spain their role of control and involvement in cash-flow servicing and market information is more important.

The issuance of each ABS has to be approved for registry by the CNMV, after a process of revision of all the legal documentation of the FT (deed of incorporation, contracts and prospectus). Rating is a legal requisite for Spanish ABS. The SGFT has to track the performance of all contracts (servicing, swaps, guaranties, investment accounts, payment agent, depositaries, etc.) during the life of the FT, watch for any breach of contract, act accordingly to demand responsibilities if any and take the necessary steps to substitute counterparties if required. The SGFT has the responsibility to liquidate the FT in favour of investors. All relevant management actions are reported to the CNMV and published in the corresponding web site of the SGFT for market knowledge.

To issue an ABS the SGFT receives from the originator/servicer loan-level data, with static and dynamic fields. Data is reviewed for internal coherence and to build a SGFT data-base capable of generating loan-level theoretical cash-flows. This data base will be used for the loan control during the life of the FT. The securitised portfolio has to be audited by an authorised auditing firm. This audit checks that the information given by the originator to the SGFT is correct.

During the life of the FT, at least on a monthly basis, the SGFT receives loan-level data from the servicer, which in almost all cases coincides with the originator. With that information the SGFT controls the performance of each loan, updates the data base and produces reports on arrears, defaults and prepayments. These are sent to the CNMV and published at the SGFT’s web site. Information is not published at loan-level.

With the periodicity of bond payments, the SGFT produces bond payment reports and estimates of future cash flows for alternative prepayment rates. Depending on each SGFT, the web site may contain richer information on the underlying portfolios and the bonds, including calculation facilities. All webs are access free and do not require registration.

Rating agencies always receive information at loan loan-level. If the agency requires the complete loan by loan portfolio for surveillance purposes the SGFT provides the information on a monthly basis. Investors

²⁰ The two Basic pieces of regulation are, Law 19/1992 and Royal Decree 926/1998

have no access to loan level information. All market participants have available the same information at the same time.²¹

In Spain the ABS information framework is well established and the above described procedures are applied to all types of ABS underlying portfolios without distinction. However, as of today, loan-level information doesn't satisfy the standard of the ECB template, in particular in what refers to debtor's data. In general these are the fields banks have to improve, in particular those of a dynamic character.

The Spanish ABS market, by means of the role played by SGFTs, is well positioned relatively to other EU markets to accomplish with the ECB information requirements. The SGFT already have in their data systems all the information on a loan by loan basis of all the Spanish ABS now in the market. It may not be 100% complete under the standard of the proposed ECB template, but it is ready for delivery.

The Spanish SGFT in conjunction with the official market AIAF, where all ABS are listed, are proposing the ECB to create a unified web portal for Spanish ABS, to give investors access to whatever bond and loan information is required, with the level of disaggregation finally decided.

4. The Future of securitisation

The unprecedented leverage that has given way to the present crisis has been possible by the wide spread use of asset based financing. This includes both securitisation and secured financing, being the latter basically represented by covered bonds and the former by ABS in the most ample sense. Germany has been the issuer by excellence of CB, with an outstanding volume of pfandbriefe of more than a trillion Euros at the beginning of the decade; adding up marketed jumbo issues, illiquid and registered bonds. During the decade the outstanding volume of pfandbriefe has decreased continuously, being substituted by French Obligation Foncières and Spanish Cédulas, along with new covered bonds from practically the rest of EU countries. Covered bonds remain as a European product, except for a testimonial volume issued from USA and Canada. As of today, the outstanding volume of marketed jumbo CB approximates 900 billion Euros. The illiquid (small transaction volume) and registered (non listed) covered bonds, basically pfandbriefe, may be in the range of 600 to 800 billion.

The total outstanding volume of European securitisation, including all type of collateral, barely exceeds the total European covered bond volume (including illiquid and registered issues): that is, a figure in the range of 1.7-1.9 trillion Euros. These numbers compare to those of securitisation in USA which are in the range of 7 trillion.²²

As it is well known, the crisis has hit harder securitisation compared to covered bonds markets. The disruption of securitisation markets at the earliest stages of the crisis caused their virtual disappearance and they have remained basically closed until today. As it has been mentioned above, the episodes of defaulted ABS in Europe have been anecdotic but the nature of ABS makes it difficult for these markets to operate under a generalised lack of confidence. This is however somewhat paradoxical if compared to CB, because it is possible that an apparently robust counterparty (the CB issuer) suddenly defaults, as we learned with Lehman, but it is much more difficult that an underlying ABS portfolio suddenly collapses. Evidently, the

²¹ In addition to providing information for the market and the rating agencies, the SGFT are responsible to provide the information required by Circular 2/2009 of CNMV (audited accounts, and standardised aggregated information on assets, liabilities and the SPV structure model) and Regulation (EC) 24/2009 of the European Central Bank on 19 December 2008 concerning statistics on assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2008/30).

²² More precise and detailed data can be found in the quarterly ESF Securitisation Data Report, and for covered bonds in the UNICREDIT Covered Bond Chartbook, issued twice a week.

market collapse cannot be explained in terms of probabilities of default. Anyway, the covered bond market disappeared as well in the eve of the crisis and only came back after the strong support of the ECB covered bond purchase program, still operative.

The future seems to be favourable for covered bonds and not so much for securitisation. This assertion is justified by the effect of certain changes in regulation and some reactions to the crisis that reduce some of the benefits of securitisation:

- Transferring credit risk by means of securitisation and consequently reducing capital consumption has become more difficult. Derecognising securitised assets has been increasingly difficult even before the crisis, at least in what refers to Spanish banks due to the supervisory practices of the Bank of Spain. In addition, expected new regulation to align issuers and investors and disincentive originate-to-distribute strategies, by requiring some form of tranche retention by originators, will also amount to a reduction in risk transfer, and consequently make securitisation less attractive for issuers.
- Rating agencies have modified their criteria giving more importance to counterparty risk and commingling risk. This is increasing the cost of securitisation, in particular to those issuers which do not have maximum short-term rating level. In most securitisations the originating bank acts as counterparty of swaps and other instruments of credit enhancement and is, at least transitorily, depository of cash-flow accounts and reserve funds. The need to use high rated third parties for these purposes increases costs and reduces their liquidity position.
- The SEC amendment to Rule 17 g-5 complicates ABS rating processes and increases its costs.
- Requirements of information for accounting and supervisory purposes have increased dramatically for ABS as compared to CB. This increases the relatively higher burden and cost of securitisation.
- Investors penalise the complexity of pass-through structures, typical of securitisation, in relation to the simplicity of CB.
- SIVs were the fundamental pillar for the leverage of the financial system. Their importance as investors at the eve of the crisis may have been close to 60% of the outstanding volume of European ABS. It is very unlikely that these vehicles or other similar alternative play the same role to sustain the ABS market.
- The lack of homogeneity of ABS, even within the same class of collateral, reduces the possibility of liquidity.
- The ECB discount facility penalises securitisation given both the double triple-A requirement, the higher haircut compared to the rest of discountable bonds and the opacity of the ABS valuation criteria.²³

Summarising these negative aspects affecting securitisation, the question for issuers in general and banks in particular is, why not substitute securitisation by issuing secured bonds if the possibility of capital reduction is very limited, issuance costs are much higher and investors and Central Banks claim a higher premium? If ABS has been reduced to a funding tool and no longer can be used to optimise capital, why not use covered bonds instead? The matching of cash flows within the originating banks can not be the only justification for securitisation.

²³ Fitch Ratings has published an opinion on this issue. *The Role of the ECB in Structured Finance: Maintaining Liquidity and Facilitating a Revival*. Europe Special Report. Fitch Ratings Structure Finance. 13 May 2010

However, we have the idea that covered bonds can be exclusively issued with collateral such as mortgages and public sector loans. But the concept of secured loan, which is the covered bond concept, can be easily expanded to all types of assets.

Underneath the recent securitisation market collapse was the confusion between funding and risk transfer within the same financial instrument. Maybe bank funding should concentrate in high rated bonds, with simple financial characteristics: that is, adequately secured bullet bonds. Issued in ample and potentially liquid markets, where investors are concerned by and properly informed about the cover pools, but do not require loan-level information to evaluate market risks. On the other hand, risk transfer and capital optimisation, could be left to illiquid markets, where specialised investors will demand high information quality. This could be the future of securitisation: transfer of risk by means of illiquid transactions where funding is not the issue.

5. Conclusions

Information is crucial for all markets but it is particularly important for ABS markets. However, enhancing information, both in content and in disclosure aspects, may not be the key factor to restore the markets. In this sense, some of the initiatives from Central Banks, designed to restore investor confidence and attract new participants, may not have a significant effect in the market in the short run, however they could ultimately have a positive effect on the financial system if they induce improvements in the standards of information of banking institutions. At least for this reason, the ECB proposal of a harmonised loan data template should be welcomed.

However, too high expectations may have been placed on the effect of broad disclosure of loan-level data to restore the markets. Perhaps, most ABS could perform equally well in the market with a lower level of data disaggregation but better data content. The Spanish ABS market information structure may be a good example in that sense: it is well organised but data requires enhancement.

Other considerations apart from information issues are relevant to disentangle the difficulties of ABS markets. In the aftermath of the crisis, obstacles are growing around securitisation making it less attractive than covered bonds for funding purposes. The cost and burden of issuing and rating ABS has increased and investors demand a high premium for assets which have high market risk. Moreover, a relevant part of the demand for ABS may have disappeared definitely from the market. European securitisation grew thanks to the demand from SIVs. These off-balance vehicles promoted by investment banks to play the role of term transformation without capital requirement, do not seem to have a place in the architecture of the future financial system, unless they incorporate some form of capital. Final long term investors, such as investment funds, pension funds and insurance companies, also under the discipline of mark to market and liquidity risk, may not generate sufficient demand to absorb long term ABS to the volumes seen in the past. Probably, the future of funding is for covered bonds, while securitisation will have to retreat to illiquid transactions designed to optimise the use of capital and as a cash-flow matching tool for corporate future flows transactions.

EUROPEAN SECURITISATION: MARKET UPDATE AND TRANSPARENCY INITIATIVES

Anna Zennaro
Association of Financial Markets in Europe / European Securitisation Forum

1. Introduction

On the 27th May 2010, at the OECD Workshop on Securitisation in Madrid, AFME presented an update on the European securitisation market and transparency initiatives. This document provides further detail on the content in the AFME presentation, which can be found in Annex 1. Please note that the information in this document is relevant to May 2010.

2. AFME: Who We Are

The Association for Financial Markets in Europe (AFME) represents the shared interests of some 200 global and European market participants in the wholesale financial markets. AFME focuses on a wide range of matters, which includes wholesale markets, business, and prudential issues. The objective of AFME is to promote fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of market participants. Annex 2 includes a Core Presentation introducing AFME.

3. AFME / ESF Research Reports

AFME / ESF publishes the following two data reports on securitisation:

- Securitisation Data Report, and
- Securitisation Monthly Data Supplement

3.1. Securitisation Data Report

The data report is produced on a quarterly basis and is published on the AFME website, <http://afme.eu/dynamic2.aspx?id=194>, with a link to an excel spreadsheet containing the underlying data. The quarterly report provides updated data on the European securitisation market, which includes:

- Market commentary on current trends and issues
- Primary issuance statistics
- Outstanding volumes
- Performance statistics
- Spreads of the primary and secondary markets
- Prices
- Total return data
- ABCP data

Primary issuance statistics includes both European and US total historical issuance figures from 2000 to YTD on a quarterly basis, denominated in Euros. European and U.S issuance figures for the current and previous years are provided by assets class, country of collateral, rating, and deal size. Market commentary is also provided, indicating the portion of the market issuance that is placed with investors or retained by the banks.

Outstanding volumes consist of volumes, denominated in Euros.

Performance statistics indicate the performance of by providing the volume of upgrades and downgrades as provided by Standard and Poor's, Moody's, and Fitch Ratings.

3.2. Securitisation Monthly Data Supplement

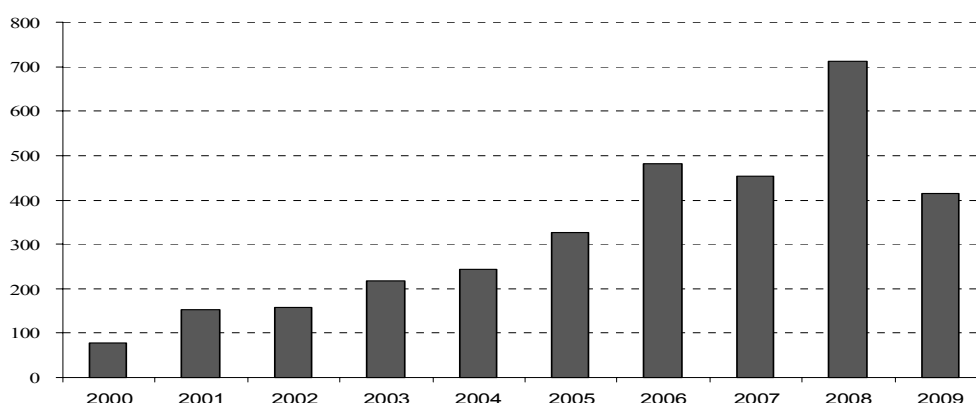
The securitisation monthly data supplement is published on the AFME website on a monthly basis, <http://afme.eu/dynamic2.aspx?id=1552>. The supplement provides updates on selected charts contained in the quarterly data report, which includes spreads and prices of European and US RMBS and CMBS, indices, and total return data.

4. European Securitisation Issuance Market

4.1. Total European Securitisation Issuance

Figure 4.1, below, provides the historical total European primary issuance figures from 2000 to 2009. The graph indicates that from 2000 to 2006, there was a steady increase in securitisation issuance. However, issuance numbers saw a decline in 2007. In 2008, issuance totalled EUR 711.3bn, which appears to be an increase from 2007; however, 99.8% of issuances were retained in 2008, meaning only EUR 1.42bn was placed with investors. In 2009, the total European securitisation issuance totalled EUR 414.1bn, a 42% decrease from the 2008 total of EUR 711.3bn. However, 94% of deals in 2009 were retained; therefore, only EUR 24.8bn of all issued securitisations were placed with investors. Therefore, in terms of placed issuance, 2009 saw a 17 fold increase from 2008.

Figure 4.1: European Securitisation issuance, EUR billion



4.2. European Securitisation Issuance by Asset Class

Figures 4.2 to 4.4 indicate the segmentation of market issuance according to asset class, from 2007 to 2009. The charts provide that the RMBS market from 2007 to 2009 consistently made up the majority of the market. In 2008, only 17.7% of issuance was due non-RMBS ABS; in 2009, the non-RMBS ABS accounted for 42.3% of total issuance, suggesting that the other ABS markets improved. In particular, the

CDO markets, specifically the CLO market, improved 2009, increasing from 6.8% of total issuance in 2008 to 28.1% in 2009.

Figure 4.2: European Securitisation Issuance, 2007

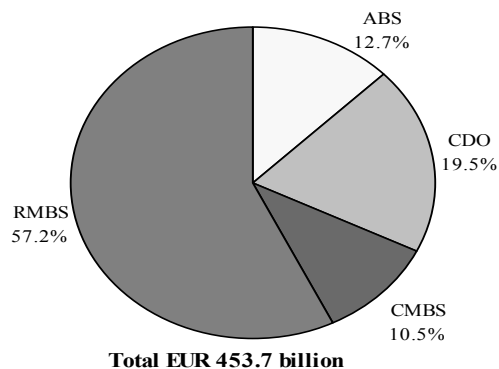


Figure 4.3: European Securitisation Issuance, 2008

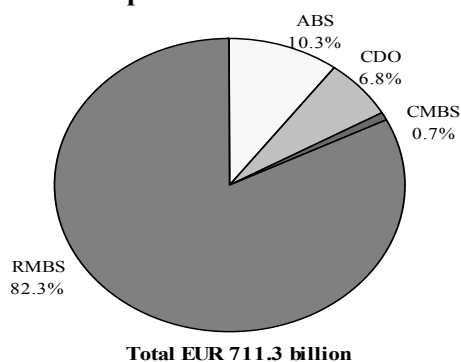
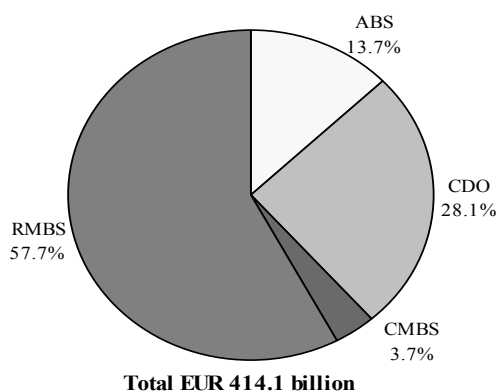


Figure 4.4: European Securitisation Issuance, 2009



4.3. European Securitisation Issuance by Country of Collateral

Figures 4.5 to 4.7 indicate the segmentation of market issuance according to country of collateral, from 2007 to 2009. The charts provide that the UK market from 2007 to 2009 consistently was the largest issuer of securitisation. Spain and the Netherlands were also relatively large issuers during this period.

Figure 4.5: European Securitisation Issuance, 2007

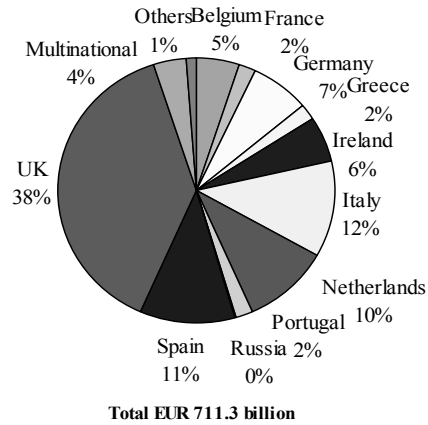


Figure 4.6: European Securitisation Issuance, 2008

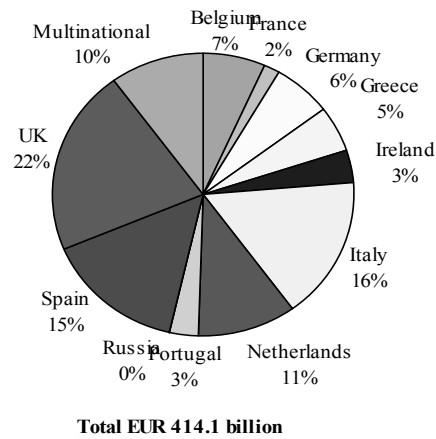
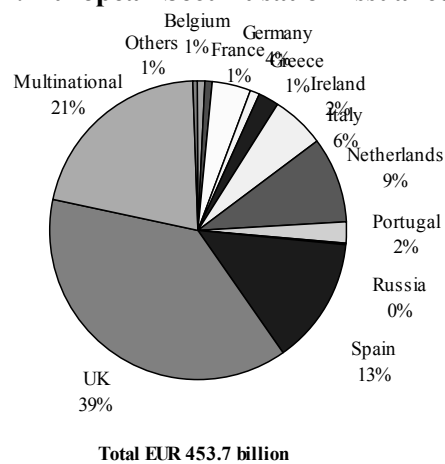


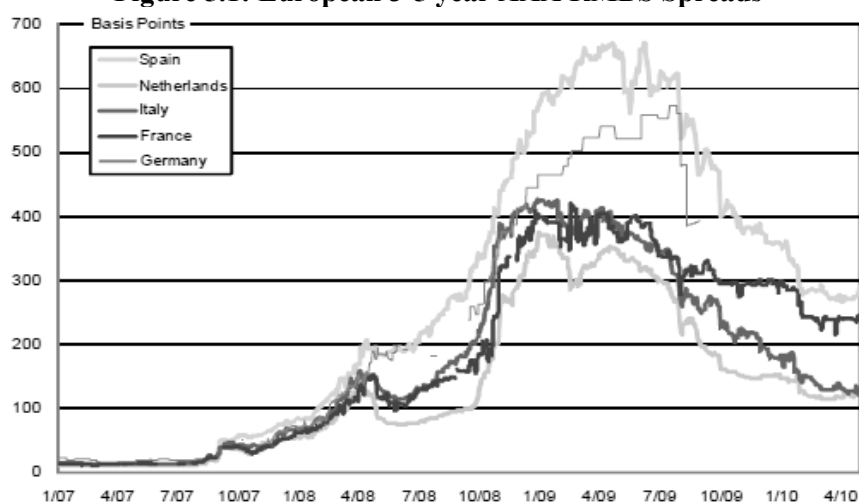
Figure 4.7: European Securitisation Issuance, 2009



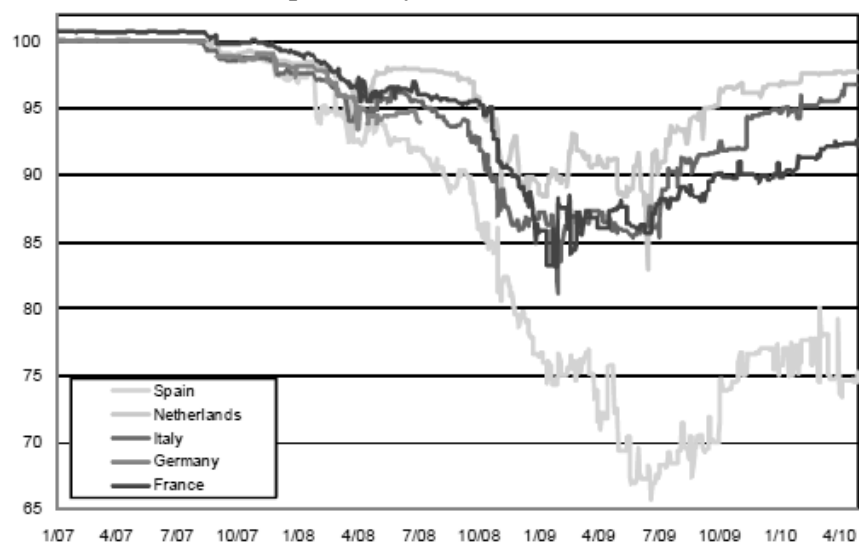
5. European Securitisation Performance Update

Figures 5.1 and 5.2 provide the spread and price performance data for European 3-5 year AAA RMBS, benchmarked from January 2007. The charts indicate that from 2007 to mid 2009, spreads consistently widened and reached a maximum (approximately +680bps for Spanish AAA RMBS). However, the charts indicate that the market improved post mid-2009, as spreads began and continued to tighten (approximately +300bps for Spanish AAA RMBS), and prices increased. The Spanish AAA RMBS market showed the greatest fluctuation from 2007 to 2009 and Dutch AAA RMBS performed the best, maintaining spreads no greater than +350bps at any time.

Figure 5.1: European 3-5 year AAA RMBS Spreads



5.2: European 3-5 year AAA RMBS Prices



6. ABS Evolution in the ECB Collateral Framework

On 20 November 2009, the ECB announced a tightening of eligibility criteria for ABS in the collateralised framework. From March 2010, all newly issued ABS are required to have two triple-A ratings at issuance.

Also, the second-best available rating must comply with the minimum applicable threshold (“second-best” rule).

Figure 6.1: ABS Evolution in the ECB Collateral Framework

	2006	2007	2008	2009
Average ABS eligible	€ 0.5 trillion	€ 0.7 trillion	€ 1.1 trillion	€ 1.3 trillion
Average value of assets put forward	€ 930 billion ¹	€1,101 billion ²	€ 1,579 billion	€2,034 billion
Average share of ABS	12%	16%	28%	23%
Overall ABS amount submitted	€ 112 billion	€ 176 billion	€ 442 billion	€ 468 billion

From 2006 to 2009, the amount of ABS eligible for repo at the ECB and Bank of England increased by 160%, from €0.5tr to €1.3tr. Of the amount eligible, the overall amount submitted for repo from 2006 to 2009 increased by 320%, from €112bn to €468bn. The proportion of the amount of ABS from the total outstanding volumes eligible for repo increased from 2007 to 2008, from 54% to 75%. However, the proportion eligible subsequently reduced in 2009 to 72%. The tightening of the eligibility criteria means that the proportion of ABS eligible for repo may further decrease. Additionally, from 2007 to 2008, the amount of ABS submitted for repo as a proportion of total outstanding volumes increased from 14% to 25%. However, from 2008 to 2009, the amount submitted stayed approximately the same at 25%.

Generally, the trend of increased volumes submitted for repo from 2006 to 2009 is in line with the large portions of issued ABS retained by the banks and the need to refinance.

7. RMBS Issuer Principles for Transparency and Disclosure

With the aim of enhancing four aspects of data disclosure in the RMBS market (transparency, accessibility, comparability, and granularity), AFME / ESF actively consulted European issuers and other market participants to develop standardised guidelines on RMBS transparency and disclosure. In December 2008, AFME / ESF published “RMBS Issuer Principles for Transparency and Disclosure”, voluntary guidelines for issuers on the provision of pre-issuance and post-issuance information on European RMBS to investors and other market participants (Annex 3).

AFME / ESF also finalised two data reporting templates, the “ESF Prime RMBS Standardised Reporting Template” and the uniform “Credit Rating Agency Template for UK Non-Conforming RMBS”, for issuers to use in conjunction with the principles.

14 endorsing firms and 19 programme issuers endorsed the principles and agreed to report at least 90% of the data fields set out in the ESF Prime RMBS Standardised Reporting Template by 31 December 2009. Additionally, three credit rating agencies agreed to adopt the uniform reporting template for the minimum data to be provided by UK non-conforming RMBS issuers from 31 March 2009.

Issuer	Programme	Jurisdiction
Obvion N.V.	Storm	The Netherlands
SNS Bank N.V.	Hermes and PEARL	The Netherlands
Abbey National PLC	Holmes Master Issuer PLC	United Kingdom
Barclays Bank PLC	Gracechurch Mortgage Financing PLC	United Kingdom
Bradford & Bingley PLC	Aire Valley Master Trust	United Kingdom
Britannia Building Society	Leek	United Kingdom
Clydesdale Bank PLC	Lanark Master Issuer PLC	United Kingdom
GMAC-RFC Ltd (UK)	RMAC	United Kingdom
HBOS	Permanent Master Issuer PLC	United Kingdom
Investec Bank PLC	Residential Mortgage Securities, Money Partners Securities, Kensington Mortgage Securities and Landmark Mortgage Securities	United Kingdom
Lloyds TSB Bank PLC	Arkle Master Issuer PLC	United Kingdom
Nationwide	Silverstone Master Issuer PLC	United Kingdom
Paragon Group	Paragon Mortgages PLC	United Kingdom
Royal Bank of Scotland Group	Arran Residential Mortgages Funding PLC and Greenock Funding Limited	United Kingdom

7.1. Pre-issuance disclosure principles

The pre-issuance principles intended to build on the minimum information requirements of the Prospectus Directive and enhance comparability, transparency, and disclosure in relation to RMBS through the standardisation of the type of information disclosed and the process of disclosure.

The principles recommend issuers to make Prospectuses freely available to investors and other interested parties. In summary, the principles recommend that Prospectuses should:

- Be easy to access by all market participants, subject to relevant marketing and selling restrictions;
- Provide information to investors appropriate to the nature of the RMBS pool and in accordance with any confidentiality obligations on the issuer;
- Be presented in a digitalised format by 31 December 2009;
- Be presented in a clear and easily understood format; and
- Meet the requirements of the Prospectus Directive and the implementing national regulations.

7.2. Post-issuance reporting principles

The post-issuance principles intended to provide recommendations to enable issuers to provide standardised post-issuance information periodically to investors in an accessible format. In summary, the principles recommend:

- Issuers to make periodic investor reports publicly available, without password protection, on their websites;
- Periodic investor reports will be made available on or shortly after the applicable principal distribution/payment date or otherwise at least in line with the cash flows and updated as may be necessary to comply with the Market Abuse Directive and the Transparency Directive;
- Reports should allow typical RMBS investors to process the information quickly and efficiently;
- Use standardised terms and definitions in the reports;
- Reports will be regular and ongoing.

8. ESF UK Working Groups

AFME / ESF set up three UK working groups with the objective to collect detailed industry feedback on the changes to the Bank of England's repo collateral framework that was to be announced in 2010. The three working groups were:

- AFME / ESF Working Group on Standardisation of Investor Reports: working on a standardised template for UK RMBS applying to both stand alone and master trust structures.
- AFME / ESF Working Group on Standardisation of Definitions: Creating commonly agreed definitions for terms such as prime and non-prime arrears, valuation amounts, early repayments among others.
- AFME / ESF Working Group on Standardisation of Documentation: Building a standardised prospectus for stand alone RMBS first, and master trust RMBS thereafter.

9. AFME / ESF Investor ABS Transparency Survey

In April 2010, AFME / ESF conducted an investor survey on ABS transparency. Generally, the investor survey indicated that investors supported more standardised and a greater volume of ABS information to be provided by issuers. In summary, the results provided:

- 90% of investors deal with senior tranche investments and 68% of investors deal with mezzanine tranche investments;
- 77% believe that loan-by-loan level data would be useful and 67% believe that they would have the capability to use this form of data;
- 84% believe that standardised investor reports would make analysis of ABS easier;
- 87% believe that historical performance data would be useful;
- 84% believe that more accurate cash flows would be useful; and

- 90% believe that standardised summary of legal structure of each transaction is useful.

10. Regulatory Initiatives Overview

Four major regulatory initiatives include:

- CRD changes
- ECB and BoE projects re loan-by-loan reporting
- IOSCO and CESR projects and pre- and post-trade transparency (MiFID Review)
- SEC revision of ABS offering rules

10.1. CRD changes

CRD II (Article 122a), with an implementation date of 1st January 2011, requires issuers to retain 5% of new securitisation issuances and investors to comply with due diligence requirements.

CRD III, with an implementation date of 1st January 2011, will remove trading book treatment for securitisation and will also introduce higher risk-weight assets for resecuritisation exposures.

CRD IV, with an implementation date of 2015, will require CRD regulated banks to maintain a certain level of “high quality” liquid assets under the Liquidity Coverage Requirement.

10.2. Loan-by-loan reporting

ECB loan-by-loan reporting requirements under its collateral framework, at a date to be determined, will require issuers to provide standardised data in standardised templates in order to make bonds eligible for repo.

Bank of England loan-by-loan requirements under its collateral framework, implanted in 2011, will require issuers carry out loan level reporting for bonds posted under the Discount Window Facility (DWF)

10.3. 10IOSCO and CESR on pre- and post-trade transparency

The MiFID review, effective in 2011/2012, will require issuers to carry out disclosure of pre and post-trade prices and volumes for certain bonds trading in an organised trading facility.

10.4. SEC revision of ABS offering rules

The US SEC proposes new disclosure rules that would require ABS issuers to provide specific data for each loan in the asset pool both at the time of securitisation and on an ongoing basis.

11. AFME Contacts

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SECURITISATION AS TOOL TO SUPPORT SME FINANCING

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Abstract

Securitisation has, after a period of significant growth throughout the last 10-15 years, become the finance area which has fallen the most from its peak – both in terms of new volumes as well as its image as an innovative and efficient financing tool.

While market insiders, including regulators, increasingly understand that securitisation can play a positive role in extending the sources of finance to the real economy, the perception of the wider public and the media remains negative. There were undoubtedly parts of the structured finance market which at least partially caused and clearly exacerbated the financial crisis. The excesses and the effects of these, notably the US subprime mortgage debacle as well as highly leveraged structures with problems of the alignment of interests, have been widely documented. The advantages of a functioning securitisation market are however often less obvious. This paper contributes to the substantiation of the discussion around securitisation.

With a focus on the securitisation of loans to Small and Medium sized Enterprises, or SMEs (SMESec), we outline the benefits of this technique for the financing of SMEs; moreover we explain the need for the use of public resources to support this important market segment.

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Markus Schaber, head EIF's Securitisation, which forms part of EIF's Guarantee & Securitisation activities.
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A crisis also provides opportunities – in a more “healthy” environment of reduced moral hazard, reduced information asymmetries, and cognisant and careful risk taking, SMESec can provide an important contribution to SME’s access to finance and is as such even more important in the aftermath of the crisis.

Over the past decade SME Loan Securitisation (SMESec) has become an element of the financing of Small and Medium sized Enterprises (SMEs) in Europe with growing significance in some European markets such as Spain, Germany, the UK and Italy. However, the near-collapse of the European structured finance market, in tandem with the other markets around the globe more generally, has profoundly affected the status and outlook of SMESec.

While there is no doubt that parts of the structured finance markets have significantly contributed to the financial and subsequently economic crisis worldwide, many asset classes within structured finance have performed relatively well. Whereas some areas such as subprime mortgages have been built on inflated asset prices, the market segment SMESec is suffering by and large from contagion effects – economically, but also with regard to the public perception.

Securitisation per se is not good or bad - it is a toolbox, an instrument, a technique. As such it is value-free; but its aggressive, opaque, and overly complex use has negative consequences for ultimately both issuers as well as investors. Negative repercussions are however also created by an overly simplified discussion where everything related to structured finance is lumped together and dismissed or branded as “toxic”, as sometimes stated in the press.

The instrument is neither “toxic” nor is the underlying asset (SME loans!) “toxic waste”. On the contrary – loans to SMEs are a key driver for the functioning of the economy and, properly applied, the securitisation technique is a replicable tool that can enhance access to finance for SMEs. Using this instrument in developed capital markets, public sector support for SMEs (e.g. guaranteeing mezzanine tranches) can create multiplier effects - and hence it is an efficient use of public resources, which is especially important against the background of a high public debt burden in many key countries. Policy makers need to withdraw from the expensive crisis-driven support measures and securitisation can help to cushion negative effects (see as well IMF, 2009). There are currently signs of a fragile recovery of the (public) securitisation market but it is still too early to identify a real re-opening.

This document explains the principles of SMESec and why it is to the benefit of SMEs. Moreover it shows ways towards a revitalization of this very important market segment.

1. Background

Certain parts of the structured finance markets have significantly contributed to the origin of the financial and subsequent the economic crisis worldwide.²⁵ Although it did not contribute to the emergence of the crisis, the market segment SMESec is suffering from contagion effects – economically, but also with regard to the public perception.

Over the past decade - and until the arrival of the financial crisis – the securitisation of loans to SMEs, had become an important element of SME financing in some European countries, notably Spain and Italy for funding purposes and Germany for risk transfer purposes. With a few exceptions (which will be explained

²⁵ The story of the go-go years was that all of these securitisations and derivatives were about “risk management”... But then the story changed. The new story, suggested that securitisation and the exotic derivatives could be nothing more than a new way of selling snake oil. And as this new story about the Wall Street and its products replaced the old story, the life drained out of the financial markets” (Akerlof and Shiller, 2009).

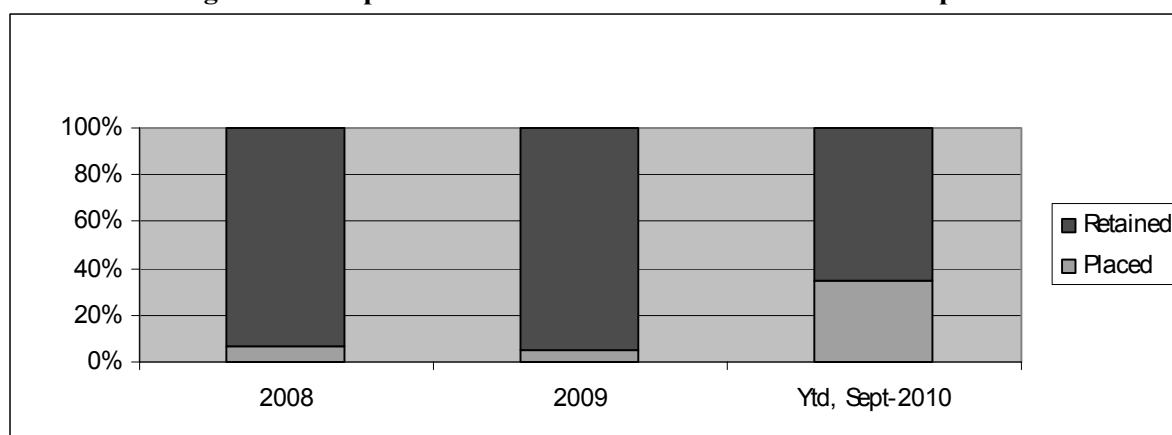
later) SMESec transactions are characterized by a large number of debtors in the underlying portfolios. Typically, the majority of these debtors are SMEs (according to the EU definition).²⁶

The European structured finance market - in line with markets globally - has dramatically dropped over the past two and a half years: with the exception of securitisations structured with the sole objective of benefiting from European Central Bank (ECB) refinancing, there have been only a handful of transactions. The introduction of ECB's asset repurchase or "repo" facility, which allows (among other assets) Asset Backed Securities (ABS) to be used as collateral for funding, shows the importance of the securitisation market. As a matter of fact, since mid 2007, most transactions have been retained by originators for ECB re-financing purposes (or Bank of England's equivalent interventions), as the whole market came to a complete halt during the period between mid 2007 and mid 2009.²⁷

While the investor base for this asset class has not completely disappeared, it has shrunk significantly, particularly in Europe and for mezzanine tranches. Despite the recent spread tightening, spreads are currently still very high and many transactions are economically not very attractive to bank issuers. Moreover, investors are faced with new regulatory requirements (e.g. Art. 122a CRD).

In general, in Europe, there has been a large volume of the broadly defined structured finance issuance in 2009 (approx. EUR 414bn, for comparison – 2008: EUR 711bn, see figure 3 later in this paper), but this issuance was mainly (in 2009 around 95%, see figure 1) retained by the originators and used when needed for short term liquidity management through repos with the ECB (Unicredit, 2010). However, the ECB's tightening of the eligibility requirements for ABS (when used in Eurosystem credit operations) signals the beginning of a more stringent regime with regard to central bank dependent financing.

Figure 1: European securitisation issuance – retained versus placed



Source: Authors, based on data from Unicredit

There are some signs of a slow market recovery for non repo-driven transactions, with a few SME deals being structured (but mostly for private placement). In H1/2010 a tentative opening of the market emerged. The volume of EUR 14.5bn placed publicly in Q1 was only equivalent to 1998/1999 levels but was a positive change from the issuance drought of late 2007 to late 2009 (Deutsche Bank, 2010a); however it is

²⁶ For information on the EU SME definition please see: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm. Later in this paper we are going to explain in more detail the importance of the SMEs for the European economy.

²⁷ The proportion of collateral put forward to the ECB consisting of Structured Finance securities rose from 4% in 2004 to 18% in 2007 and 28% in 2008 and down to 23% by end 2009, when the value of Structured Finance collateral held had increased further to EUR 468bn (see FitchRatings, 2010 a and b).

currently too early to identify a sustainable re-opening, especially with respect to SMESec. In Q2/2010 issuances went down again, but July and September showed again a recovery. The investor based market remains fragmented and limited to best-in-class and simple structures (Deutsche Bank, 2010 b and c).

In July 2010, Lloyds TSB re-opened the SME securitisation market with the first term transaction after the crisis which was actually placed with private sector investors. The securitisation comprised a portfolio of UK SME loans which was securitised through Sandown Gold plc, a special purpose vehicle set up for this transaction. The static portfolio included GBP 807m of loans with 1,407 borrowers and loan sizes ranged from GBP 25,000 to GBP 5.5m. The purpose of the transaction was to provide additional funding for Lloyds TSB. EIF supported this market opening deal with a guarantee over EUR 60m for a mezzanine tranche which provided additional credit enhancement to the senior notes. A few other transactions have closed or are expected to close towards year end, mainly through private placements.

The recovery of the structured finance market will depend heavily on several key aspects:

- **Macroeconomic development:** the performance of underlying pools of loans or leases depends on the macroeconomic development and the availability of bank lending; loan defaults are expected to slow down but not to the low pre-crisis levels; moreover, there is a negative correlation between default and recovery rates.
- **Regulatory environment:** there will be several regulatory adjustments, such as risk retention requirements, additional risk management provisions, and higher capital ratio requirements in the banking system. In this context, the rating agencies are also playing a pivotal role – they have adjusted their levels of risk tolerance and many market participants are expressing a view that the pendulum has swung from too generous towards too risk averse.
- **Investor behaviour:** the remaining risk appetite will be mostly in perceived ‘lower risk’ transactions, including requests for features like high quality pools, low counterparty risk, simple structures, high quality originators, etc. Moreover, given the perception that rating agencies have not always adequately safeguarded the interest of investors, they are likely to become less “external rating” driven than in the past – instead, they are going to perform their own due diligence of the transactions, especially for investments in respect of the more junior tranches.

Market insiders, e.g. IMF, BIS, Financial Stability Board, European Financial Services Roundtable, continue to articulate the need for and importance of securitisation. Also the introduction of the ECB’s “repo” facility, which allows (among other assets) ABS to be used as collateral for funding, has shown the importance of the securitisation market. However, the public reputation of securitisation remains often negative, particularly in Europe.

It is difficult to quantify the effects of securitisation and empirical studies are rare.²⁸ The IMF states that policy makers need to withdraw from expensive crisis driven support measures and that securitisation can help to cushion negative effects (IMF, 2009). A recent study (BearingPoint, 2010) concludes that without a functioning securitisation market, a credit crunch cannot be avoided, but that a revival of the market will only happen in 2011.

In the following chapters we first describe SMESec and its benefit for SME financing, we then distinguish the SMESec from the sub-standard, excessively risky areas within securitisation; before finally explaining why and how the European Investment Fund (EIF) will remain a stable, long-term committed investor in this important market segment.

²⁸ One example with a focus on the US market can be found in Sabry and Okongwu (2009).

2. SMESec: What is it – and what is in it for SMEs?

SMEs are the backbone of the European economy and need to have reliable access to finance.²⁹ In recent years, and even more in the aftermath of the financial and economic crisis, there has been (besides a more important funding and liquidity discussion) a continuing focus on the scarcity of “equity capital” in the banking sector. A reason for this is inter alia the changing regulatory environment (Basel II & III). In addition to these important regulatory challenges, banks are making strong efforts to improve their risk management instruments. In this banking environment, SMESec is an important tool for banks to continue to be able to offer SME loans at attractive terms.

A key for the understanding of the usefulness of securitisations for SMEs is the realisation that banks will not lend to SMEs based purely on macroeconomic development motives (i.e. supporting the economy) which is sometimes indirectly asked by politicians and lobbyists. Banks will always make a complex calculation of the profitability of their SME lending business, especially relative to their other activities. In these calculations there are multiple parameters such as origination and marketing as well as credit assessment and servicing costs.

Three areas will however have an overriding impact on the profitability of SME lending and hence on the required loan margins for SMEs: refinancing spreads, risk costs and capital requirements. While risks costs in the form of expected losses based on underlying credit quality and collateral (i.e. PD – EAD – LGD) cannot be transferred easily to third parties, securitisation can play an important role in the funding strategy as well as for capital relief purposes and we explore these aspects in more detail below. However, before going into more detail on the reasons for securitisation as a valuable funding and risk management tool, it is worth recapping the basic elements of a SMESec.³⁰

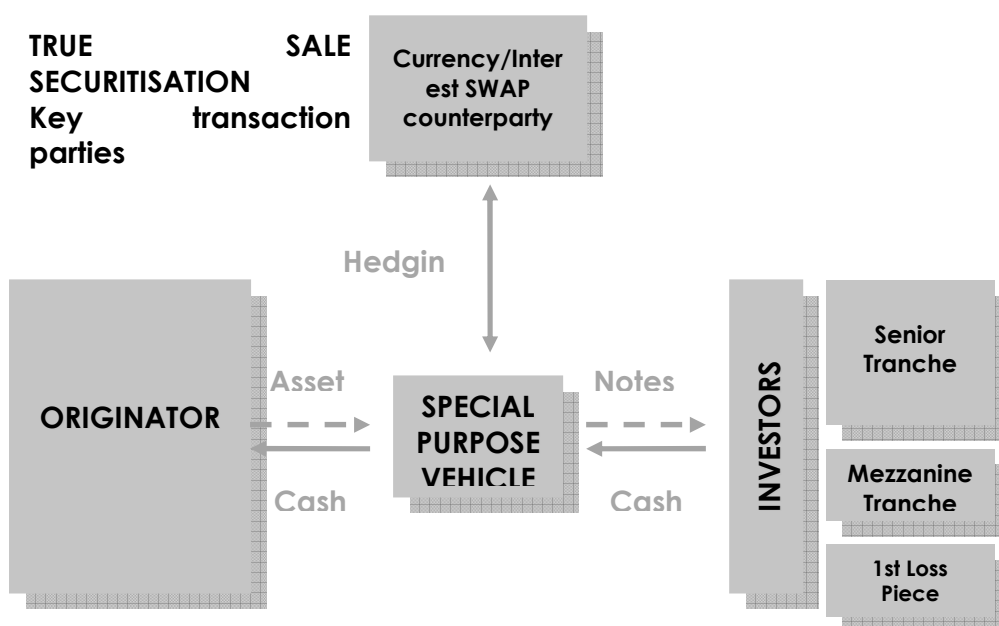
SMESec creates indirectly a “secondary market for SME loans”, combined with funding for the originator: a bank (the “originator”) extends loans to its SME customers (“primary market”), bundles them in a pool (“portfolio”), and sells the portfolio to capital market investors through the issuance of notes by a special purpose vehicle (SPV), backed by such a loan portfolio (Asset Backed Securities, ABS).

The asset-backed notes, classified by risk categories, are placed with capital market investors and i.e. represent tranches of the underlying portfolio. Investors buy a tranche (or several tranches) of the notes and often they intend to hold the notes until maturity (Ranné, 2005), while the most junior tranche is retained in full or in part by the originating bank. Figure 2 shows a typical “true sale” securitisation transaction structure.

²⁹ More information on the importance of SMEs is provided in chapter 4 of this Working Paper.

³⁰ For information: a glossary can be found in Annex 2 of this document.

Figure 2: Typical structure of a SMESec transaction



Source: European Investment Fund

As an alternative to this true sale of the portfolio there is the so called “synthetic securitisation” where traditional securitisation techniques are combined with credit derivatives. In this case the credit risk of a selected reference portfolio of loans (but not the loans themselves, which remain on the balance sheet of the originator) are transferred to a special purpose vehicle that places notes (Credit Linked Notes, CLNs), classified by risk categories, in the capital market.³¹

There are many advantages of SMESec – for banks, for investors, for the economy, and – most importantly – for the SMEs. At first sight, the advantages are mainly for banks and investors, but these benefits channel through to a positive effect on SME’s access to finance and hence to the SMEs themselves (see e.g. Ranné, 2005).

From a lender/issuer perspective, the following points are generally the most relevant ones:

2.1. Economic and regulatory capital relief

The reduction of credit risk exposure can be reflected in a corresponding economic and regulatory capital relief. The pace at which the capital base can be reused for new loans increases, raising the profitability of SME lending. Replenishment features in SMESec have a positive impact as well: often, during the first years of a transaction, banks can replenish the portfolio with new loans up to a preset maximum amount and according to certain quality criteria. Hence, banks can originate new loans and include them into the existing securitisation structure, thus generating new SME loans at relatively limited capital cost.

It has been stated that securitisation does not transfer actual credit risk to third party investors but is rather used for regulatory capital arbitrage in which the originating bank merely exploits regulatory loopholes

³¹ There are many publications on the structures of securitisations, e.g. Fabozzi (2008), or De Servigny and Renault (2004), just to mention two. German speaking readers can find an introduction to SMESec as well in Kraemer-Eis et al. (2001).

while most credit risks, except for maybe some remote catastrophic portfolio loss risks, are retained by the bank. It is true that some of the older transactions were used primarily for Basel I capital relief purposes and there are also a number of more recent private bilateral transactions which exhibit regulatory arbitrage tendencies, but pre-crisis there were a large number of transactions where the first loss position was sold to third party investors. This was particularly true in SMESec in Germany, UK, Benelux and Italy. Moreover, it can certainly be argued that the financial crisis has shown that tranches with previously relatively higher ratings can be affected in a severe economic downturn, i.e. loss expectations have significantly shifted from pre-crisis expectations – one argument why it is always difficult to discuss regulatory capital arbitrage ex ante. There is currently limited scope for economic capital relief transactions given an adjustment of rating agency methodologies in combination with still wide spreads for first loss and mezzanine tranches. However, we would forecast a return of risk transfer driven transactions because banks are likely to have continuing capital pressures going forward and we believe that investors' confidence is likely to be restored once the current economic and financial uncertainty is reduced to “more normal” levels.

2.2. Alternative source of funding for the originating banks

- SMESec can be an alternative source of funding for banks in cases where they have either limited access to capital markets' refinancing tools or unsecured bank bonds can only be sold at high cost. In fact, banks will need to shift capital markets funding from unsecured to secured issuance. Compared to unsecured bank bonds, securitisation provides investors with additional safety features including the securitisation by an underlying pool of assets and credit enhancement such as subordination, over-collateralization, cash collateral and excess spread. Due to these features that contribute to improve the security of the senior investor, in normal market conditions, funding costs comparable to top rating borrowers can be achieved for a large part of a granular, professionally originated and serviced portfolio sold. This is especially interesting for banks or other financial intermediaries such as leasing companies which face higher refinancing costs due to their lower ratings.

A number of different features relating to the provision of funding are worth highlighting:

- Regional banks only rarely tap the capital markets due to their size and rating, and are typically deposit-driven institutions that rely on inter-bank borrowing for the medium term funding. As such, securitisation can be a means to diversify their funding base, as well as to gain access to medium term funding at costs consistent with top rated issuers that could otherwise not be achieved through direct borrowing on an unsecured basis.
- Banks which do rely to a certain extent on wholesale funding as opposed to client deposits will and have already started to return to securitisation as a funding tool, notably using residential mortgages. We expect to see also more SME funding transactions if and when spreads on senior tranches of securitisations tighten further. This will happen if market confidence in a more stable economic recovery is restored.
- Maturity matched funding through securitisation has become more relevant in view of the tighter regulatory requirements on banks' liquidity, particularly for longer dated loans. At the moment there is limited investor appetite for long dated ABS, nevertheless we would expect that secured funding (i.e. Covered Bonds and securitisation) will become more important in the coming years particularly in view of the need for banks to control their liquidity position more closely.
- An important element of SME finance is not directly provided by banks but rather by leasing or factoring companies. Various surveys on access to finance show that bank loans and overdrafts are the most widespread debt financing methods for SMEs, but that alternative sources like leasing and

factoring have been growing in importance (see e.g. ECB, 2007). In the latest ECB survey, 30% of SME respondents mentioned leasing, factoring or hire-purchasing as one of their sources of financing (ECB, 2010a). While in the past sometimes used for tax reasons, leasing has for many become the main financing source for small to medium size investment in IT equipment, cars and trucks. In many countries, leasing is used particularly by fast-growing SMEs, especially those in Belgium, Finland, Ireland and Spain (Ayadi, 2009). Leasing and trade receivables have been used widely as collateral in securitisations pre-crisis, often through Asset-Backed Commercial Paper programs (ABCP).

- Independent leasing and factoring companies have previously depended on bank finance (often secured) but availability of this finance has been reduced during the crisis. Main reasons are capital constraints, liquidity issues and operational risks in smaller leasing companies which in total have led to lower availability of financing for leasing companies and in any case to significantly higher refinancing costs. Securitisation can effectively provide an additional important funding source for these non-bank finance providers.

2.3. Portfolio management and capital restrictions

For smaller banks which face lending restrictions due to their size, securitisation or similar portfolio transactions (such as basket trades) can be crucial, as limits and concentration restrictions narrow their capabilities to offer larger loans or additional loans to the same customer. Transferring risks to the capital markets therefore reduces restrictions on lending capacities of smaller banks. As closer customer relations and better monitoring capabilities give smaller banks a competitive edge in lending to smaller companies, for which public information is rarely available, securitisation enhances the overall SME lending capacities.

On a more macro level, the following aspect should be mentioned:

2.4. Risk diversification

From an investor perspective, SMESec allows for investments in assets which would otherwise not be available. This can be attractive from a risk-return as well as from a portfolio diversification perspective. Investors can diversify their portfolio risk by adding SME exposure (additional investment possibilities); moreover, the bundling of portfolios from various regional banks can have positive effects on portfolio diversification. In the past, European transactions were often placed into the bank or near-bank sector (Structured Investment Vehicles (SIV) or ABCP conduits). This investor base, with the exception of a few large banks, has largely evaporated with so called “real money” investors (investment and pension funds, insurance companies etc.) becoming more prevalent. These non-bank investors are ultimately diversifying and spreading risks originated by banks, both in terms of asset classes as well as geographically. One of the lessons learned in the crisis was the fact that banks rather than non-banks had amassed significant direct and indirect exposures to structured credit assets; hence the apparent positive effect of risk diversification across the complete spectrum of investors was actually less evident than it should have been. The transfer of risks to the non-bank sector nevertheless continues to be an important factor of securitisation going forward.

In summary, in order to lend new long term loans to SMEs, banks need long-term sources of finance and available capital. If capital resources are restricted or the return is not attractive, then SME lending can only be granted on a replacement basis. However, through the use of SMESec, the lending capacity of banks can be increased. Also, with securitisation, the pace at which the capital base can be reused for new loans increases and accordingly the profitability of SME lending activity. At the same time, the business relationship with the SME client can be maintained.

In the normal strong competition of most European banking markets, these advantages are passed on to the bank's customers, leading not only to a decrease in SME lending costs but also to higher volumes of SME lending. The securitisation of an individual loan does not necessarily improve the access to finance for the individual SME, but on a portfolio level the banks are able to expand their SME lending. As such, SMESec has a positive impact on the overall availability and conditions of loans to SMEs.

The revitalisation of the securitisation market per se and the segment of SMESec in particular can therefore be seen as a systemic solution to strengthen banks' capabilities to supply long-term funding to SMEs. Supporting the development of the SMESec is pivotal for the future of SME financing.

3. Differentiating SMESec from other asset classes

This paragraph looks at SMESec relative to other securitisation and/or fixed income markets. While it is not an exhaustive comparison, we believe that it is imperative to contrast SMESec with other related asset classes in order to determine the potential of SMESec in the current environment.

Perception

Securitisation per se is not good or bad - it is a toolbox, an instrument, a technique, and as such it is value-free - but the arbitrage-driven, opaque, and overly complex nature can create negative repercussions across financial market participants. In general, regulators (as market insider) are less negative vis-à-vis properly regulated securitisation than the public opinion and policy makers. They do recognise the importance of this part of the financial markets and are thinking about the revitalisation (e.g. Fender and Mitchell, 2009 or IMF, 2009). A "failure to restart the securitisation market may impair the supply of credit to some sectors of the economy, for instance small and medium-sized enterprises" (ECB, 2010b).

However, the perception of securitisation as a whole among many politicians, the media and the wider public remains somewhat negative, based on an oversimplified discussion which does not distinguish sufficiently between "traditional" balance sheet transactions and overly complex or arbitrage driven transactions.

Underlying assets

European securitisation markets are traditionally dominated by Residential Mortgage Backed Securities (RMBS). SME loans have often been more difficult to securitise than other asset classes. Less than 15% of the European securitisation volume over recent years was SMESec (see figures 3 and 4). The track record of this asset class in Europe is relatively short; the market started only towards the end of the 1990's – at the time, this segment was unknown to investors and rating agencies, and the technique of securitisation was also new to most of the originators. The related uncertainty was one of the reasons for conservative structures in the SMESec segment. And in the years running up to the crisis there were first signs also in Europe of a drift away from key principles and main success factors for SMESec – i.e. granular portfolios³² and transparent structures – for example in the form of hybrid transactions (i.e. the so-called German Mezzanine CDOs) with non-granular portfolios, larger (mid-cap) borrowers and non-aligned incentive structures. The generally poor performance of these transactions provides lessons for the future of SMESec, which are referred to later in this paper.

SME loans are, in principle, less homogenous than residential mortgages (with regard to size, legal forms, collateral etc.) and the underwriting criteria are less standardised. Moreover there is often a lack of long-term historical data on loan performance (Ranné, 2005). On the other hand SME loans are typically

³² Highly diversified in terms of obligor concentration, sector diversification and regional distribution.

thoroughly analysed by credit experts and systems (e.g. most banks apply detailed (quantitative) internal rating methodologies on top of more qualitative assessments). Moreover, banks normally have a relationship banking approach and know their customers very well, thus enabling them to manage the risk of the customer over the long term in contrast to the more automated lending decisions seen in the mortgage and credit card markets. This distinguishes SMESec from those other securitised asset classes.

Market volumes and growth potential

Most SME securitisation has traditionally been originated in a few countries, such as Spain, Germany, Italy (especially leasing), as well as Benelux, Portugal and United Kingdom. As far as SME securitisation is concerned, market sophistication in these countries is high: securitisation laws are robust and well tested, market stability is relatively strong and banks have a relatively long SME track record. In most cases, the importance of SMEs in the economy is high.

True sale transactions have been historically dominated by Spanish banks. Reasons for the large issuance are, among others, the importance of the SME economy in the country; the strong growth in GDP and SME lending during the past pre-crisis years; the specific support provided by the Kingdom of Spain to SME securitisation with its FTPYME guarantee programme.

Similar considerations can be made for Italy, with regard to small ticket lease securitisation, i.e. typical SME, granular portfolios of lease contracts used to provide medium-term financing for investment projects, as opposed to secured lending.

Greece is a less developed and more challenging market. Although the backbone of the economy is represented by small businesses, the first SME securitisation transactions were launched only in 2006. More recently banks have securitised a substantial volume of SME loans, but only for ECB repo-financing. This ECB facility, however, is currently not available any longer for new transactions, since only AAA-rated ABS-notes can now be accepted for ECB refinancing.

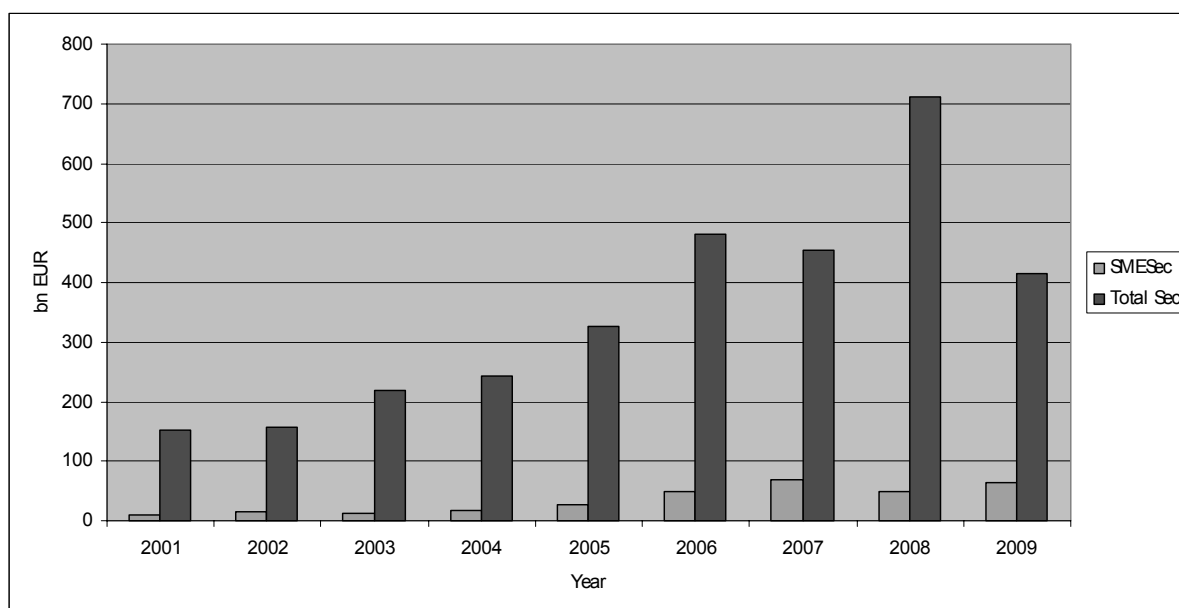
In CEE countries (e.g. Poland, Czech Republic, Bulgaria) SME securitisation has been sporadically used, although deal flow from these regions could potentially be much higher, if the uncertainty about the economy and the legal framework were reduced.

Securitisation has been used also in Turkey for several years with, among others, several future flows transactions, however no SME pools has been securitised so far.

In terms of volumes, total securitisation in Europe grew almost steadily from 2001 to 2008 (see figure 3). The overall increase over this time period was more than 460%. From 2008 to 2009 there was a – crisis-driven – sharp reduction, the market volume went down from approx. EUR 711bn to EUR 414bn (-42%), however - as already mentioned above - only a small portion of these volumes during the crisis were placed with investors.

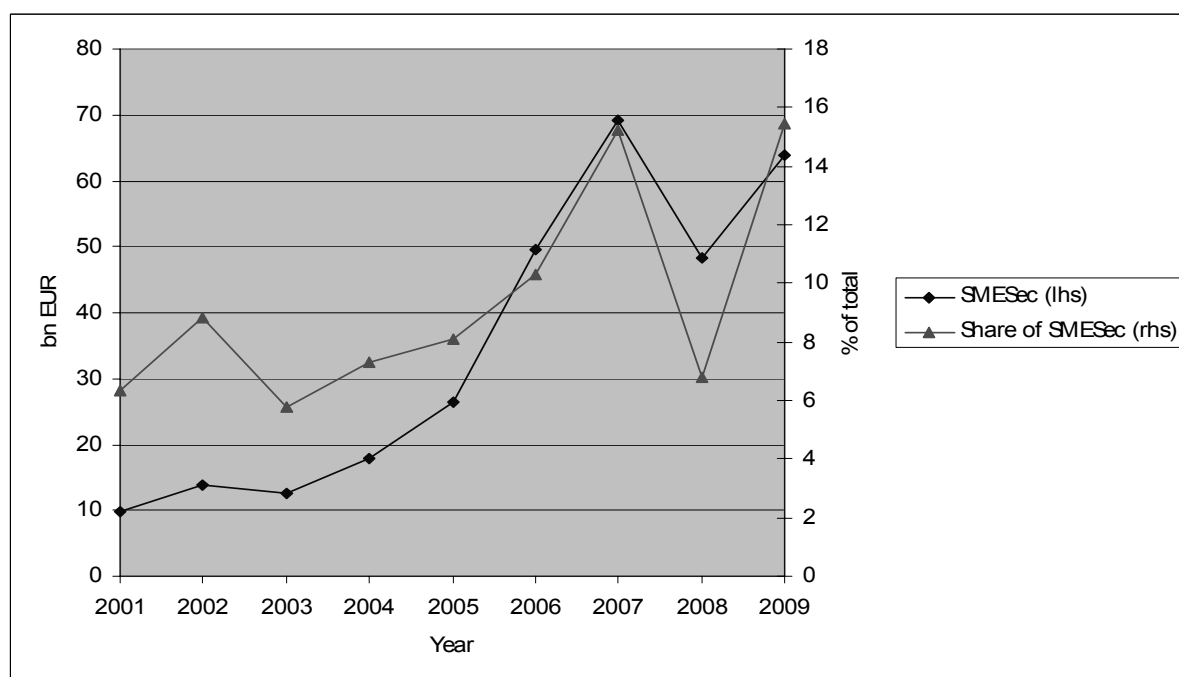
The market segment of SMESec grew even from 2008 to 2009 (see figures 3 and 4), but with no placement in the public market in 2009 (see figure 5). The total increase of SMESec volumes during the period 2003 to 2009 rose by a factor of five times to a total volume of around EUR 64bn. As shown in figure 4, the share of SMESec in total securitisation in Europe 2007 and 2009 was around 15%, historically a high share - but always in a generally weak environment. In the other years of the decade the share of SMESec in total securitisation was always approx. between 5% and 10%.

Figure 3: Development of securitisation in Europe (total and SMESec)

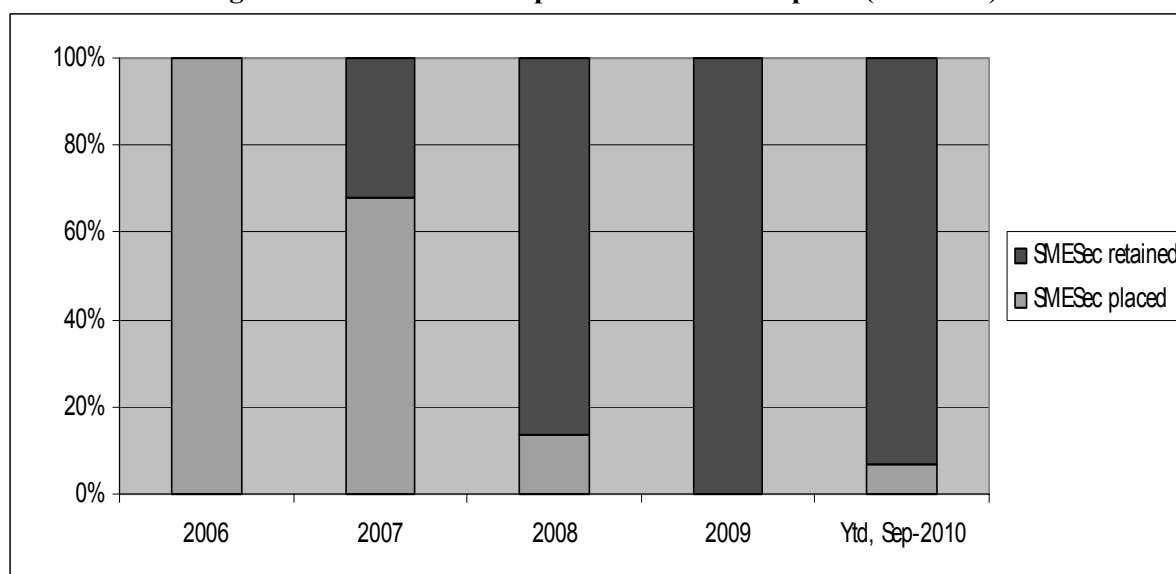


Source: Authors, based on data from KfW Bankengruppe, J.P. Morgan, Moody's, AFME/ESF

Figure 4: SMESec in Europe - total volume and share of SMESec in total securitisation



Source: Authors, based on data from KfW Bankengruppe, JP Morgan, Moody's

Figure 5: SMESec in Europe – retained versus place (estimates)

Source: Authors, based on estimates from KfW Bankengruppe

According to the rating agency Moody's, at the end of Q1/2010 there was an aggregate outstanding note balance of EUR 134bn³³, with Aaa-rated notes accounting for 51%. Spain is the largest single market with around 34% in aggregate outstanding volume, followed jointly by Germany and The Netherlands with 16% each (Moody's, 2010b).

Given the financing needs of the more than 20m SMEs in the EU-27 on the one hand, and the increasing constraints for the banks' underwriting capacities (i.e. increasing regulatory requirements, funding issues) on the other hand a further growth of the SMESec market segment can be expected if, and to the extent that investor appetite returns and the required spreads normalise. While securitisation of prime residential mortgages (RMBS) together with Covered Bonds in this area will remain the mainstay for the European market, we see SMESec increasing on a relative basis, partly as a result of house prices remaining subdued for some time with non-conforming RMBS playing a diminished role.

Going forward, we expect SME securitisation (excluding pure ECB-related transactions) to mostly restart from the more sophisticated markets, i.e. in the "traditional" countries (Germany, Italy, Spain, Benelux, etc.), although the weight of Spanish issuance is likely to be lower than in the past, due to the ongoing concerns about its economic situation. Other countries, such as Portugal and Greece, will follow suit, always subject to restoration of investors' confidence, particularly with regard to Greece.

Poland and Turkey have significant potential as they both exhibit strong fundamentals (i.e. critical mass, important domestic/SME market, potential economic growth due to catching-up effect with the neighbouring countries, securitisation laws in place), which would make securitisation an efficient tool for banks to meet the growing domestic credit demand.

In terms of deal structuring, recent true sale transactions have been substantially simplified, mostly with a view to attracting senior investors and/or using the ECB repo facilities (often only two tranches: a large junior piece and one senior class of notes).

³³ EMEA SME ABS (Europe, Middle East, and Africa, with most of the transactions being in Europe).

We expect this trend to continue, with senior notes from relatively large true sale transactions placed with investors (partly privately, partly publicly), while the rest of the capital structure will likely be retained by the originators. In terms of deal size, for larger originators the volume to be actually placed with market investors (i.e. the senior notes) may be expected to be in the EUR 500m - EUR 1bn range, and EUR 100m - EUR 500m for smaller banks.

Similarly, for risk transfer transactions, straightforward synthetic structures (e.g. with short replenishment periods and short weighted average life) aiming at attracting equity/mezzanine investors may be expected in the future. In terms of deal size, we expect originators to securitise portfolios of typically EUR 1.5bn – EUR 3bn, with the equity and/or mezzanine tranches to be placed representing approximately 5%-8% of the total amount.

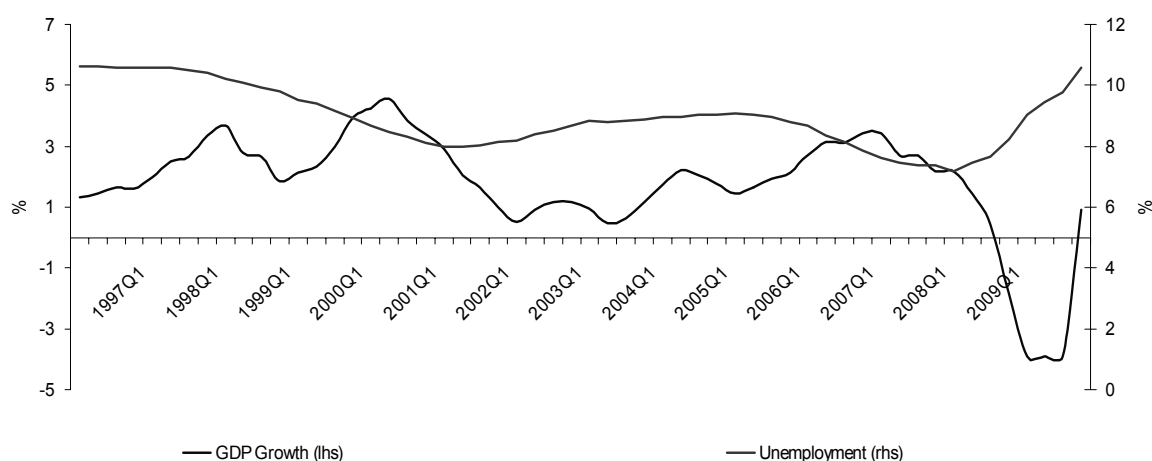
An increasing number of mid-sized banks that have been using securitisation for ECB short term refinancing are now considering SME securitisation transactions for term funding purposes. Therefore, we expect SME securitisation to increase in numbers and volumes in the years to come, also in view of the likely phasing out of the ECB repo facilities over the next 2 years.

More generally, funding spreads for banks are expected to remain at relatively high levels compared to the past years, while ABS spreads for senior notes have eased and will likely further tighten. Accordingly, several banks are considering tapping the ABS market again, mostly for funding purposes, in the expectation of further ABS spread tightening, especially for most senior notes.

Performance

Financial markets problems which started in mid-2007 were followed by a significant contraction in the world economy in 2008 and beyond. Figures 6 and 7 show that 2009 was exceptionally weak, with consensus estimates for GDP growth for the Eurozone at around -4%, increasing business insolvencies, and increasing unemployment.

Figure 6: Eurozone - GDP growth and unemployment (%)

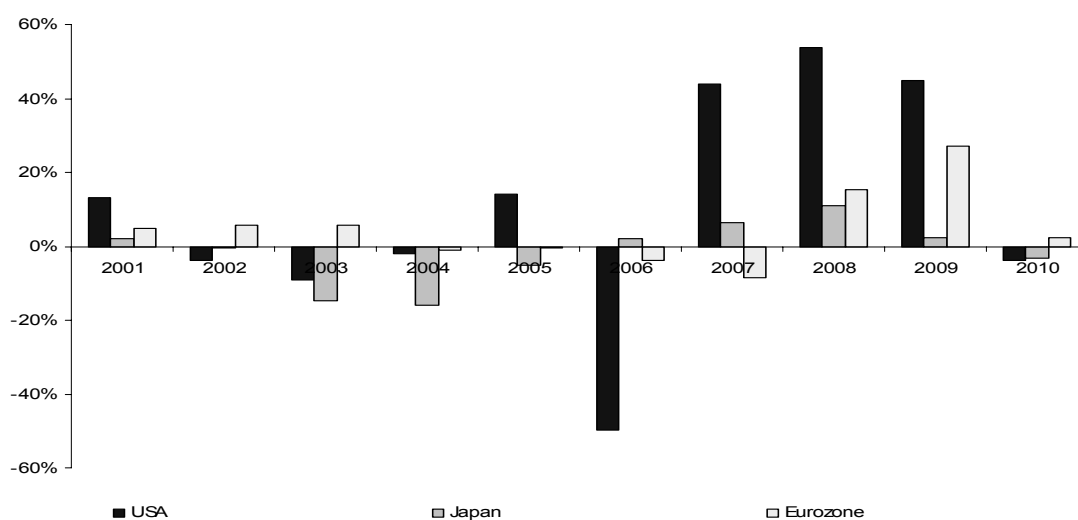


Source: Authors, based on data from European Central Bank and IMF

In 2009, SMEs all over Europe saw a significant decrease in sales and profits along with increased production costs, suggesting that they have been more affected than large corporates. Moreover, there are now tougher financing conditions, in particular for smaller businesses and fast growing, innovative

SMEs. While there is some debate if there is or will be a “credit crunch” for SMEs, more difficult access to credit has certainly contributed to a more challenging market environment for SMEs, resulting in a sharp increase of bankruptcies in 2009 which is, according to Euler Hermes, expected to continue throughout 2010 (figure 7 below shows the growth of business insolvencies overall for selected regions).

Figure 7: Business Insolvencies, growth year on year 2000-2010³⁴



Source: Authors, based on data from Euler Hermes

Against this backdrop, one could expect defaults in European securitisation transactions to go up dramatically. However, so far, European transactions in general have performed robustly and the performance is very different compared to the US Subprime-RMBS or CDO of CDOs/CDO of ABS. To date, the portfolio losses in most of the transactions are below 1% (for details see e.g. DZ Bank 2009 a and b). Also the rating agency Standard and Poor's (S&P) states that “over the three-year period since the beginning of the recent crisis, European Structured Finance proved generally resilient” (Standard & Poor's, 2010b). According to their recent reports (Standard & Poor's, 2010b) the cumulative default rate of ABS based on SMEs between mid 2007 and mid 2010 is only 0.2% (for comparison: CDO of ABS 10.15%; all European transactions 0.65%; all US transactions 6.19%).

However, of course, there have been signs of deterioration in Europe with downgrades in 2009 also for SMESec. The rating agency Moody's for example reports 50% of their ABS downgrades being linked to the “ABS of SME” sector (Moody's, 2010a). Performance deterioration happened notably in Spain, but also in Greece, Portugal, the UK and the Benelux countries. Performance for typical SME transactions is comparatively better in Germany (Moody's, 2010b).

³⁴ 2009 and 2010 are estimations respectively forecasts.

In addition to the general economic downturn, there were 3 main reasons for the wave of downgrades:

- Changes in the rating methodologies (without grandfathering; so far the rating agencies Moody's and Fitch have adjusted their methodologies; S&P might follow),³⁵
- As already mentioned, Spain is historically a strong SME securitisation market and has gone into a severe recession, and
- Thirdly there are non-typical SMESec transactions (i.e. the already mentioned German Mezzanine CDOs) that have suffered significantly and have featured the most severe downgradings.

The relatively strong resilience of SMESec ratings is also shown by the pace of rating migration. According to Moody's (Moody's, 2010b) almost 85% of all Aaa-ratings in EMEA³⁶ were maintained, compared to 76% globally (over the 2-year period from 30.04.2008 to 30.04.2010). Figure 8 shows the rating transition matrix for the respective period.

Figure 8: Moody's Rating Transition Matrix: 30.04.2008 to 30.04.2010, EMEA ABS SME³⁷

	Current rating %								Total
	Aaa	Aa	A	Baa	Ba	B	Caa	Ca/C	
Aaa	84.84	9.43	5.74	0.00	0.00	0.00	0.00	0.00	100
Aa	0.00	67.11	14.47	15.79	2.63	0.00	0.00	0.00	100
A	0.00	2.70	54.95	18.02	13.51	8.11	1.80	0.90	100
Baa	0.00	0.00	0.90	48.65	21.62	9.91	13.51	5.41	100
Ba	0.00	0.00	0.00	3.33	50.00	15.00	26.67	5.00	100
B	0.00	0.00	0.00	0.00	0.00	62.50	18.75	18.75	100
Caa	0.00	0.00	0.00	0.00	0.00	0.00	75.00	25.00	100
Ca/C	0.00	0.00	0.00	0.00	0.00	0.00	0.00	100	100

Source: Moody's (2010b)

With respect to the securitisation of non-standard portfolios, the performance of German Mezzanine CDOs, as already mentioned above, provides interesting lessons for the limits of SMESec: these transactions are based on non-granular portfolios (e.g. 30 to 150 obligors) with high obligor and sector

³⁵ For example, on 17 March 2009, Moody's published an updated rating methodology for assessing the credit quality of portfolios of SME loans. This provides a refined approach in which Moody's first determines a country-specific base Probability of Default assumption for a pool of SMEs and then adjusts it for the securitised portfolio quality and macro-economic factors. Among 2009's total ABS downgrades by Moody's 30% were the result of the revised methodology for SME ABS (Moody's, 2010a). S&P's announced on 06.08.2010 that it is undertaking a review of the assumptions and methodologies that it uses to rate securitisations of loans to European SMEs (Standard & Poor's, 2010c).

³⁶ As mentioned before, the "EMEA region" includes Europe, Middle East, and Africa; with regard to Structured Finance most of the transactions in this region are in Europe.

³⁷ % of ratings migrating from a rating category to another over the period. This includes rating changes for notes that were redeemed, or for new transactions issued over this period.

concentrations and with – compared to standard transactions – complex structures, often with no collateral, in the form of subordinated loans or profit participation rights.

Between 2003 and 2007 around 450 companies have been financed via these transactions, the total volume was around EUR 4.4bn. This represents only around 3% of the total SMESec during this period, but in terms of financial and reputational losses the impact of this type of transaction is high. The transactions show by now high default rates, e.g. as of March 2010 the transactions “Preps 2007-1” and “Heat II” had losses of almost 20% of the original portfolio; for “CB Mezzcap” and “Heat I” the figures are even higher at around 23% (Finance, 2010 and Handelsblatt, 2010). Other transactions of this nature have not performed much better with very few performing roughly as expected.

While intended to be a good addition to the spectrum of SMESec with the macroeconomic benefit of providing a standardised mezzanine finance instrument to Midcaps (less so for small companies), in hindsight there were substantial shortfalls of the concept which has led to the poor performance:

- Significant competition between banks to attract clients to these programs as banks tried to ramp up portfolios on a parallel basis; no interaction between banks which led to overlaps between transactions (i.e. corporates received monies from more than one program),
- Consequently magnifying the loss risk in the sector as corporate defaults occurred in more than one transaction simultaneously,
- Relatively low margins on the assets (considering the risk) given the competition which required a relatively high leverage of the securitisation to be economically viable,
- Limited diversification eroded excess spread very quickly given generally high leverage and low margins (i.e. transactions did not have strong enough cash flows to absorb lumpy defaults),
- Subordinated nature and no collateral almost always leads to a 100% loss in case of a default,
- Limited management opportunities for portfolio asset managers to interact with the corporate (i.e. limited covenants, no right to force the management of the borrower to act in a certain way); combined with an inability to sell the asset (no liquidity in the underlying asset),
- Adverse selection issues given the originate-to-distribute model which could not be overcome by the due diligence process used in these programs.

While these points on an individual basis might have been manageable, the combination of factors was ultimately decisive for the poor performance. These important lessons give us a template of what we believe are key success factors in a SMESec.

Key success factors

As a result of the above discussion and based on the “lessons learnt”, we can summarise some key features of successful SMESecs:

- Granular, diversified portfolios (i.e. with regard to single obligor exposure, sectors, regional distribution);
- Transparent and standardised structures (and no multiple securitisations like CDO of CDOs/CDO of ABS);

- Proper and transparent incentive structures in order to avoid moral hazard;
- Loans originated in line with relationship banking;
- Investors/guarantors should perform their own analysis/due diligence and should not be only “external rating driven”.

Most transactions reflect these features, but in some they have been disregarded. If originators and arrangers follow these success factors, we believe that SMESec can be revived. Given the background of its importance for SME financing on the one hand, and an attractive risk-return profile for investors on the other hand, it could be re-established as a growth segment in the short to medium term.

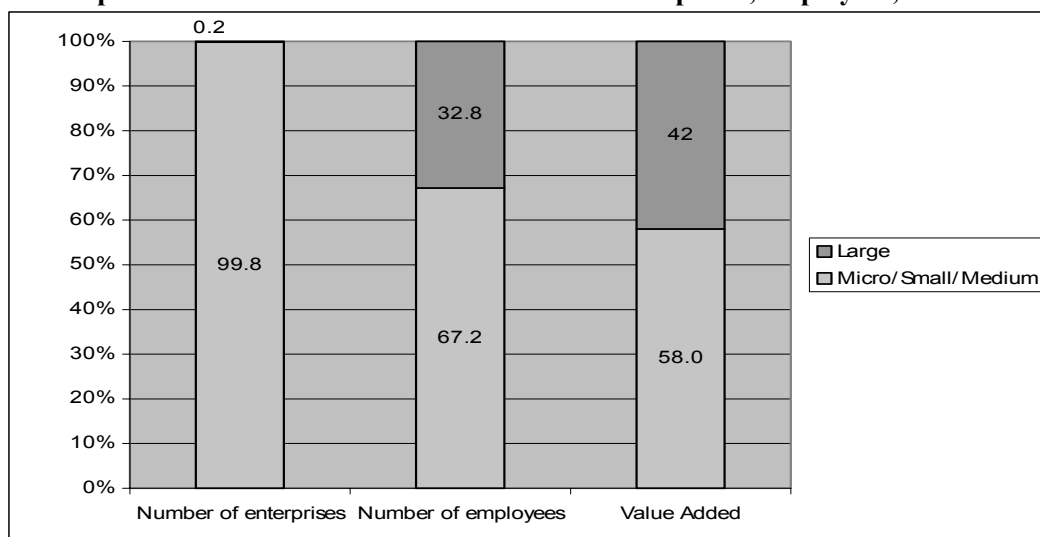
4. The role of public sector support for SMESec

The importance of SMEs as backbone of the European economy has been explained in many publications. In the EU 27, SMEs represent 99.8% of the total number of enterprises (out of around 20.5m), more than 2/3 of employment, and almost 60% of Value Added³⁸ (data as of 2007, see figure 9).

In economic literature, going back many years, a potential market failure is traditionally assumed in the area of debt financing for SMEs during a deep recession. The reasons are characterized by insufficient supply of credit and inadequacies of the demand side. The market failure is mainly based on asymmetric information (information gap between lender and borrower), combined with uncertainty, causing agency problems that affect debt providers’ behaviour (see Akerlof, 1970; or for agency problems - hidden information/hidden action – Arrow, 1985).

As we have shown, SMESec is an effective instrument to improve SME financing, hence we see public support of SMESec in a non-market distorting way as a legitimate measure.

Figure 9: Importance of SMEs in terms of number of enterprises, employees, and Added Value



Source: Authors, based on data in EIM, 2009

³⁸ Value added (at factor cost, Eurostat definition): can be calculated from turnover, plus capitalised production, plus other operating income, plus or minus the changes in stocks, minus the purchases of goods and services, minus other taxes on products which are linked to turnover but not deductible, minus the duties and taxes linked to production. Alternatively it can be calculated from gross operating surplus by adding personnel costs.

In 2004, the European Commission initiated an impact analysis of SMESec (European Commission, 2004). The study confirmed that, given its flexibility as a gateway to capital markets, SMESec is an important aspect to the SME credit markets and most likely has a positive impact on the systemic availability of finance for SMEs, thereby deserving continued support from the public sector. The findings of the study furthermore support the view that SMESec is favourable for the SME sector and could over time lead to improved access to finance for SMEs. The study made the case that public sector activity in SMESec can be useful in advancing EU economic goals (European Commission, 2004).

The development of SMESec has been spurred by stimuli from national support schemes, such as KfW's Promise platform in Germany and Spain's FTPYME securitisation scheme. Moreover, supranational support through the EIF (as guarantor) has played a key role in the development of the European SMESec market.

Now, in the aftermaths of the financial crisis and as shown by the recent ECB surveys on SME's access to finance, credit conditions for companies have tightened significantly (see ECB, 2009 and ECB, 2010a). The annual growth rate of loans to non-financial corporations is currently negative (ECB, 2010c). This development is still broadly consistent with business cycle regularities, suggesting that in terms of growth rates real loans to non-financial corporations tend to lag economic activity behind by about one year (ECB, 2010c).

However, according to the ECB, while net demand for short-term loans to corporates remained in negative territory in the second quarter of 2010, net demand for long-term loans turned positive for the first time since the first quarter of 2008 (ECB, 2010c). It remains to be seen if the increasing demand is going to be accompanied by increasing supply. In case of difficult or worsening credit conditions, large firms are able to compensate by tapping bond markets. For SMEs, this is not possible and many experts still see the risk of a credit crunch for small businesses.

Currently this market remains difficult despite some promising first attempts to revive the asset class. Investors will only return in volume if they regain trust in the quality of the transactions and if there is satisfactory secondary market liquidity. Originators will return if transactions are economically feasible. For both, a stable and reliable regulatory framework is a key precondition as well.

Given the importance of SMESec going forward and the lack of a diversified investor base at the moment, public sector support of this market segment can help to accelerate positive developments and can be crucial for its revitalisation. From a policy standpoint, such support has to be conditional upon ensuring "additionality", i.e. extending new loans to SMEs – so that SMEs effectively benefit from the support given to the SMESec transaction. The public sector support needs to have sufficient size to foster the market. As already indicated above: other asset classes can be more easily securitised (e.g. in the case of RMBS) and may be used in e.g. Covered Bond issuances. Hence, in case there is no revitalisation of the SMESec market, SME loans have become in relative terms even more illiquid as compared to such other assets.

Integrated EU capital markets (and their need for transparency and standardisation) and the relative complexity of the securitisation techniques require considerable know-how and show the necessity for specialised institutions. As an established and respected player in the European market, EIF can play a role via market presence, reputation building, and signalling. It typically provides guarantees on mezzanine or junior AAA tranches, but can also act as guarantor for senior tranches of SMESecs for funding driven transactions.

The respective tranches are enhanced with the EIF's AAA/Aaa rating and investors in the guaranteed tranches can benefit from EIF's risk weighting of 0% (MDB status/AAA rating). EIF charges a risk

premium for its guarantees which is generally in line with market rates (see Annex 1). In addition to the direct benefits of its guarantees, other factors of EIF's involvement can play an important role in facilitating the execution of a securitisation transaction:

- EIF's involvement can facilitate placement of tranches with investors. From the originator's point of view, EIF reduces uncertainty and supports the marketing of a deal through its "anchor" investor status ;
- Guaranteeing e.g. a junior AAA tranche can also provide additional rating stability and shorter weighted average life to senior tranches, thus reducing their risk, which in turn should attract additional investors ;
- Smaller banks profit from EIF's experience and knowledge of the SME securitisation process (support and spread of best market practise). Usually, EIF is involved very early in the transaction and can assist the originator ;
- The EIF facilitates overall lower transaction costs ;
- EIF acts in the "traditional" securitisation markets and with "traditional" key players, but expands the idea of SMESec into non-core market countries (e.g. Central and Eastern Europe), and to new originators ;
- In general, EIF facilitates standardisation, improves transparency, and spreads of best securitisation market practise.

Moreover, EIF supports the introduction of quality standards with signalling effects. For example, the European Financial Services Roundtable (EFR) in cooperation with the European Securitisation Forum (AFME/ESF) have been coordinating the establishment of standards for Prime Collateralised Securities (PCS) with the involvement of the ECB and the EIB Group. The idea is to establish PCS as a brand such as key attributes like quality, simplicity, transparency and liquidity to establish a market standard. In Germany, the True Sale International (TSI) and the Association of German Banks (BdB) are coordinating the establishment of a German prime market for securitisation.

5. Final remarks

It is very likely that much lower levels of bank financing available for the overall economy will negatively impact the strength of the economic recovery. Typically, SMEs are not able to raise money directly in the capital markets and are therefore dependent on traditional bank financing, which is itself limited by constraints due to both bank's refinancing capacity, their risk appetite and capital adequacy. In this environment SMESec can play an important role in contributing to the indirect access of SMEs to the capital markets.

The revitalization and further development of SMESec is pivotal for the future growth of SME financing, and this paper argues that public sector support can contribute to the revitalization of the market in a way that avoids moral hazard and assists in the provision of consistent reliable information on the SME loan asset class.

Properly applied SMESec can enhance access to finance for SMEs and it is a replicable tool for SME support that provides a multiplier effect; i.e. the investing in/guaranteeing of relatively small (mezzanine) tranches facilitates the securitisation of much higher volumes and is as such an efficient way of deploying

public sector support. Moreover, in addition to complementing private sector money, the participation of an institution like the EIF in SMESec can “crowd-in” private resources via its positive signalling effect. This leverage and efficient use of public resources is especially important against the background of high public debt burden in many key countries and will serve to substitute for the expensive crisis-driven support measures, which have typically had lower leverage u.

A crisis also provides opportunities: in a more “healthy” environment of reduced moral hazard, reduced information asymmetries and cognisant risk taking, a reinvented SMESec can provide an important contribution to SME’s access to finance as well as providing an attractive asset class to long term investors.

ANNEX 1

Typical EIF involvement in SMESec

The general purpose of EIF's credit enhancement operations is to support new SME financing. EIF focuses mainly on deals backed by SME financing, although it does not exclude other asset classes.

Examples of SME financing securitised with the help of EIF:

- SME loans, SME loan guarantees
- Small ticket lease receivables
- SME trade receivables
- Venture financing (lease/loans)
- Micro loans

EIF guarantees senior and/or mezzanine tranches of risk, typically with a minimum rating equivalent to BB/Ba2.

EIF guarantees are provided in different forms, such as note guarantees, bilateral guarantees, credit default swaps, etc.

EIF guarantees facilitate the execution of securitisation transactions, allowing financial institutions to diversify their funding sources and/or to achieve economic and regulatory capital relief via credit risk transfer:

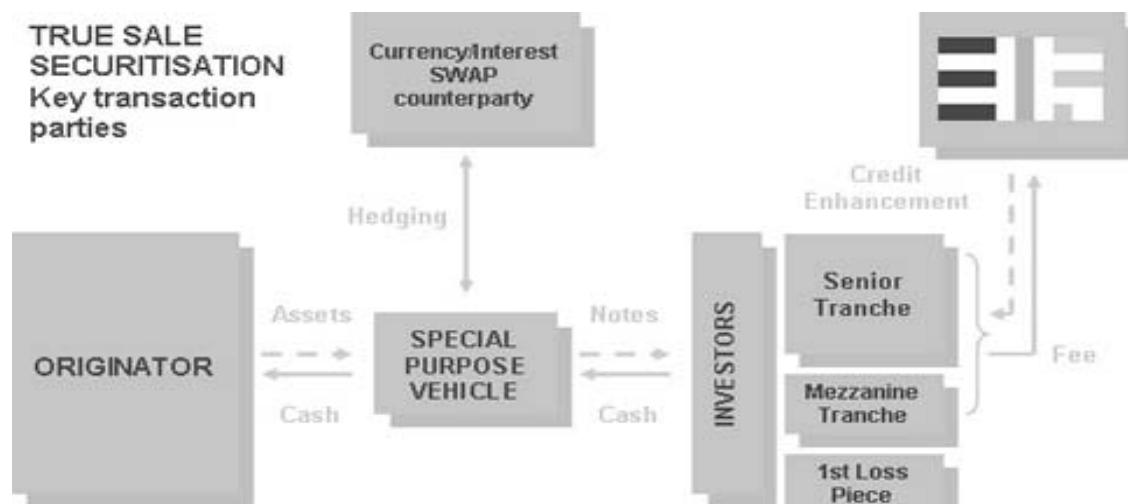
- Asset-backed securities guaranteed by EIF are assigned its AAA/Aaa/AAA rating.
- EIF can sell protection on the underlying portfolio itself, e.g. directly to the benefit of the originator in synthetic deals.
- Credit risk transfer and capital relief - through the placement of notes with cash investors or otherwise - are further facilitated by the zero risk-weighting assigned to assets guaranteed by EIF (Basel II), thanks to its Multilateral Development Bank status.
- EIF guarantees are offered at competitive prices, after a detailed analysis of the transaction and of the originator.

EIF may conduct its activities in the territory of the Member States of the European Union, in candidate and potential candidate countries to the European Union and in the European Free Trade Association (EFTA) countries.

Moreover, EIF has been mandated by the European Commission to participate in securitisations using EU funds from the CIP - Competitiveness and Innovation Framework Programme 2007-2013.

TRUE SALE TRANSACTIONS

EIF guarantees on ABS are provided in different forms, such as note guarantees or bilateral guarantees to the noteholders.



Examples of true sale securitisations from EIF's track record:

Name	Asset class	Country
Geldilux-TS-2010	SME loans	Germany
Sandown Gold 2010 plc	SME loans	UK
BEST SME 2008 B.V.	SME loans	Netherlands
Zephyros Finance S.r.l.	Small ticket lease receivables	Italy
Geldilux-TS-2005 S.A.	SME loans	Germany
ProCredit Bulgaria	Micro loans	Bulgaria
ROOF Poland Sp z o.o.	Small ticket lease receivables	Poland

SYNTHETIC TRANSACTIONS

In synthetic transactions, EIF can either guarantee Credit Linked Notes to investors or sell protection on the reference portfolio directly to the originator.

Examples of synthetic transactions from EIF's track record:

Name	Asset class	Country
GATE SME CLO 2005-1	SME loans	Germany
BEL SME 2006	SME loans	Belgium
BEST SME 2007 B.V.	SME loans	Netherlands
CoSMO Finance 2007-1 and 2008-1	SME loans and guarantees	Germany
Goodwood Gold SME CLO	SME loans	United Kingdom
Gracechurch Corporate Loans Series 2007-1	SME loans	United Kingdom
ROOF CEE 2006-1	Small ticket lease receivables	Czech Rep. and Poland

ANNEX 2

Glossary

Basket Trade

A single order or trade in 15 or more securities, especially in large amounts.

Credit Default Swap

An agreement used in synthetic securitisations where the originator (protection buyer) sells the credit risk of an underlying portfolio to a counterparty (protection seller) without transferring the ownership of the assets.

Credit Enhancement

Refers to one or more measures taken in a securitisation structure to enhance the security, the credit quality or the rating of the securitised instrument, e.g. by providing a third party guarantee (such as the EIF guarantee). The credit enhancement could be provided in the form of:

- (i) Structural credit enhancement (tranching of the transaction in senior, mezzanine and junior tranches);
- (ii) Originator credit enhancement (cash collateral, profit retention mechanism, interest sub-participation mechanism);
- (iii) Third party credit enhancement (EIF or monoline insurers).

Credit Linked Notes (CLN)

A security issued by an SPV (or directly from the balance-sheet of the originator) credit-linked to the default risk of an underlying portfolio of assets. Usually used in synthetic securitisations for the mezzanine tranches of a transaction.

First Loss Piece

Part of a securitisation transaction which is usually kept by the originator (as an “equity piece”) and which covers the risk of first loss in the portfolio. Its size is a function of the historical losses, so as to protect the investors against the economic risk (estimated loss) of the transaction.

Issuer

Refers to the SPV which issues the securities to the investors.

Mezzanine Risk

Risk or tranche which is subordinated to Senior risk, but ranks senior to the First Loss Piece.

Originator

The entity assigning receivables in a securitisation transaction (funded transaction) or seeking credit risk protection on the assets (unfunded transaction).

Primary market

The market in which securities are issued.

Secondary market

The market where issued securities are traded.

Senior

The class of securities with the highest claim against the underlying assets in a securitisation transaction. Often they are secured or collateralised, or have a prior claim against the assets. In true sale structures they rank senior in the cash flow allocation of the issuer's available funds.

Servicer

Refers to the entity that continues to collect the receivables, enforcement of receivables, etc. Generally, the originator is also the servicer.

Special Purpose Vehicle (SPV)

Issuing entity holding the legal rights over the assets transferred by the originator. An SPV has generally a limited purpose and/or life.

Subordinated

The classes of securities with lower priority or claim against the underlying assets in a securitisation transaction. Typically, these are unsecured obligations. They are also called Junior (or Mezzanine) notes and bonds.

Synthetic securitisation

A transaction where the assets are not sold to an SPV but remain on balance sheet; and where only the credit risk of the assets is transferred to the market through credit default swaps or credit linked notes.

Tranche

A piece, a portion or slice within a structured transaction.

True sale

It refers to the separation of the portfolio risk from the risk of the originator, i.e. there is a non-recourse assignment of assets from the originator to the issuer (special purpose vehicle). To be contrasted with synthetic securitisations where only the underlying credit risk is transferred.

ANNEX 3

List of Acronyms

- ABCP: Asset Backed Commercial Paper
- ABS: Asset Backed Securities
- AFME/ESF: Association for financial markets in Europe/European Securitisation Forum
- CDO: Collateralized Debt Obligation
- CEE: Central and Eastern Europe
- CLN: Credit Linked Note
- CRD: Capital Requirements Directive
- EAD: Exposure at default
- EBRD: European Bank for Reconstruction and Development
- EC: European Commission
- ECB: European Central Bank
- EFR: European Financial Services Roundtable
- EFTA: European Free Trade Association
- EIB: European Investment Bank
- EIF: European Investment Fund
- EMEA: Europe, Middle East, and Africa
- EU: European Union
- IFI: International Financial Institution
- IMF: International Monetary Fund
- LGD: Loss given default
- MDB: Multilateral Development Bank
- OECD: Organisation for Economic Co-Operation and Development
- PD: Probability of default
- PCS: Prime Collateralised Securities
- RMBS: Residential Mortgage Backed Securities
- SMEs: Small and medium sized enterprises
- SMESec: SME Loan Securitisation
- SIV: Structured Investment Vehicle
- SPV: Special Purpose Vehicle
- TSI: True Sale International

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APPENDIX

... The European Investment Fund

The European Investment Fund (EIF) is the European body specialised in small and medium sized enterprise (SME) risk financing. The EIF is part of the European Investment Bank group and has a unique combination of public and private shareholders. It is owned by the EIB (61.2%), the European Union - through the European Commission (30%) and a number (30 from 17 countries) of public and private financial institutions (8.8%).

The EIF supports high growth innovative SMEs by means of equity (venture capital and private equity) and guarantees instruments through a diverse array of financial institutions using either its own funds, or those available through mandates given by EIB (the Risk Capital Mandate or RCM), the EU (the Competitiveness and Innovation Framework Programme or CIP), Member States or other third parties.

Complementing the EIB product offering, the EIF has a crucial role to play throughout the value chain of enterprise creation, from the early stages of intellectual property development and licensing to mid and later stage SMEs.

Mid 2010, EIF had invested in some 300 venture capital and growth funds with net commitments of over EUR 4.3bn. At mid 2010, the EIF net guarantee portfolio amounted to over EUR 13.5bn in some 170 operations.

The EIF fosters EU objectives in support of innovation, research and regional development, entrepreneurship, growth, and job creation.

... EIF's Research & Market Analysis

Research & Market Analysis (RMA) supports EIF's strategic decision-making, product development and mandate management processes through applied research and market analyses. RMA works as internal advisor, participates in international fora and maintains liaison with many organisations and institutions.

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ACCOUNTING TREATMENT OF SECURITISATION, DERECOGNITION PRINCIPLES AND CURRENT PROPOSALS

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Banco de España
Fernando García Martínez
Universidad Complutense de Madrid

1. Introduction

In this paper we will try to describe the financial effects of traditional-style securitisation, by means of a short depiction of the accounting standards governing these structures.

When an institution securitizes a portfolio of assets embodying similar cash flow and risk features, it basically looks for cheap funding or risk transfer, either in which the transaction involves transferring assets. However, a legal transfer does not automatically involve surrendering exposure to the asset's financial implications, and accordingly it should not automatically imply removing the assets from the balance sheet.

Therefore the challenge from an accounting perspective is to determine whether the transferor retains exposure to the asset, in which case the asset is kept on balance sheet instead of being written off. In the accounting realm, the issue is referred to as the “derecognition” of financial assets, and its implications range from the mere conceptual backbone of accounting to more intricate prudential issues affecting financial institutions³⁹.

Accordingly, only through careful analysis of the derecognition rules for financial assets can the accounting treatment of securitisation be explained. The rest of the paper will provide the reader with a snapshot of the current principles, how they affect securitisation and some of the proposals to revisit them.

2. Derecognition of financial assets: current principles

2.1. Current derecognition principles

The current principle that governs derecognition of financial assets can be plainly described as follows: you either derecognise when the rights to the cash flows from the asset have expired or when the asset is transferred and certain conditions are met.

The first case comprising the principle seems obvious, and is exemplified by a debtor discharging its obligation by paying the holder of the asset, or by an option expiring. Generally speaking, whenever the asset ceases to exist the holder no longer has the rights to any cash flow and therefore the asset has to be written off the balance sheet.

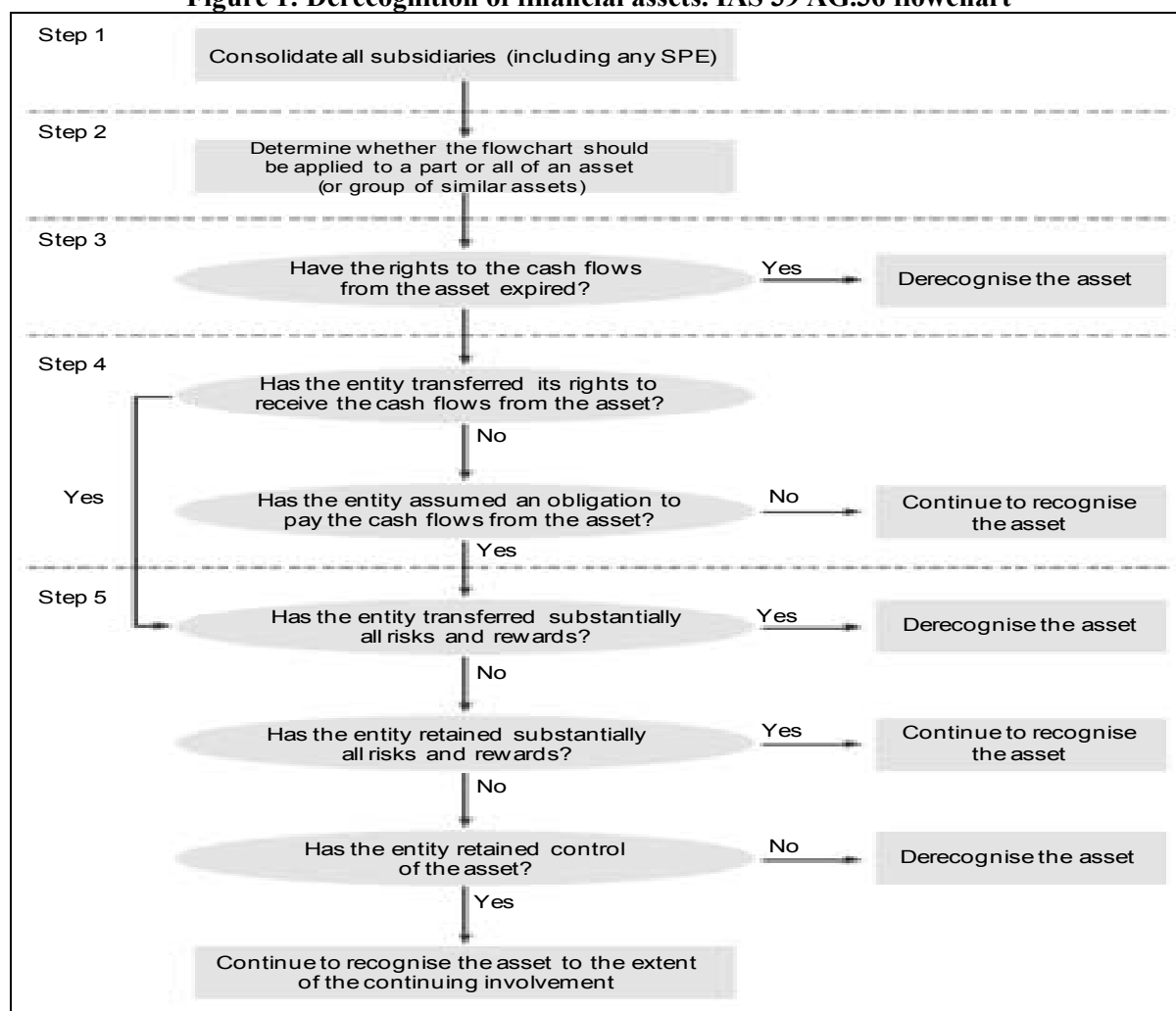
³⁹ Prudential rules affecting financial institutions require among other things that capital be set aside to cover the risk of unexpected losses due to the institution's exposure to risks. In this context, it would be awkward for a transferor to derecognise a financial asset and thus release regulatory capital while still being subject to losses arising from the transferred asset.

On the contrary, as regards the second part of the principle things are not so clear. As already mentioned in the introduction, not all transferred assets have to be written off the balance sheet. Or, to be more correct, some transferred assets must be kept on balance sheet. Accordingly, for the transferred asset to be derecognised a number of conditions have to be met.

2.2. Applying the principles: the derecognition flowchart

In order to understand the concrete aspects of the approach more clearly, the derecognition flowchart provided by the IASB in IAS 39 proves extremely useful. This flowchart elaborates on the derecognition principle, establishing a series of tests that provide concrete answers to the question whether a financial asset should be written off the balance sheet.

Figure 1: Derecognition of financial assets. IAS 39 AG.36 flowchart



Source: IAS 39

Step 1 in the flowchart requires that all subsidiaries and vehicles be consolidated. Although more conceptual than technical, this is one of the most important requirements affecting securitisation, its purpose being to avoid derecognition of assets that are sold to controlled parties such as SPVs, trusts or partnerships.

Step 2 will not be discussed here since it doesn't really affect the issues presented in this paper, namely securitisation.

Step 3 is the practical depiction of the derecognition principle's first part. As mentioned in paragraph 2.1, it is quite obvious that writing the asset off the balance sheet becomes inevitable when the rights to the cash flows from the asset expire.

However if those cash flows have not expired things become a bit more complex, entering the realm of asset transfer. As previously advanced, there are some conditions that the transfers have to meet for the asset to qualify for derecognition.

In that context, **step 4** asks whether the entity has transferred its rights to receive the cash flows from the asset. In principle, a negative answer to this question should end the debate and ban derecognition, but even retaining its rights over the asset's cash flows the entity would be obliged to surrender them on to a third party if a pass-through arrangement was in place. For such arrangement to qualify as a transfer certain conditions have to be met, most notably the prohibition to sell or pledge the original asset, except in the case of clean-up calls⁴⁰.

If either the entity has transferred its rights to the asset's cash flows or a valid pass-through arrangement exists, then the flowchart moves on to **Step 5**, asking whether the entity has substantially transferred all risks and rewards stemming from the asset.

At this stage the first of two conditions required for the transferred asset to be derecognised comes in place, related to the concept of "risks and rewards". In keeping with such concept, an answer to the question in Step 5 is provided by means of a first test which compares the entity's exposure to the variability of the asset's cash flows before and after the transfer.

In most cases determining who bears the risk exposure before and after the transfer is apparent, and therefore the outcome of the comparison is straightforward. But occasionally a thorough analysis is needed to determine whether risks and rewards have been transferred⁴¹.

After implementing such comparison (be it straightforward or more elaborated) it could be concluded that the transfer eliminates the exposure to cash flow variability, in which case risks and rewards would be considered to be transferred and the asset would therefore be derecognised. An example of this is the outright sale of a debt security, in which exposure to the variability in the amount or timing of cash flows due to market and credit risk is eliminated from the moment in which the asset is sold.

However, occasionally the variability exposure is not eliminated, and a second test must be performed to ascertain whether the exposure is just reduced or even kept unchanged after the transfer.

If the exposure was unchanged, the entity would be considered to have retained substantially all risks and rewards, and thus the asset would continue to be recognised. Good examples are repurchase agreements, which imply the transfer of an asset without surrendering exposure to the related credit risk, due to the simultaneous agreement to repurchase it within a short interval at a price which would exceed the selling

⁴⁰ Within traditional securitisation structures, clean-up calls are rights that allow the issuer of the ABS to redeem the issue's outstanding amount when its principal is down to a residual amount (normally a cap of 10% is established). Accordingly a pass-through arrangement would still be valid even if the involved assets were sold outright, as long as such transaction was aimed to redeem the outstanding amount of the corresponding issue.

⁴¹ Such analysis should in any case use some measure of the exposure to cash flow variability, e.g. the weighted standard deviation of the asset's discounted cash flows.

price to include an interest component. In other words, transferring an asset via repo does not prevent the transferor being exposed to the possibility of the issuer defaulting on the repayments, since the transferee will sell the bonds back at a fixed price irrespective of whether the issuer of the bond defaults in the meantime.

Moving to the accounting domain, cases in which the transferor is still subject to credit risk after transferring the asset should be booked as collateralized loans, which means recognizing cash received and a liability representing the obligation to repurchase the asset. To put it in IAS 39's terms, those would be examples of the transferor retaining risks and rewards from the asset.

If the exposure was rather reduced (though not eliminated) a third test must be applied to check whether the entity has retained control of the asset. This introduces the second condition that has to be met for a transferred asset to be derecognised, in this case related to the concept of "control".

The control test is based on the transferee's practical ability to sell the asset, which is assumed to be the case when the asset is traded in an active market. Accordingly, if the transferor loses control of the asset, it must derecognise it, while retention of control implies continuing to recognise the asset to the extent of the transferor's continuing involvement, and simultaneously recognizing a liability to that same extent. At this stage it should not be difficult to grasp that the extent of the transferor's continuing involvement means the extent of its continuing exposure to the cash flow variability of the asset.

To illustrate this, one could think of a transfer of readily obtainable bonds including an option for the transferee to put the assets back to the transferor during a specified period at a specified price. Since the scheme makes it possible that the assets flow back to the transferor via the put option, exposure to the variability of the asset's cash flows is reduced but not eliminated, and accordingly the transferor would neither transfer nor retain the risks and rewards of ownership, although it would lose control of the bonds because the transferee would be clearly enabled to sell them (note that even in cases where the option was deep in the money, the transferee would be able to easily obtain the bonds in the market).

3. Accounting treatment of securitisation

Having gone through the derecognition flowchart, it is now time to describe how it applies to securitisation.

To begin with, though obvious it should be noted that traditional securitisation structures imply the transfer of financial assets. The problem remains determining which of the existing paths within the flowchart best suits a specific structure. As described below, in most cases analysis of the accounting impact of a securitisation structure results in a quick exit from those gloomy passages, due to the retention of risks and rewards.

3.1. Consolidation

First of all, when dealing with securitisation, it is crucial to consider the consolidation requirements.

The former US rule on consolidation (ARB 51) focused on equity-based majority voting interests to require consolidation, arguing that equity receives the residual economic interest generated by a business. This concept of equity ownership was replaced in December 2003 by a "control" concept through FIN 46R, and accordingly consolidation is now required in US GAAP whenever one entity has a controlling financial interest in another.

The IASB had introduced the concept of control for consolidation purposes well before 2003. Control is defined by IAS 27 as the "power to govern the financial and operating policies of an entity so as to obtain

benefits from its activities”, while the specific application of that general definition to SPEs is performed through SIC 12. The combination of both rules provides a framework that prevents effective control over certain vehicles to be concealed by forcing their inclusion within the boundaries of consolidated financial statements despite the controller’s minority voting interest, thereby limiting the scope to structure transactions aiming to sweep liabilities and losses off the financial statements.

Securitisations are often effected by means of SPEs, and therefore determining the scope of application of the derecognition principles requires verifying whether the transferor effectively controls the vehicle. To that end SIC 12 provides a list of factors that may indicate such control, one of them deeming it to exist if the residual risks and benefits of either the SPE or its assets are retained by the transferor in order to obtain benefits from its activities.

The business of a securitisation vehicle basically consisting in collecting the cash flows from assets received and passing them on to the bondholders, no real distinction exists between being enabled to the risks and benefits of the SPE or to those of the vehicle’s assets themselves. Therefore verifying effective control over the vehicle is reduced to determining whether the transferor retains the residual risks and benefits of the transferred assets after transferring them.

In most cases, issuing ABS requires a high credit rating, i.e. the perceived risk of default of assets underlying the securities must be low. To achieve that rating, securitisation structures use credit enhancements, which normally imply the transferor’s involvement in the conduit’s issue, for instance by means of guaranteeing a return or providing credit protection to outside investors.

Whatever the specific features of such involvement are, it essentially means that the transferor remains liable for the performance of the transferred assets, thus retaining the residual risks. Though specific provisions can be set in place enforcing such involvement, due to reputational concerns the transferor normally stands ready to back the structure in case of asset default even if not obliged to. Therefore in most cases the transferor retains the risks and benefits of the transferred assets and thus controls the securitisation vehicle.

3.2. Asset transfer

As just explained the consolidation framework provides for the transferor most likely controlling the securitisation vehicle, which is consolidated accordingly. If that is the case, assets remain within the group and thus a pass-through test would have to be applied from a group perspective to determine whether a transfer in fact takes place.

In other words, unless the vehicle assumes an obligation to pay the cash flows from the asset to a party alien to the group and the pass-through conditions are met, the asset will continue to be recognised. Few securitisations meet all these requirements, so most likely the walk through the flowchart will end up here.

3.3. Retention of risks and rewards

In any case, even if the pass-through conditions were met (or if a real transfer of rights to the asset’s cash flows took place), it would be unlikely that substantially all risks and rewards were transferred out of the group, due to the need for the originator to provide credit enhancements that make the ABS attractive to potential investors.

If such is the case that risks and rewards have not been substantially transferred because the transferor is still exposed to cash flow variability, the question is whether those risks and rewards have been retained, or to what extent the transferor is still exposed to cash flow variability.

As already discussed, in most cases the necessary existence of credit enhancements makes it impossible for the transferor to avoid covering losses, and therefore the exposure to cash flow variability is practically unchanged after the transfer. To put it in the Standard's terms, normally the transferor retains substantially all risks and rewards and therefore continues to recognise the asset.

3.4. Retention of control

It could also be the case that a reduction of the exposure to cash flow variability took place. Even then the transferor would most likely continue to recognise the asset to the extent of the continuing exposure, because assets transferred in securitisation structures are normally included within singular portfolios that are not readily obtainable in the marketplace and accordingly the transferor would be considered to retain control owing to the transferee's impossibility to sell the assets.

4. Current proposals: revision of the derecognition principles

The role of securitisation in the recent crisis has prompted a debate around the adequacy of derecognition principles and the need to ensure that risks are not ignored in the financial statements.

Up to now, the debate has only yielded a new set of disclosure requirements which will allow users of financial statements to improve their understanding of transfer transactions of financial assets, particularly the possible effects of any risks that may remain with the transferring entity.

Although substantially affecting securitisations, the impact of these new disclosure requirements is minor when compared with proposals that affect the main body of financial statements. These proposals are based on a new derecognition principle which is discussed below.

4.1. Proposed new principle

The most direct consequence of the debate was the publication by the IASB of an exposure draft (ED/2009/3) that aimed at revising the derecognition rules. This ED proposes to replace the current principle by a new one focusing on the IASB's definition of asset. According to this new principle, a reporting entity should derecognise a financial asset when it ceases to qualify as an asset, this taking place either when the underlying future economic benefits no longer exist or when the reporting entity no longer controls those benefits. In turn, the reporting entity no longer controls the asset's underlying future economic benefits when it no longer has the ability to access those benefits and to restrict others' access to them.

4.2. Impact on securitisation

The new principle springs up from the "reporting entity" concept, thus keeping the scope of the derecognition analysis unchanged when dealing with securitisations. That means that derecognition of securitised assets has to be analysed on a reporting entity perspective, which amounts to a group perspective when a SPE is involved.

However, concerning the concepts that underlie conditions required for a transferred asset to be derecognised a substantial change is introduced by the ED, namely the elimination of the "risks and rewards" concept which up to now prevailed over the "control" concept. Specifically concerning securitisation, the current retention of risks and rewards that prompts continuing recognition of assets is now transformed into retention of asset control by the reporting entity. Additionally, the proposal clearly links this notion of control to the definition of asset, thereby building the derecognition framework on the conceptual foundations of accounting.

However, at this stage there are diverse reactions towards the proposal, some of which criticize the withdrawal of the risks and rewards concept since it would substantially affect the securitisation industry by preventing entities from derecognizing any of the securitised assets as long as they retain any kind of involvement. In their opinion, a risks and rewards test better captures the substance of transactions performed under an “originate and distribute” model and results in a more appropriate accounting treatment, allowing assets to be derecognised if a substantial transfer of risks and rewards takes place.

However, in our understanding the only substantial change affects structures in which the degree of risks and rewards transfer is blurred, by eliminating the “continuing involvement” approach. This approach was technically difficult to implement and implied a high degree of management judgment, opening the floor to manipulation, so the proposal has tried to avoid arbitrary derecognition of the implied assets in light of concerns raised by the credit crisis: in short, assets should continue to be recognised whenever the reporting entity retains their control, and in this connection any kind of involvement of the originator should be considered as an indicator of such retention. This aims at avoiding the omission of risks arising from certain structures, and caters for situations in which the originator would cover losses even in the absence of specific credit enhancements due to reputational issues⁴².

Turning to USGAAP, the US proposed amendment to SFAS 140 (which deals among other things with the accounting for transfers of financial assets) requires for the transferred assets to be derecognised not only that they comply with criteria similar to those proposed by the IASB, but additionally that they are bankruptcy remote. This is also required by Basel II to exclude securitised assets from the calculation of regulatory capital, and it means not only the reporting entity, but also eventually the receiver having to surrender any control over the asset. In other words, the transfer would need to be designed as a “true sale”.

5. Examples

5.1. Example: Part of a financial asset subject to transfer

The entity A has two debt instruments, whose fair value is 850.000 € and 6.500.000 € respectively. In this time, the entity A transfers to Entity B:

- a) A 90% pro rata share of all cash flows from the first debt asset. The entity A and B participate in a fully proportionate share of losses.
- b) The right to the first 6.000.000 € of cash flows that are delivered from the first instrument. The entity A absorbs the first 500.000 € of losses from the debt instrument.

Can entity A apply the derecognition model to these debt instruments?

Solution:

The entity A can apply the derecognition model to the 90% of the first debt instrument. However it cannot apply the derecognition model to part of the second debt instrument., because it has neither transferred identifiable cash flows, nor a fully proportionate share of all of the cash flows.

⁴² The existence of implicit guarantees is most difficult to verify, and therefore determining whether a transferor would cover losses even in the absence of specific provisions implies assessing not only all contractual commitments but also the potential reputational consequences for the originator of letting a sponsored vehicle fail.

5.2. Example: Pass-through

The entity A enters into the following two arrangements with entity B:

First arrangement. Entity B pays entity A 3.500.000 € for receiving cash flows on 3.500.000 € of debt instruments. Entity A retains the contractual rights to receive the cash flows from the debt instruments but assumes an obligation to pay cash flows from the debt instruments to entity B. Entity B purchases a financial guarantee contract from entity A for 2.800.000 €.

Second arrangement. Entity B pays entity A 2.800.000 € for receiving cash flows on 3.500.000 € of debt instruments, being expected losses on the debt instruments 20% of interest and principal cash flows. Entity A retains the contractual rights to receive the cash flows from the debt instruments but assumes the obligation to pay cash flows from the debt instruments to entity B when collect the money.

Is there pass-through in these arrangements?

Solution:

In the second arrangement there is pass-through, but in the first one there is not pass through because entity A will pay 2.800.000 € to entity B, even when it does not collect the equivalent amount from the original debt instruments.

5.3. Example: Risk and reward test and accounting

Entity A sales receivables to entity B and to entity C with two arrangements:

First arrangement has the following conditions:

Carrying amount (amortised cost): 600.000 €

Entity A issues a put option which expires in 30 days. The entity B may put the receivables back to entity A for 752.000 €. The put strike price is 2.000 €

Entity B pays 750.0000 € for the receivables which a fair value of 700.000 €

There is a remote possibility that the fair value of the receivables increasing to 752.000 € in the next 30 days.

Second arrangement has the following conditions:

Carrying amount (amortised cost): 200.000 €

Entity A issues a put option which expires in 30 days. The entity C may put the receivables to entity A for 223.000 €. The put strike price is 3.000 €.

Entity C pays 223.0000 € for the receivables which a fair value of 220.000 €

If entity C does not put the receivables to entity A, entity C must pay entity A 10.000 €.

There is a remote possibility that the fair value of the receivables increasing to 223.000 € in the next 30 days.

How should these arrangements be accounted?

Solution:

In first arrangement, the entity A has retained substantially all the risks and rewards of receivables because at the inception, the exercise of the option appears virtually assured. Entity A's statement of financial position is showing the receivables with the assets and with the liabilities a secured borrowing of 748.000 € and a derivative of 2.000 €. The secured borrowing is measured at amortised cost and 4.000 € (752.000-748.000) is amortised using the effective interest method in 30 days. The derivative is measured at fair value with fair values changes recognised in profit or loss.

In second arrangement the entity A has retained substantially all the risks and rewards of receivables too, because at the inception, the exercise of the option appears virtually assured. The accounting treatment is similar to first arrangement.

5.4. Example: Risk and reward test with pass through

Entity A have and seven years interest-bearing loan of 800.000 € and enters into an agreement with entity B with the following conditions:

Entity B pays 750.000 € to entity A

Entity A pays the first 750.000 € plus interest of cash collected form the loan, and entity A retains a subordinated residual interest (rights to the last 50.000 € plus interest)

If expected losses are 10.000 € , has entity A transferred substantially all the risks and rewards?

Solution:

Entity A has not transferred substantially all the risks and rewards of the loan because of the subordinated retained interest. It absorbs the expected losses of 10.000 €. It's impossible the derecognition of the loan.

5.5. Example: Risk and reward test and the ability to sell

Entity A sells bonds and mortgage loans in tow arrangements:

First arrangement. It has the following conditions:

Entity A sells bonds that are possible to buy in an active market.

Entity B pays to entity A 70.000 € for the bonds.

The carrying amount is 60.000 €.

Entity A issues an option and entity B can put the bonds back to entity A for 75.000 € in the next 30 days.

The option is neither deeply in nor deeply out of the money.

Second arrangement. It has the following conditions:

Entity A sells a mortgage loan to entity C for 5.000.000 €

The carrying amount is 6.000.000 €

Entity C issues an call option, and entity A can repurchased the loan for 6.000.000 €.

The option is neither deeply in nor deeply out of the money.

Has entity A retained substantially all the risks and rewards of ownership?

Solution:

In the first arrangement, the entity A has neither transferred nor retained substantially all the risks and rewards of the ownership. The put option does not preclude derecognition, but being the bonds readily obtainable in the market, it is possible the derecognition of the bonds for entity A.

In the second arrangement, the entity A has neither transferred nor retained substantially all the risks and rewards of ownership. The call option does not preclude derecognition, but not being the mortgage loan readily obtainable in the market, entity C can not the practical ability to sell the mortgage loan (although this agreement contains no explicit conditions restraining entity C from selling), because if entity A exercises its right under the call option, entity C must have access to the original mortgage loan. For entity A is not possible the derecognition of the mortgage loan.

5.6. Example: Securitisation of a portfolio of mortgage loans

Entity A making use of a portfolio of mortgage loans of 27.000.000 €, obtains effective funding, because the mortgages loans are purchased by a vehicle specifically set up which repackages the mortgages loans as asset-backed securities and sells them in the market to investors. Entity A provides a credit guarantee to the vehicle over 9.000.000 €. The expected losses of the mortgages loans are 9.000.000 €.

Does entity A continue to recognise the portfolio of mortgage loans?

Solution:

Entity A has retained substantially all the risks and rewards of ownership of the portfolio of mortgage loans. For this reason, entity A, in its statement of financial position, continues to recognise the portfolio of mortgage loans and will recognise a financial liability for the proceeds received.

SESSION 2

THE ROLE OF STATISTICIANS IN THE PROCESS

FIRST PART

TRYING TO DELIMIT THE SECURITISATION PHENOMENON: DEFINITIONS, AGENTS WHO INTERVENE (ORIGINATORS, SPVS OR FVCS, ADMINISTRATORS) AND KINDS OF OPERATIONS

IMPLEMENTATION OF FVC DEFINITION; SPECIFIC CASES IN THE NETHERLANDS

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1. Introduction

Securitisation took off at the beginning of this century and has been one of the most important financial innovations of the last decades, not only in the Netherlands⁴³ but also in the euro area. The increasingly influential role of securitisation is of interest to central banks. From a monetary policy perspective, securitisation not only has an impact on the transmission mechanism via the supply of loans, but it also - through its effect on the funding of banks and credit markets - affects monetary analysis.⁴⁴ In order to provide the European Central Bank (ECB) for this monetary policy purpose with adequate statistics on the financial activities of Financial Vehicle Corporations (FVCs) which are engaged in securitisation transactions, the ECB has introduced a Regulation⁴⁵.

In this FVC Regulation definitions are laid down on securitisation and FVCs. Applying definitions in practice, usually brings interpretation problems and borderline cases to the surface, for which decisions still have to be made. This also goes for the definitions of FVCs and securitisation. Therefore, the ECB gives guidance on these definitions to help in the application of these definitions by providing advice on the interpretation of its different elements. This is not only very useful, but also needed in order to apply uniform definitions and interpretations for producing harmonised statistics on FVCs within the euro area.

In this document four specific cases on possible FVCs are described. Some of them may initially, e.g. on basis of market practices, be regarded as an FVC or just not be considered to be an FVC. The question, however, is whether these structures should be classified as a securitisation structure and FVC according to the definitions in the FVC Regulation. Before doing that, first the definition of originator will be examined, since this plays an important role in (especially) two of the four cases.

In preparing this note I owe many thanks to especially Antonio Matas Mir from the ECB for his further clarification of the concept of originator and his valuable contributions and views on the cases presented here.

2. Definition of originator

The definition of originator is rather important because reference is made to the originator in both the definition of FVC and the definition of securitisation. In two cases which are described in this document

⁴³ De Nederlandsche Bank, Statistical Bulletin, December 2009, Packaging of loans through securitisation stalls, covered bonds gain popularity, page 17-22.

⁴⁴ European Central Bank, Monthly Bulletin, February 2008, Securitisation in the euro area, page 81- 94.

⁴⁵ Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions. The preparations for this Regulation were, by the way, already ongoing when the credit crisis emerged.

the question on whether there is an originator plays a major role. Therefore, it is important to understand the concept of originator.

In the FVC Regulation the originator is defined as "the transferor of the assets, or a pool of assets, and/or the credit risk of the asset or pool of assets to the securitisation structure". In the definition of securitisation reference is made to "the transfer of ownership of the securitised assets from the originator". This could mean that the originator owned the assets, which in fact makes them the seller of the assets. But the question is whether this is meant. Perhaps the concept of originator is broader than that, e.g. as described in the Banking Directive 2006/48/EC⁴⁶. In this Directive the originator is defined as follows:

‘originator’ means either of the following:

- a) An entity which, either itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised; or
- b) An entity which purchases a third party's exposures onto its balance sheet and then securitises them.

So, questions in this respect are:

1. Is the concept of originator in the FVC Regulation different from the one in the Banking Directive?
2. Is the concept of originator meant in the FVC Regulation broader than that of the seller of the assets?

Sub 1 Concept of originator in FVC Regulation different from Banking Directive?

The definition of originator in the Banking Directive (subsection (a)) refers to an entity which directly or indirectly was involved in the creation of the assets being securitised. The application of such a definition for the compilation of statistics on FVC could lead to the problem of identifying the originator in securitisation vehicles which have a manager actively buying collateral in the secondary market. This particularly concerns managed CDOs, most CLOs and some vehicles that look more like an investment fund but (formally) only issue debt securities (and not investment fund shares/units), which are also intended to be covered by the FVC Regulation. In order to prevent this problem and the argument that “if no originator can be identified, there is no FVC”, the FVC definition of originator speaks of a transferor of assets. A transferor of the assets - if interpreted broadly as a secondary market seller too - will always be identifiable. The concept of originator in the FVC Regulation could in that sense be regarded as fairly broader than the concept of originator in the Banking Directive.

Sub 2 Concept of originator broader than seller?

As mentioned above, the FVC definition of originator speaks of “transferor of the assets”. The use of the term “transferor” indicates that the originator should have owned the assets which have been transferred or at least should have had the assets at their disposal. This would mean that they were in fact the seller of the assets, which concept seems narrower than the concept of originator (see sub 1). However, the seller of the assets to the securitisation vehicle should be interpreted as broadly as possible, since an originator selling directly, an originator selling indirectly via an intermediary seller and a (notional-originator) secondary market seller would all be encompassed by the concept of “seller” and more generally of “transferor”.

⁴⁶ Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast).

Nevertheless, since there has to a transferor - and as such actually a seller- of the assets, this implies that the assets already should have been created before securitising them, meaning that there should already be a first lender. The definition of originator in the Banking Directive seems to include also kinds of securitisation where there was no first lender, although this may be less relevant for banks in the framework of capital requirements. Looking at market practices, however, where cases in which there is no first lender are usually also considered as a form of securitisation, this implies a somewhat stricter interpretation of FVC and securitisation.

One could conclude from the considerations above that the FVC definition of originator is somewhat more comprehensive than the definition of originator in the Banking Directive, in particular in order to cover also CDOs/CLOs specifically. On the other hand, the term “transferor” in the FVC definition implies a little more restrictive interpretation of the concept of originator than in the Banking Directive and than usually applied in market practices, since it requires that the assets were already created before securitising them.

3. Specific cases

Now let us look at four specific cases which arose in the Netherlands and for which initially it was not quite clear from the definitions in the FVC Regulation whether they would qualify as an FVC or not.

Case 1. Company issuing pass-through bonds

A bankruptcy-remote single purpose company has been established to finance loans to a certain type of enterprises. The vehicle issues pass-through bonds. The capital raised is used to finance the purchase of properties by these enterprises. If an enterprise wishes to fund a specific project through the funds obtained on the European capital market, it will approach the parent company of the issuing company. Loan agreements with identical terms will form part of a loan pool and the issuing company will raise funds in respect of a loan pool by an issue of notes. The proceeds of the issued notes are passed through to the enterprises in the form of loans provided by the issuing company. This issuing company has outsourced all operational activities in connection with the conclusion of loans agreements, the creation and finalisation of loan pools and the issuing of the notes to its parent company.

Considerations

Although loans are packaged into bonds, the loans have not been contracted before the bond issue and, therefore, there is no first lender which means that this structure would not be considered as a securitisation under the FVC Regulation. On the other hand, the issuing company has outsourced all operational activities in connection with the conclusion of loans agreements, the creation and finalisation of loan pools to its parent company. In this respect, it could be argued that the parent company is the originator (but not the seller). Still, in line with discussions with the ECB the view has been reached that because the loans have not been granted before, there is no actual transfer of loans, and therefore no originator according to the FVC Regulation.

Assessment

No FVC, the issuing company can be considered as a ‘first lender’ and therefore as a specialised lending corporation rather than an FVC.

Case 2. Funding corporation US and purchasing company NL

This is a construction in which a funding corporation resident in the US issues short-term securities (Asset-Backed Commercial Paper), of which the proceeds are lent in the form of bilateral loans to a purchasing

company resident in the Netherlands. This purchase, or asset holding, company uses this money to purchase asset-backed securities issued by Dutch FVCs (and possibly other assets).

Considerations

The US issuer and the NL purchaser could be considered as a multi-vehicle securitisation structure, i.e. an FVC structure in which short-term securities are issued and ABS (and possibly other assets) are purchased. This is in accordance with the definitions in the FVC Regulation. Peculiar in this case is that the multi-vehicle structure is a cross-border one.

In fact, these entities could also be considered to form an integrated structure together with the Dutch FVCs in which the purchase company invest, especially when these are somehow affiliated. On a consolidated basis one could argue that the loans (i.e. corporate and consumer loans) which have been securitised by the FVCs at first, have been funded by short-term securities issued in the US eventually (see the simplified balance sheets below).⁴⁷

Anyway, in this case the purchaser should be included in the Dutch FVC population and data. The issuer is resident in the US and would therefore not be included. The assets on the balance sheet of the purchase company consist of securities and the liabilities consist of loans (from the funding corporation).

Funding corporation US ⇒ FVC in US	
Loans to purchasing company NL	Securities (ABCP)
Purchasing company NL ⇒ FVC in NL	
Securities (ABS) (Other assets)	Loans from funding company US
<i>Funding corporation US and purchasing company NL consolidated ⇒ FVCs consolidated</i>	
<i>Securities (ABS) (Other assets)</i>	<i>Securities (ABCP)</i>
FVC NL ⇒ FVC in NL	
<i>Corporate and consumer loans</i>	<i>Securities (ABS)</i>
<i>Funding company US, purchasing company NL and FVC NL consolidated ⇒ FVCs consolidated</i>	
<i>Corporate and consumer loans</i>	<i>Securities (ABCP)</i>

Assessment

- The funding corporation is in fact an FVC, but will not be included in the FVC population of the euro area, because it is resident outside the euro area.
- The purchasing company is an FVC.

Case 3. Real estate loan fund

A real estate loan fund has taken over the risk of real estate loans from a bank by means of credit default swaps. The loans are secured by real estate abroad. It has raised capital through private loans (not through

⁴⁷ It should be noted that in the FVC statistics FVCs are included on a gross, non-consolidated basis. Possible assets and liabilities between FVCs (within the euro area) could be distinguished by sector of the counterparty.

issuance of securities) placed with two creditors. The proceeds are put on deposit. The entity thinks about issuing notes if there is sufficient interest from investors.

Considerations

The FVC Regulation contains a broad characterisation of the issuance and/or funding activity in its definition of an FVC: "it issues, or intends to issue, securities, securitisation fund units, other debt instruments and/or financial derivatives". The question is whether the loans should be considered as the issuance of "other debt instruments". The ECB is of the opinion that the number of creditors and the amount issued could be used as an indication of whether these debt instruments would be covered by the Regulation. If finance obtained via bilateral, private loan agreements, but issued to a significant number of distinct creditors, this can be considered tantamount to a private placement of notes (apart from the fact that the debt is documented as a loan). The ECB advised that when private loans are not granted by more than five distinct creditors (or ten when these do not rank *pari passu*) and the total amount does not exceed EUR 500 million, the entity is in general not considered to be an FVC. This applies to the case of the real estate loan fund.

Assessment

No FVC, since there are only two creditors and the total amount of loans is less than EUR 500 million.

Case 4. Issuing company UK and holding company and originator NL

An issuing company resident in the United Kingdom issued commercial mortgage backed securities (CMBS). According to the company this issue is not structured as either a true sale or synthetic securitisation, but as a "secured loan" securitisation structure whereby an SPV issuer creates its own asset by lending note proceeds to an asset holding company. The issuer lent the proceeds of the note issuance to a holding company (the borrower) who in-turn, lent the loan proceeds to two companies which own a portfolio of UK real estate. The holding company and the real estate owning companies are Dutch residents.

The company itself speaks of a securitisation transaction. However, according to the same company, the issuer is not an FVC since it is a UK resident which is outside the euro area. They also take the view that the holding company and real estate owning companies are no FVCs since there is no sale or credit risk transfer of assets and there is no "originator from whom the relevant companies in question can be bankruptcy remote".

The real estate owning companies already existed before the issuance of the securities and the proceeds of the issued securities were used for redemption of intra group debts (there still remains an intra group debt, approximately one third of total debt). Further, the holding company has the collateral over the assets of the real estate owning companies.

Considerations

It can be argued that the credit risk of already existing and owned real estate has been transferred from the real estate owning companies to the investors in the bonds issued by issuing company. The real estate owning companies could, therefore, be regarded as the originators. However, there is no asset purchasing company, at least not a company which purchases the real estate.

Nevertheless, since the only activity of the holding company is providing a commercial mortgage loan (secured by this real estate) to the real estate companies, and this is financed eventually by the CMBS issuer, this could be regarded as a multi-vehicle securitisation structure, with one of them resident in the

UK. A possible counterargument, namely that the holding company is engaged in 'first lending' or 'origination' as main activity and hence is a lender and not an FVC, would be rather far fetched. In fact, the economic reality can be looked at much better the other way round; i.e. it is the real estate owning company that issues a (secured) liability to the holding company, who passively holds it and in doing so serves the purpose of a commercial mortgage loan securitisation. In this respect, the real estate company could be viewed as the originator of the asset being securitised (the commercial mortgage loan), but only a special kind of originator that is originating a liability. However, the question could then be raised whether this from a legal point of view is in line with the FVC Regulation which speaks of an asset (or pool of assets) being securitised and transferred, and not of possible liabilities.

Still, for the moment this case is being considered as a cross-border multi-vehicle securitisation structure consisting of an issuing and holding company. Their aggregated (or perhaps better: consolidated) balance sheet would show a secured - real estate - loan to the real estate owning companies at the asset side and issued securities at the liability side (see the simplified balance sheets below). However, because the issuing company is resident in the UK, only the Dutch holding company would be included in the FVC statistics.

Issuing company UK ⇔ FVC in UK

Loans to holding company NL	Securities (CMBS)
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Holding company NL ⇔ FVC in NL

Loans to real estate companies NL (secured -real estate- loan)	Loans from issuing company UK
-------------------------------------------------------------------	-------------------------------

Issuing company UK and Holding company NL consolidated ⇔ FVCs consolidated

Loans to real estate companies NL (real estate loan)	Securities (CMBS)
---------------------------------------------------------	-------------------

Real estate owning companies NL ⇔ originator

Real estate in the UK	Loans from holding company NL Other (intra group) loans
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Preliminary assessment

- The issuing company is in fact an FVC, but will not be included in the FVC population of the euro area, because it is resident outside the euro area.
- The holding company is an FVC.

4. Concluding remarks

The analysed cases show that it is important to apply uniform interpretations of the definitions on FVCs in the euro area, because otherwise certain types of securitisation vehicles could be included in one euro area country and excluded in another. This could imply inconsistent (and still not completely harmonised statistics) on FVCs engaged in securitisations. To prevent this, guidance from the ECB should be followed and new cases in which this does not foresee yet, should be put forward for further advice.

Furthermore, awareness of the specific characteristics of the FVC definition and its application is recommended, because the resulting FVC statistics could lead to deviations from data based on market practices (e.g. by data providers) and on supervisory sources. However, when interpreting the definitions in

STD/DOC(2011)3

the FVC Regulation, market practices and economic realities should be taken into account as much as possible, also in order to reduce these deviations to the minimum.

OVERVIEW OF SECURITISATION ACTIVITIES IN IRELAND

Clive Jackson

Central Bank & Financial Services Authority of Ireland

1. Introduction

Securitisation has been used extensively by Irish credit institutions in recent years, and lending to residents that has been moved off credit institution balance sheets has been accounted for in the statistics published by the Central Bank due to its relevance in understanding credit developments and lending growth rates. However, statistical information on the wider population of entities which have been engaging in securitisation – involving credit institutions not resident in Ireland and, indeed, non-credit institutions – is only now available.

The purpose of the presentation, and the contribution it hopes to make the OECD workshop, is to provide some background to the securitisation industry in Ireland and to provide an overview of some diverse activities carried out. Most importantly, the usefulness of qualitative information regarding the activities carried out will be stressed – both for the analysis of the sector, and also as a tool to help ensure quality.

2. Background

Securitisation in Ireland uses special purpose vehicles ('financial vehicle corporations'). As in other common law jurisdictions, the vehicle is typically set up as a bankrupt remote 'orphan' company with the beneficial shareholding held on trust by share trustees. Directors of the FVC are often provided by its "corporate services provider" in addition to a registered address for the vehicle and other administrative roles.

FVCs come under the framework of Section 110 of the Taxes Consolidation Act 1997, as amended by Section 48 of the Finance Act 2003. Qualifying companies must register with the tax authority⁴⁸, and may then utilise certain tax treatments which allow them to be structured as profit-neutral, and hence tax-neutral. They may hold a wide range of financial assets, including equities, bonds, receivables, carbon credit, leases, and derivatives.

3. Development of securitisation by Irish banks

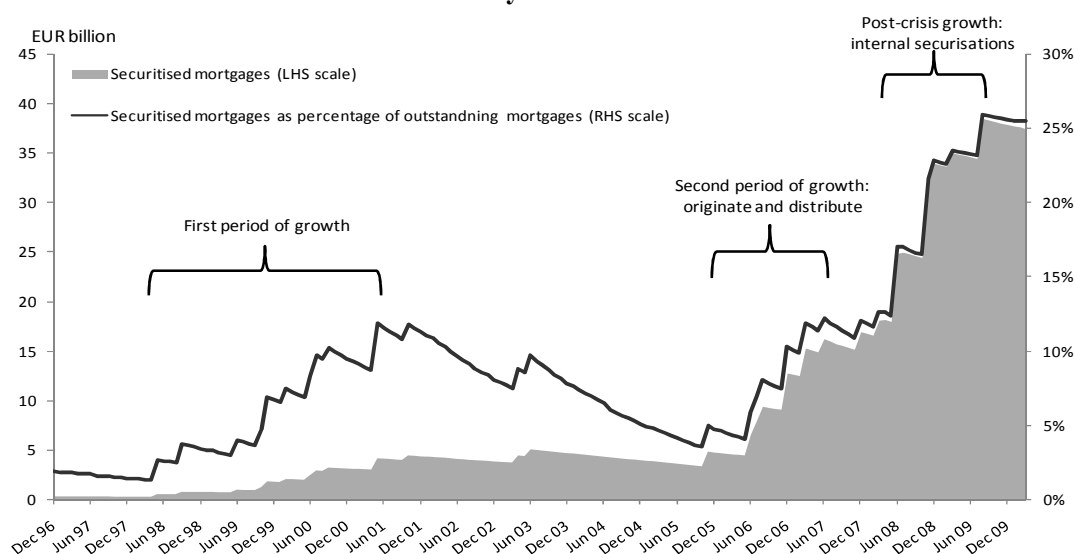
The first securitisation of Irish mortgages took place in 1996, but volumes have since grown to around €37 billion. Chart 1 shows the growth of securitisation of domestic residential mortgages, which has been in three stages. In the early stages it was conducted primarily by specialist mortgage lenders. Although its use was not widespread, the percentage of total outstanding residential mortgages which were securitised reached 12% in mid-2001. In the second stage of rapid growth, the use of off-balance sheet securitisation became more widespread, and played an important role in filling the funding gap which arose in a period of expanding credit.

⁴⁸ Not all qualifying 'Section 110' companies are FVCs, however.

Despite the freezing of these markets during the financial crisis, the levels of securitised lending reached unprecedented levels, at a peak of 26% of all outstanding mortgages in mid-2009. The motivation for these ‘internal’ securitisations was to create eligible assets to be used in refinancing operations with the European Central Bank. Statistically, these have been treated by the Central Bank as ‘off-balance sheet’ in the same way as the previous securitisations.

Securitisation may also be effected through the issuance of covered bonds, which was enabled by legislation in 2001, and first carried out in 2004. A number of banks created “mortgage banks” under this legislation. Loans were transferred to these institutions, which then issued Asset Covered Securities. As these institutions were themselves Monetary Financial Institutions (MFIs), the loans stayed on banks’ balance sheets⁴⁹.

Chart 1: Securitisation by domestic credit institutions



4. FVC Regulation ECB/2008/30

The FVC Regulation has a very broad definition of securitisation which encompasses the transfer of assets or a pool of assets to a securitising entity, or the transfer of credit risk to a securitising entity. The activities of the FVC which may qualify as “issuance” include issuing of debt securities publicly or through private placement, and also potentially funding through the use of derivatives or loans.

The first collection of data under the FVC regulation in Ireland was with respect to Q4 2009. Most vehicles supply the full reporting requirement on balance sheets, financial transactions and write-downs/write-offs of securitised loans. In addition, holdings of debt securities are provided on a security-by-security basis, where the security has an ISIN code identifier. Smaller FVCs – below a threshold of €180 million – have a reduced requirement, and provide only a total assets figure on a quarterly basis. This derogation applies to over a third of vehicles, but their aggregated total assets are less than 5% of the national total.

Preliminary data show that the aggregated balance sheet for the sector was over €500 billion. However, there are a number of grey areas at the margins of the definitions – in particular around the issue of

⁴⁹ Opinions vary on how these fit in to the concept of “securitisation”. As this method does not use FVCs, they will be disregarded in the remainder of this note.

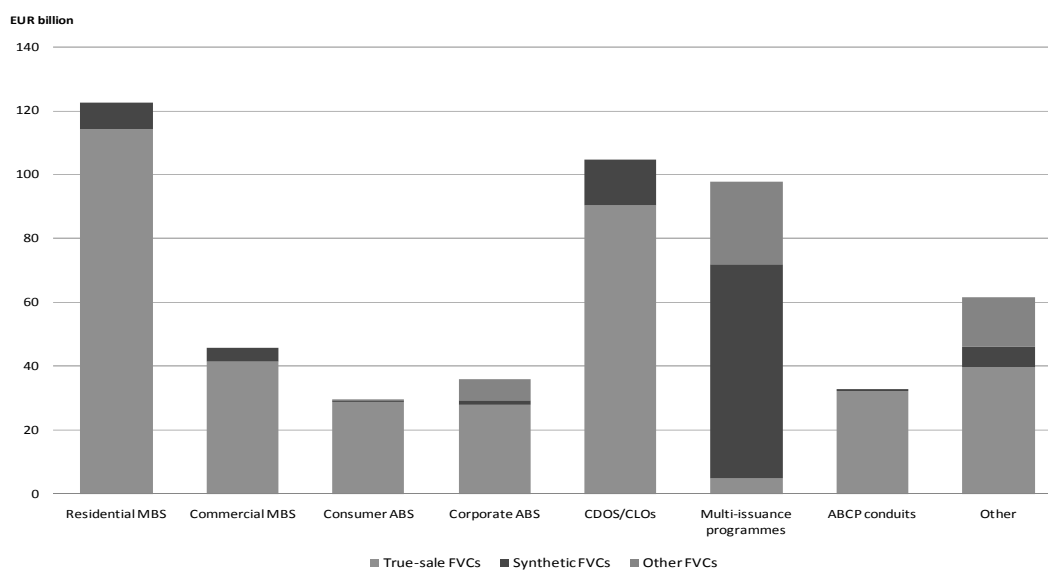
issuance – which remain to be resolved. Clarification of the definition at a (harmonised) euro-area level will be important in establishing the official register of FVCs and reporting population.

5. Securitisation activities of FVCs resident in Ireland

The register of FVCs must include the nature of securitisation – true-sale, synthetic, or ‘other’ FVC. True-sale FVCs make up 72% of the population by total assets. The volume of synthetic securitisation is significant in Ireland relative to many other jurisdictions, at 19%. Currently, 9% of resident FVC total assets are in the ‘other’ nature of securitisation category. These include, in the main, vehicles which are carrying out both true-sale and synthetic securitisations. It has not been decided whether these should stay in this category, or be assigned to another category based on majority, or split on a pro rata basis between categories.

As well as the nature of securitisation, Irish FVCs were also requested to provide information on the type of the vehicle⁵⁰. This information was in addition what was required by the FVC Regulation. Where the type of activity provided was not available or insufficient, other sources for the classification were used, for example the prospectus, stock exchange or audited annual accounts. FVC activities and nature of securitisations are provided in Chart 2.

Chart 2: Activities of resident Financial Vehicle Corporations

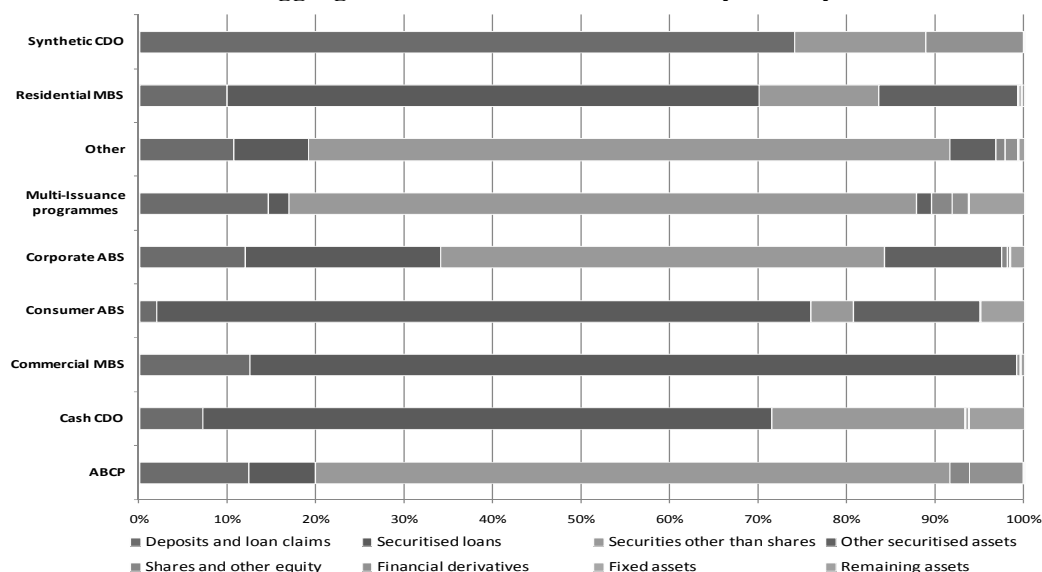


Due to the obvious heterogeneity of the activities carried out by resident FVCs, this additional information provides an important extra dimension in understanding the sector and underlying developments. The aggregated balance sheets of FVCs by activity are provided in Chart 3⁵¹.

⁵⁰ The list included Residential MBS, Commercial MBS, Consumer ABS, Corporate ABS, Cash (i.e. true-sale) CDO, Synthetic CDO, and Other. Two common ‘other’ classifications have been added by the Central Bank as categories: ABCP and Multi-Issuance Vehicles (MIVs).

⁵¹ Note, again, that this is preliminary data.

Chart 3: Aggregated balance sheets of FVCs by activity



Information on the type of FVC also provides an additional tool in ensuring the quality of the data, as a misclassification by reporting agents can be more easily determined when one knows what should be underlying the securitisation.

6. Conclusion

There is scope to enhance the usefulness of quantitative data by combining the information on the nature of securitisation (true-sale, synthetic) with information the type of activity engaged in by the FVC (RMBS, CMBS, etc). The value-added of even high level qualitative information is considerable.

The FVC type categories used in this presentation are in line with common industry classifications, with the addition of “multi-issuance vehicle”⁵² as a specific national type. This could be supplemented with more detailed information on activities or strategies of vehicles, although there are likely to be diminishing marginal returns.

Further information on the links between vehicles and sponsor or arranging banks would also be useful in monitoring developments and ensuring the quality of data – particularly for transactions which use FVCs in a number of jurisdictions.

⁵² An MIV is a single entity which issues multiple (perhaps dozens) series of notes in which specific assets are contractually ring-fenced to a specific issuance, and are hence bankrupt-remote from each other. This is similar to structures in other jurisdictions which use ‘compartments’.

SECURITISATION AND THE DANISH MORTGAGE CREDIT SYSTEM

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Abstract

The aim of this paper is to summarize the on going discussion on whether or not we should include Danish mortgage credit bonds in securitisation statistics. According to the “Handbook on Securities Statistics” the Danish mortgage credit system is a securitisation process of type 1 or on balance sheet securitisation. The European Central Bank (ECB) does not consider this as securitisation, as they only consider processes which include the intermediation of a Special Purpose Vehicle. This paper describes briefly the key points of the Danish mortgage credit system and compares the Danish mortgage credit system with the working definitions of a securitisation process. We conclude that before including the Danish mortgage credit system into securitisation statistics it is necessary to clearly define which the objectives of the new securitisation statistic are, baring in mind the importance of the homogenization and internationally comparability of data across countries.

1. Introduction

The process of assets securitisation is a financial construction that has long existed in most countries with more or less developed economies. However, the complexity of this process has been increasing in the recent years, with the emergence of financial intermediaries specialising in securitisation transactions. The importance of the securitisation process contrasts with the lack of information concerning securitisation and the small degree of homogeneity of the information across countries.

The OECD Financial Statistics Working Group (FSWG) has focused of the importance of compiling regular and homogeneous statistics on this matter. Hence, an initial work of identifying the securitisation process in the OECD countries took place in the spring 2007 in the form of a questionnaire to be answered by all OECD countries. The questionnaire focused on the securitisation processes with the intermediation of Special Purpose Entities (SPEs).

In the case of Denmark, as we will comment in this paper, the Danish mortgage credit system resembles a securitisation process but with no intermediation of any SPE. The question is then whether the Danish mortgage credit system should be included in securitisation statistics in order to insure homogenisation. This question is the aim of this paper. The remainder of the paper is organized as follows. Section 2 summarizes definitions and purposes of a regular and homogeneous statistics on securitisation. Section 3 describes the Danish mortgage credit system. Section 4 comments on the stabilizing properties of the Danish mortgage credit system for the Danish economy. Section 5 analyses the convenience of considering the Danish mortgage credit system as securitisation process for statistical purposes and concludes including highlights of the discussion in the OECD workshop on Securitisation held in Madrid (Spain) 27-28 May 2010.

⁵³ This paper has been prepared by Maria Jse Alvarez Pelaez, Department of Economic Statistics for presentation at the OECD FSWG workshop on Securitisation in Madrid (Spain) 27-28 May 2010.

2. Securitisation and the purposes of homogeneous statistics

OECD's work definition of securitisation is very broad. It defines securitisation as the process whereby an institutional unit raises funds by issuing securities and enabling the investors investing in these securities to buy directly parcels of specific financial assets. Securities are issued to fund assets and the cash flow of the underlying assets represents the interest claims of the securities issued.

In the System of National Accounts 93 (SNA 93) securitisation is based on the existence of a pool of assets. In paragraph 11.75 says: "new negotiable securities are often issued backed by existing assets such as loans, mortgages, credit cards debt, or other assets. This repackaging of assets is often referred to as securitisation. The creation of the new assets gives rise to entries in the financial account".

The securitisation process has been increasing in complexity with the emergence of financial intermediaries, the so-called Special Purpose Entities (SPEs). These entities are of special interest since their activities are not regulated in many countries.

Securitisation has evolved very much in the last decades. The evolution has been driven by different considerations:

- For non-financial corporations, it is a way of obtaining funds at a lower cost than funding available through banking facilities.
- For financial institutions the securitisation process can be used to transfer assets of the balance sheet, so banks can lend more with the same capital. Therefore, it can be a way of getting around the regulatory capital requirements. It is also a way of diversification of funds that allows for the transfer of the risk. In recent years, it has also been a way of transforming unrated or low rated assets into high rated assets which e.g. can be used as collateral for short term credits by the European Central Bank.

When deciding which statistics to compile, it should be clear which information we want to capture and why.

There are several reasons for suggesting the compilation of securitisation statistics:

1. Different risk profile of the securitisation process from "normal" finance entities.
2. High leverage, i.e. debt to equity ratio in the SPEs.
3. Securitisation could make the financial system more instable by implying a lack of incentives to monitor who you lend to (fx. subprime mortgages).
4. The securitisation process implies maturity mismatch: the liquidity risk in the liability side is much shorter than the one in the asset side.

5. Increasing complexity of the loan process: long intermediation chain, with intervention of financial intermediaries specialized in these transactions. The following figure is borrowed from Shin (2009) “Reshaping the Financial System After the Crisis”:

Long Intermediation Chain



6. Impact on analysis of financial flows and securities markets.
7. It hampers correct analysis of the growth in credit extended by credit institutions within the framework of financial regulation policy (as it makes the system less transparent) and within the framework of monetary policy (as an activity indicator), since securitisation affects the Monetary Financial Institutions (MFI) statistics on which monetary analysis is partly based.

3. The Danish mortgage model

The traditional Danish mortgage model reflects the way Danish mortgage institutions operate. Mortgage institutions grant loans secured by mortgages on real property, having only one source of funding: bonds sales (a mortgage institution does not operate in the same way as commercial banks).

The Danish mortgage model is more than 200 years old. It emerged after the Great Fire of Copenhagen in 1795, when a quarter of the city burnt to the ground. After the fire, a great need arose for an organised credit market as a large number of new buildings were needed over a short period of time. A number of wealthy persons took the initiative to establish the first mortgage association in Denmark in 1797, that granted loans based on the issuance of bonds. It was the lenders who established the association, with tight rules to ensure low risk.

Regarding the legal framework, there is a statutory loan-to-value limit: the loan can not exceed 80 percent of the value of the property at the time of the sale. Mortgage institutions must observe the rules of the Danish Financial Supervisory Authority when assessing the value of a property.

Due to regulation, mortgage institutions do not retain prepayment risk. The borrower can exercise a penalty-free prepayment option and therefore, investors assume prepayment and thus reinvestment risk. But the regulatory approach and the fixed exchange rate policy for the Danish Krone vis-à-vis the euro may have reduced volatility by giving investors of callable Danish mortgage bonds access to low-cost hedging of market risk in euro-based markets. This has resulted in a bond market which has shown little or no stress in periods with significant refinancing.

Beside, there are specific limits, based on the so-called Balance Principle, to the amount of risk mortgage institutions can assume. The Balance Principle consists of the following restrictions:

- It restricts mortgage institutions possibilities to take interest rate, exchange rate, liquidity and option risk, i.e. it limits the institutions' ability to assume other risks than credit risk.

The Balance Principle requires that mortgage institutions fund their lending activities by issuing mortgage bonds with cash flows that fully match those of the underlying mortgage loans. That is what it is called the matching funding principle, which ensures:

- Transparent loan cost, since the cost is equal to the sum of interest, principal payments and the margin charged by mortgage institutions. Bonds are listed on a stock exchange.
- Market-based prices, which follows current financial market trends.
- Attractive prepayment options, by buying the underlying bonds in the market at a price of 100 (par).

As a result, the Danish mortgage credit model has several attractive properties:

- Innovations in the mortgage loans will be reflected on the funding side.
- Investors who buy the mortgage bonds do not in practice incur any default risk. Almost all bonds are AAA-rated.
- It has a smoothing effect on the Danish business cycle and helps sustain financial stability.

From the borrowers point of view, the Danish mortgage credit system has many advantages:

- Interest rates are attractive. The legal framework and credit policy of mortgage institutions make loans very secure.
- Everybody can monitor loan prices on a current basis.
- Borrowers may prepay their loans on attractive terms.
- Mortgage institutions cannot call loans prematurely.

Danish mortgage bonds are considered as very safe investment objects. Danish legislation describes mortgage bonds as "gilt-edged securities". Danish mortgage bonds are repo-eligible with Danmarks Nationalbank, and some EUR-denominated mortgage bonds are also repo-eligible with the European Central Bank. Danish mortgage bonds are among the highest rated mortgage bonds with international credit-rating agencies.

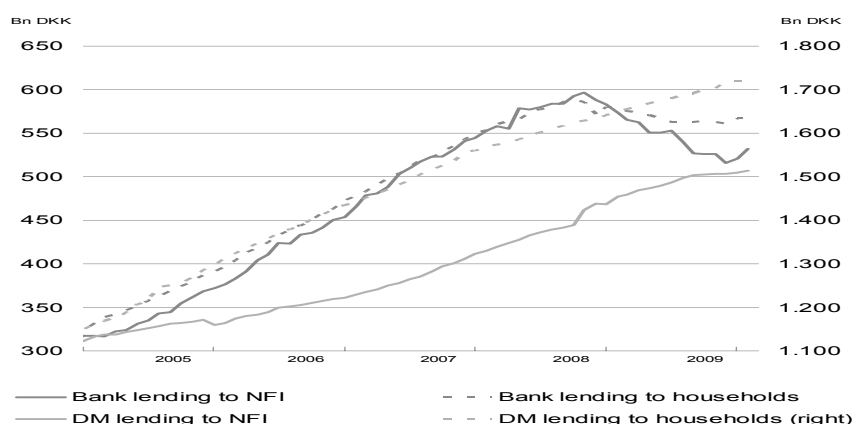
The high level of security has generated broad interest in Danish mortgage bonds – among Danish as well as foreign investors. The majority of the bonds are held by commercial and mortgage banks, investment funds and insurance and pension companies, which combined account for 70-75% of the bonds. In recent years, foreign investors have held 10-15% of the total mortgage bond portfolio.

4. The Danish mortgage credit system and Financial Stability

The Danish mortgage bond market is one of the largest in the world, both in absolute and relative to the size of the economy. The nominal outstanding amount of Danish mortgage bonds is approximately 300 billions EUR, about 72% of the total Danish bond market and over 1.4 times Danish GDP. It is more the 4 times larger than the Danish Government bond market (August 2009).

The Danish mortgage credit system has survived all economic downturns thanks to a strong foundation. That foundation has contributed to stabilize the Danish economy. As we can see in Figure 1, mortgage lending continued during the latest financial crises.

Figure 1. Bank and mortgage lending to households and non financial institutions

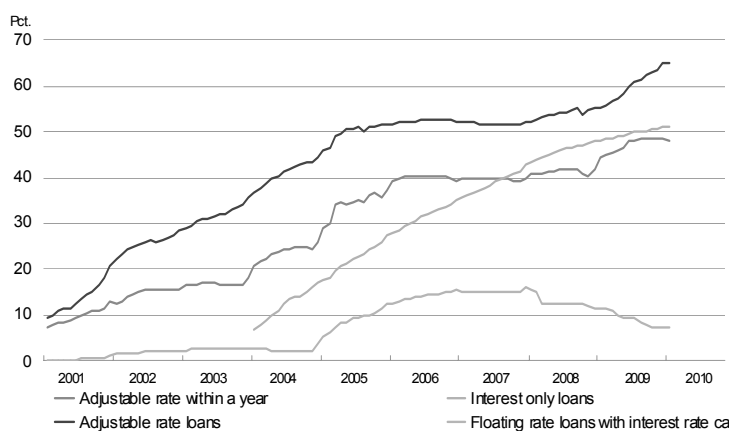


The Danish mortgage lending sector did not require government guarantees for mortgage bonds. Banks restricted lending in 2008 but mortgage institutions continue their lending activity throughout the entire crisis because new bonds were saleable. Consequently, Danish homeowners and companies seeking financing for properties did not experience any serious credit crunch attributable to the financial market turmoil. It was possible to sell bonds for refinancing of adjustable-loans in the amount of 350 billions DK during the financial crisis.

Homeowners may benefit from falling interest rates. With fixed rate loans, there is a protection against housing price declines: housing prices drop when interest rates increase, which implies a drop in bond prices. As mortgage debt is linked to bond prices, it will decrease. Fixed rate loans are about 35 percent of total stock of bonds.

Figure 2 shows the distribution of mortgage lending to households in the last decade. There has been a rapid expansion of the interest only loans from mid 2003.

Figure 2. Mortgage lending to households



5. Danish mortgage credit system as securitisation

If we come back to the OECD work definition for securitisation, it is true that the Danish mortgage credit system is a process whereby an institutional unit raises funds by issuing securities. And it is also true that the prices enable the investors investing in these securities to buy directly parcels of specific financial assets.

If we focus on the last part of the definition, it is also true that the securities are issued to fund assets and where the cash flow of the underlying assets represents the interest claims of the securities issued. Therefore, we can conclude that the Danish mortgage credit system reflexes the characteristics of a securitisation process, but as the historical characteristics summarized above, it is not part of the recent development of the securitisation process, and even more important, there are not special purpose entities in the system. This last characteristic is what makes the European Central Bank (ECB) to conclude that the Danish mortgage credit system should not be considered as securitisation, as information on Danish mortgage institutions is included in monetary financial institutions (MFI) statistics.

Beside that, the Danish mortgage institutions take the risk of payments if the mortgages are not realized. Furthermore, the Danish mortgage credit system is not designed with the purpose of circumventing the regulatory capital requirements and there are no transfers of risk.

Therefore, whether or not the Danish mortgage credit system should be included in securitisation statistics depends on the statistical targets:

If the statistical aim is to capture information on securitisation not covered elsewhere, then the Danish mortgage credit system should not be considered as securitisation, since the information is already in MFI statistics.

But if the statistical aim is to be able to compare between countries using the present very broad definition of securitisation, then the Danish mortgage credit system should be included.

In the “Handbook of Securities” a broad definition of securitisation permits to classify the Danish mortgage credit system as securitisation of type 1, or securitisation on balance sheet. That type of securitisation is not considered as securitisation by the European Central Bank (ECB), who includes as a necessary condition the intervention of a special purpose entity in the process.

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**ASSESSING SECURITISATION ACTIVITY IN PORTUGAL
– COMPILATION AND MEASUREMENT ISSUES –**

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This note addresses a number of issues affecting the measurement of securitisation statistics in Portugal, and provides an overview of the late developments in Portuguese securitisations. Starting with a brief reference to the applicable legal framework, the note will subsequently depict some of the main features of Portuguese securitisation structures, describe the sources and methods used in the compilation of related statistics and offer a quantitative assessment of the securitisation market in Portugal. To conclude, a few short remarks on data dissemination and institutional reporting will be put forward.

1. Legal framework

Securitisation operations by Portuguese monetary financial institutions (MFIs) made their first appearance in 1997, despite of the non-existing specific regulation applicable. At first, the securitisations deals made use of offshore structures and the range of asset classes to be sold by the originators was restricted to, e.g. consumers' credit areas, cars acquisitions, leasing agreements and long-term rentals.

The legal framework for securitisation transactions carried out in Portugal (hereafter referred as the "Securitisation Law"), setting up the legal requirements applicable to loan securitisation and regulating the constitution and functioning of securitisation vehicles, was put in place by Decree-Law No. 453/99 of 5 November.

The Securitisation Law offers issuers two kinds of such entities: FTCs (*Fundos de Titularização de Créditos* or securitisation funds) and STCs (*Sociedades de Titularização de Créditos* or securitisation companies). These two types of financial vehicles corporations (FVCs)⁵⁴ are subject to the same supervisory body: the *Comissão de Mercado de Valores Mobiliários* (CMVM) — the Portuguese securities market commission — which is responsible for granting activity permission, as well as for regulating the securitisation activities.

However, few securitisations were carried out under that legal environment, partly due to the minimum capital requirements applicable to the financial vehicles engaged in securitisations and to the lack of a clear (and attractive) tax legal framework. To address these issues, the Portuguese Government enacted Decree-Law No. 219/2001 of 4 August (the "Securitisation Tax Law"), setting up the tax regime applicable to the Portuguese securitisation transactions, and introducing several amendments to the Securitisation Law. In particular, the law explicitly removed withholding tax from Portuguese obligors' payments to securitisation vehicles, and from the interest on paper issued by FTCs and STCs. As a result of these revisions, there was a significant increase in securitisations carried out through Portuguese financial vehicles.

⁵⁴ Following the terminology adopted in Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2008/30).

By the end of 2003, the Government passed new legislation, through Decree-Law No. 303/2003 of 5 December, which introduced further amendments to the securitisations' legal environment, mainly by setting out the framework for securitising receivables held by the Portuguese State and other public entities and broadening the scope of securitisable assets.

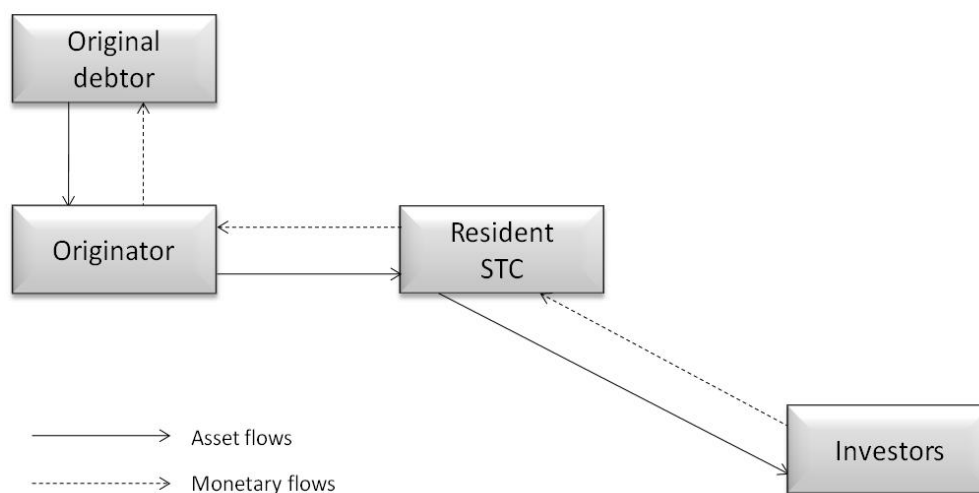
Despite the significant improvements that have been introduced in the Securitisation Law since its enactment, there are still a number of possible amendments under consideration — such as, the widening of the scope of the assets eligible for securitisation (currently only loans can be securitised), and the possibility of expanding the range of loans suitable for securitisation by all sorts of originators to loans subject to conditions or litigation (at present, only the State and the Social Security are allowed to securitise this sort of loans).

2. The securitisation sector in Portugal

The two types of Portuguese FVCs are distinct not only in the legal sense but also in view of the different ways in which the related securitisation processes are structured. At the outset, the FTC structures had capital prerequisites that were lower than the ones of STCs, which might help to explain the greater attractiveness of the former. However the difference in capital requirements has been losing importance along the way leading to an increased use of the latter.

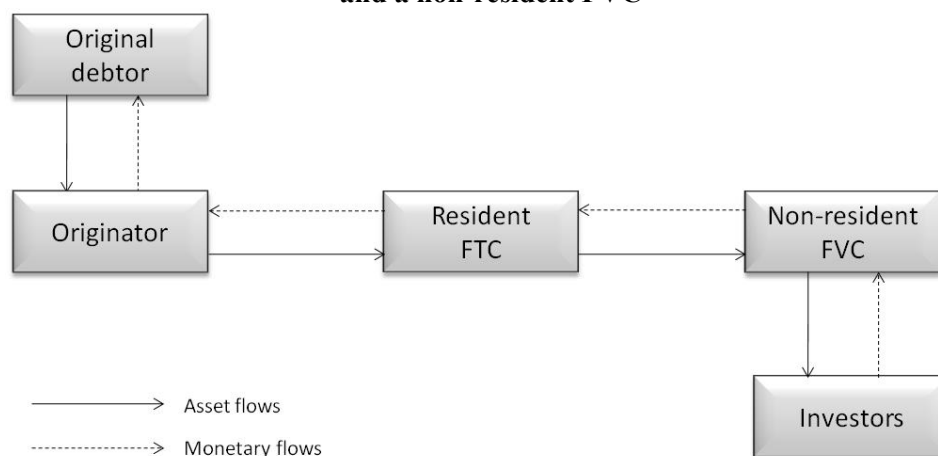
STCs are single purpose companies that take the legal form of a limited liability company. In order to finance their activities, STCs issue equity and securitisation bonds. The issue of securitisation bonds, collateralized by securitised loans, is made by private or public placement in domestic and/or in foreign markets (Figure 1).

Figure 1. Simplified scheme for a typical securitisation involving a resident STC



FTCs have a structure very similar to that of an investment fund — they issue securitisation units to finance the acquisition of loans. In Portugal, the units issued by resident FTCs are typically acquired by non-resident financial vehicles. In turn, the non-resident financial vehicles issue bonds in foreign securities markets (Figure 2).

Figure 2. Simplified scheme for a typical securitisation involving a resident FTC and a non-resident FVC



Another distinct feature of FTCs is the fact that they act as closed entities, while STCs carry out several securitisation transactions over time.

In the early days, off-balance sheet securitisations were the most widespread type of securitisation deals. However, following the adoption of the revised versions of International Accounting Standards (IAS) 32 and 39, back in 2005, this situation started to change in favour of on-balance sheet securitisation. In fact, under IAS 39, originators in a securitisation transaction are not always able to derecognise asset transfers in their accounts, given that, in a typically structured securitisation transaction, they would normally retain some of the risks/rewards of the ownership of the asset. In such cases, IAS 39 provides for two different treatments depending upon whether the originator has retained control of the financial asset following transfer. Where control is retained (as will be the case in most securitisation transactions), the financial asset must be recognised to the extent of the reporting entity’s “continuing involvement”.

Conditional on the loans being derecognised or non-derecognised in the originator’s balance sheet, and to avoid double-counting, securitisation transactions are recorded as follows:

If the securitised loans are derecognised, the amount of “loans” outstanding in the assets side of the originator balance sheet is decreased, together with a matching increase in e.g. “cash” (Figure 3). In the FVC’s balance sheet loans are recorded *vis-à-vis* the original debtor sector.

Figure 3. Statistical treatment of off-balance sheet securitisations in the originator’s balance sheet

Originator	
Assets	Liabilities
Cash	↗
Loans	↘

If the securitised loans are not derecognised, the amount of “loans” outstanding is kept unchanged; to balance out the increase in “cash” on the assets side of the balance sheet, an additional liability to the FVC is recorded (Figure 4). In order to avoid affecting the money aggregates, the entry on the liabilities side is allocated, by convention, to the category “deposit-like instruments, *vis-à-vis* OFIs, over two years”. In the FVC’s balance sheet, the loans are recorded *vis-à-vis* the originator’s sector to circumvent double-counting.

Figure 4. Statistical treatment of on-balance sheet securitisations in the originator’s balance sheet

Originator	
Assets	Liabilities
Cash	Deposits and deposit-like instruments <i>vis-à-vis</i> OFIs
Loans	

2.1. Data flow: from raw data to statistical information

The Portuguese FVCs are supervised by the CMVM, not by the *Banco de Portugal*; as such, there is no direct reporting of statistical information to the central bank. Instead, the *Banco de Portugal* has a formal agreement with CMVM for the regular remittance of (accounting) data reported by FVCs for prudential supervision purposes. These data have different periodicities, depending on the type of FVC: STCs submit their audited balance sheets annually or semi-annually if they issue securities through public subscription or have quoted securities; FTCs report monthly data.

Another important source of information on securitisations concerns data collected from the originators. Credit institutions and other financial institutions (excluding investment funds, insurance companies and pension funds) have to report data to the *Banco de Portugal* for prudential supervision purposes. Therefore, whenever these institutions act as originators in a securitisation deal, the *Banco de Portugal* has the means to identify the nature of the securitisations being carried out. In the particular case of resident MFIs, institutions that are also subject to direct reporting obligations for statistical purposes, their balance sheets provide additional statistical information on the securitisation deals.

Where the originators are non-financial entities, the *Banco de Portugal* has to make use of alternative sources of information, such as issuance prospectus, rating agencies’ pre-sales information and FTC’s management rules and regulations.

At any rate, the available statistical information on securitisations is, to a great extent, derived from accounting data, which fall short of the required standard for high quality statistics (*inter alia*, for lack of detail). To cope with this issue, complementary statistical data sources are used that allow for breaking down the accounting data into the envisaged categories and for checking the quality of primary data.

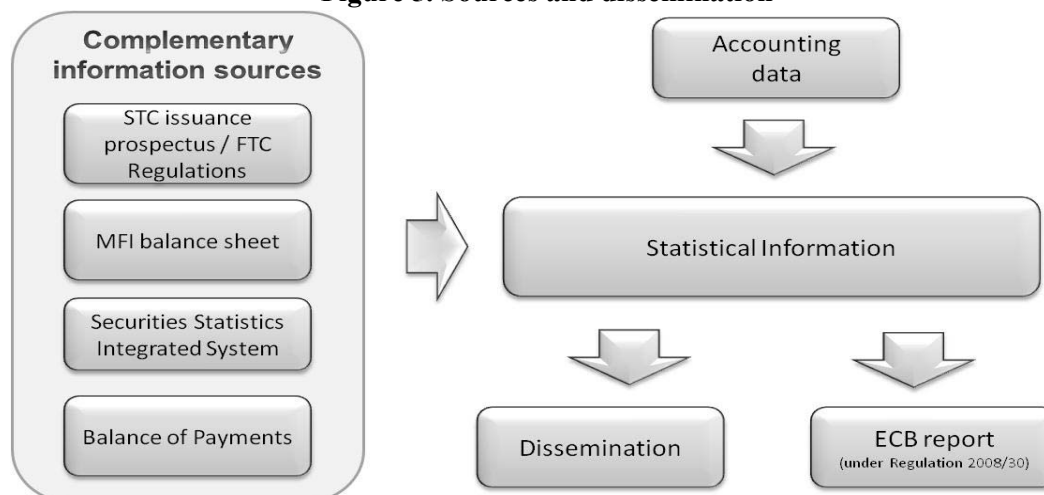
Balance of payments data, for instance, offer helpful information for the STC structures, allowing for the identification of possible anticipated amortizations of the securities issued and placed abroad.

Another key internal source of information is the Securities Statistics Integrated System (SSIS), a security-by-security and investor-by-investor database. SSIS has the advantage of gathering, in a single database,

all the information concerning securities issued by residents in Portugal and securities held by Portuguese or foreign investors that are kept in custody with resident financial institutions. Therefore, the SSIS makes it feasible, to a large extent, the identification of the holders of the debt securities and other equity issued by the Portuguese FVCs.

All these data sources combined allow for the compilation and dissemination of high quality securitisation statistics, including those reported to the European Central Bank (ECB) (Figure 5).

Figure 5. Sources and dissemination



2.2. Portuguese securitisation in numbers

Table 1 shows the FVCs' aggregate balance sheet, broken down by financial instrument. Total assets amounted to about 50 billion euros, by end-2009, as compared to 20 billion euros in 2004. In the assets side, "Loans" are, by far, the most significant entry, averaging about 95% of total assets in the period concerned. Liabilities are basically split between "Securities other than shares" and "Shares and other equity", accounting for the paper issued by STCs (30%) and FTCs (70%), respectively.

The first Portuguese FTC started its activity in December 2001, by securitising a pool of mortgage loans amounting to 1,000 million euros. By the end of 2009, forty eight FTCs were in activity. The total outstanding amount of loans securitised by this type of FVCs was of 34,239 million euros. About 79% of the loans securitised by FTCs correspond to mortgages originated by MFIs, and 11% to non-financial corporation's loans.

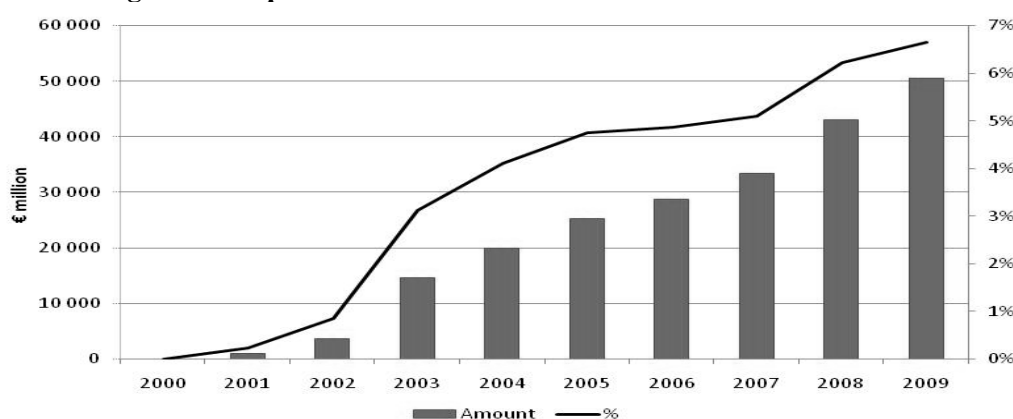
As regards STCs, the first one started its activity in December 2003, by securitising fiscal credits of the Central Government. As of December 2009, there were four STCs in activity, with securitised assets amounting to 14,133 million euros, 79% of which were mortgages originated by MFIs, and 16% corresponded to commercial loans originated by non-financial corporations.

Table 1. Aggregate balance sheet of Portuguese FVCs

	2004	2005	2006	2007	2008	2009
ASSETS	19 972	25 234	28 771	33 426	42 974	50 522
Currency and deposits	770	884	910	1 491	2 156	1 759
Securities other than shares	0	0	0	4	4	4
Loans	19 118	24 278	27 685	31 580	40 437	48 385
Shares and other equity	0	0	0	0	0	0
Financial derivatives	0	0	0	0	0	0
Other assets	84	73	177	351	376	374
LIABILITIES	19 972	25 234	28 772	33 426	42 974	50 522
Deposits	0	0	0	0	0	0
Securities other than shares	1 943	3 700	5 677	7 485	8 883	14 221
Loans	0	0	0	0	0	0
Shares and other equity	16 788	20 772	22 333	25 099	33 224	35 539
Financial derivatives	0	0	0	0	0	1
Other liabilities	1 240	763	762	842	867	761

End-of-year figures. 10⁶ Euros

Figure 6 illustrates the growing visibility of FVCs in the financial sector as a whole, representing about 7% of the sector's total assets by the end of 2009.

Figure 6. Proportion of total assets of FVCs on the financial sector

In Table 2, the sharp increases in loans *vis-à-vis* MFIs in the last four years reflect the growing importance of non-derecognised securitisations since 2005.

Table 2. Loans' counterparts, by institutional sector

	2004	2005	2006	2007	2008	2009
LOANS	19 118	24 278	27 685	31 580	40 437	48 385
MFIs	128	4 366	10 828	14 611	23 181	30 802
OFIs	128	124	143	356	592	1 874
Non-Financial Corporations	2 945	2 127	2 166	2 366	1 882	3 425
General Government	0	150	150	150	150	150
Households	15 901	17 478	14 384	14 088	14 623	12 125
o/w: Mortgage loans	14 122	16 391	13 414	13 399	14 197	11 777
RoW	16	33	14	9	9	9

End-of-year figures. 10⁶ Euros

As seen in Table 3, in 2009 the MFI sector substituted the Rest of the world sector as the main holder of securities issued by Portuguese FVCs.

Table 3. Holders of securities issued by FVCs, by institutional sector

	2004	2005	2006	2007	2008	2009
SECURITIES OTHER THAN SHARES	1 943	3 700	5 677	7 485	8 883	14 221
MFIs	8	51	100	259	2 735	9 414
OFIs	120	184	132	205	233	411
Non-Financial Corporations	0	0	0	68	165	141
General Government	0	0	0	0	0	0
Households	0	0	0	2	5	6
RoW	1 815	3 465	5 445	6 951	5 744	4 248

End-of-year figures. 10⁶ Euros

2.3. Outputs: dissemination and institutional reporting

The *Banco de Portugal* publishes quarterly data on securitisation in its Statistical Bulletin, covering data since 2001. The presented information refers to the aggregate balance sheets of Portuguese FVCs (both STCs and FTCs), broken down by instrument.

Data are also available on “BPstat|Estatísticas online”, an Internet online access to the Statistical Interactive Database of the *Banco de Portugal*. BPstat offers several features, including time series analyses, multidimensional exploration crossing several variables, dynamic comparison with other financial sub-sectors, saving *ad hoc* analyses to registered users’ Favourites folder, and receiving alerts when new information is released. Moreover, users are able to build their own tables, using the available multidimensional tools (e.g. drill-up, drill-down, expand, and collapse).

As regards the fulfilment of the reporting requirements set forth in Regulation ECB/2008/30, the *Banco de Portugal* has been submitting to the European Central Bank, since February 2010, harmonized data on the FVCs’ balance sheets. Based on these statistical data, aggregated results are compiled for the following three sub-categories: (i) FVCs engaged in traditional securitisation; (ii) FVCs engaged in synthetic securitisation; and (iii) other FVCs. Data refer to end-of-quarter outstanding amounts and financial transactions are provided on a quarterly basis. =

A restructuring of the data layout disseminated by *Banco de Portugal* is planned for the near future, in line with the breakdown reported to the ECB. This is expected to bring forth some additional breakdowns to the data that are actually published.

SECURITISATION PROCESS IN THE HANDBOOK ON SECURITIES STATISTICS

Christian Dembiermont
*Bank for International Settlements*⁵⁵

1. Introduction

1.1. Handbook on Securities Statistics: timeline

- **June 2007**: recommendations in CGFS report
- **October 2007**: recommendations in G8 report
- **November 2007**: reconvened IMF Working Group on Securities Database (WGSD)
- **March 2008**: IFC workshop in Washington on “Challenges to improve global comparison of securities statistics” (see IFC Publication on ...)
- Upon general demand BIS-ECB-IMF took joint initiative to develop Handbook on Securities Statistics (HSS), initially (Part I) to cover debt securities issues
- **May 2009**: Part 1 of the *Handbook* on statistics of debt securities issues has been published (see <http://www.imf.org/external/np/sta/wgsd/hbook.htm>)
- **March 2010**: first draft of Part 2 on debt securities holdings prepared by the BIS, the ECB and the IMF has been discussed by the Review Group
- Plan to publish Part 2 of the *Handbook* by **June 2010**
- Part 3 of the *Handbook* will cover equities statistics and is expected to be finalised by **end 2011**

1.2. Handbook on Securities Statistics

- **Objectives**
 - Improve information on securities markets
 - Develop a conceptual framework for presentation of statistics on different types of securities issued and held
 - Consistency with existing international statistical standards

⁵⁵ The views expressed are those of the presenter and not necessarily those of the BIS or the WGSD

- **Its scope**
 - Debt securities issued by institutional units in an economy
 - Positions and flows of debt securities issued
 - Not a compilation guide
- **Consistency** with existing international statistical standards
 - Harmonised with *2008 SNA & BPM6* to promote consistency, transparency and comparability
 - Linkages to other international statistical frameworks
- **Definition** of a debt security
 - A negotiable financial instrument serving as evidence of a debt

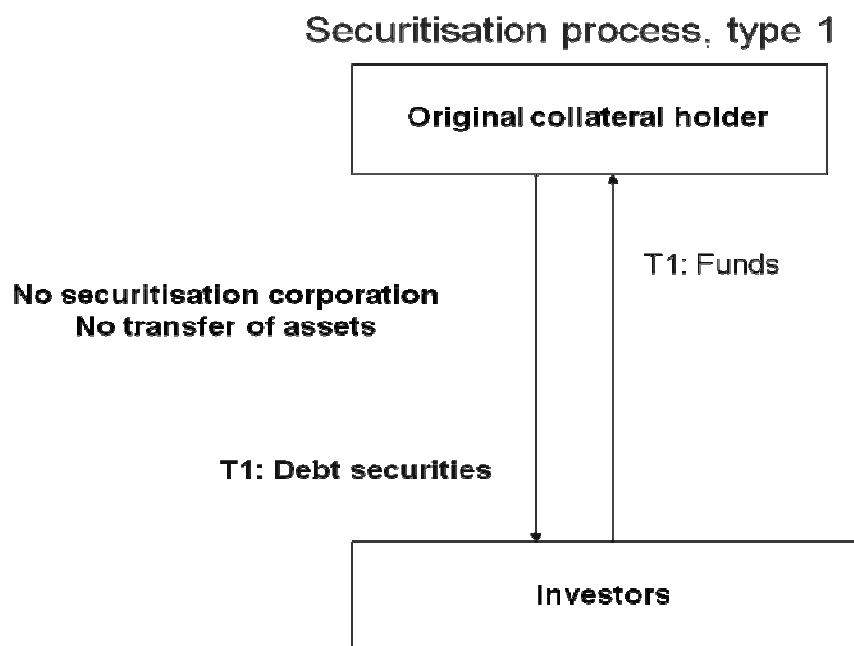
Debt securities issues: stylised presentation table

Issuing sector		Non-financial corporations	Financial corporations	General government	Households and non-profit institutions serving households	Total residents	Non-residents	Total
Currency, Maturity, Interest rate & Market								
Location of issue	Domestic market	Currency						
		Maturity						
		Interest rate						
	International markets	Currency						
		Maturity						
		Interest rate						
	Total markets	Currency						
		Maturity						
		Interest rate						
Residence of issuer								

2. Definition of securitisation

- Securitisation results in debt securities for which coupon and principal payments are backed by payments on specified assets or future income streams
 - A variety of assets or future income streams may be used securitised
 - residential and commercial mortgage loans
 - consumer loans
 - corporate loans
 - government loans
 - credit derivatives
 - future revenue.

3. Securitisation process Type 1



3.1. Examples of type 1 securitisation

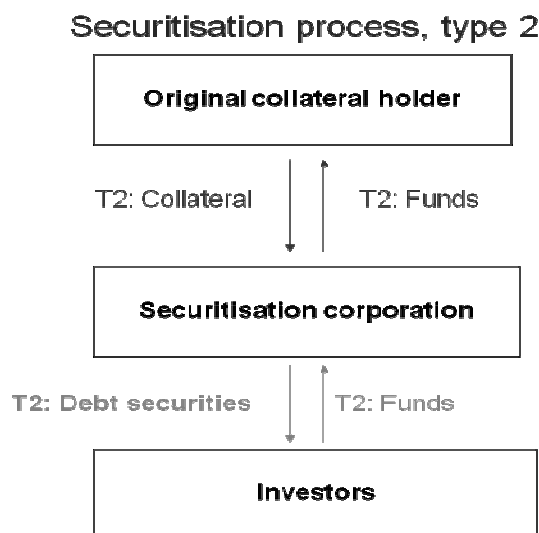
- Debt securities issued under similar schemes as Type 1:
 - Pfandbriefe (Germany)
 - Obligations foncières (France)
 - Obbligazioni bancarie garantite (Italy)
 - Lettres de gage hypothécaires and lettres de gage publiques (Luxembourg)
 - Obrigações hipotecárias and obrigações hipotecárias sobre a sector público (Portugal)
 - Cédulas hipotecarias and cédulas territoriales (Spain)
 - Realkreditobligationer (Denmark)
- Mainly continental Europe for legal reasons
- Now being promoted in other countries, incl. US

3.2. Characteristics of type 1 securitisation

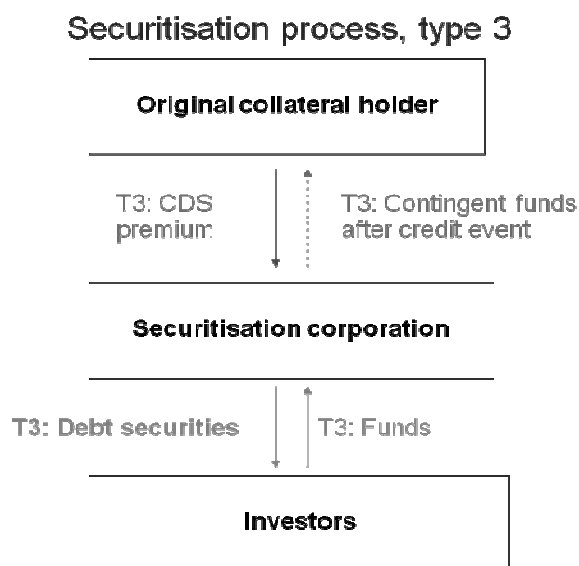
- There is no transfer of the assets to a special purpose entity
- Assets are identified and ring-fenced as per local law, and are placed as a security for the bonds
- In the event of bankruptcy of the mortgage originator, a general secured lending law or a special law relating to the covered bonds grants the bondholders recourse against the pool of mortgages over which security interest had been created

- In the event of defaults on the mortgages, investors still have a recourse against the bond issuer

4. Securitisation process Type 2



4.1. Securitisation process Type 3



5. Classification of debt securities issued in securitisation schemes

- Issuing sector:
 - Original collateral holder (non-financial corporation or financial corporation) or
 - Securitisation corporation (financial corporation)
- Type of securitisation debt securities issued:
 - Covered bonds
 - Mortgage-backed bonds (MBB)

- Asset-backed securities (ABS)
- Asset-backed commercial paper (ABCP)
- Credit-linked notes (CLN)
- Colletarised debt obligations (CDO)

European Union definition of securitisation

- ECB regulation (EC) No 24/2009 of the ECB concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (ECB/2008/30)
- ‘Securitisation’ means a transaction or scheme whereby an asset or pool of assets is **transferred** to an **entity that is separate from the originator** and is **created for or serves the purpose of the securitisation** and/or the credit risk of an asset or pool of assets, or part thereof, is transferred to the investors in the securities, securitisation fund units, other debt instruments and/or financial derivatives issued by an entity that is separate from the originator and is created for or serves the purpose of the securitisation, and:
 - a) in case of transfer of credit risk, the **transfer is achieved by**:
 - the **economic transfer of the assets** being securitised to an entity separate from the originator created for or serving the purpose of the securitisation, or
 - the **use of credit derivatives**, guarantees or any similar mechanism; and
 - b) where such securities, securitisation fund units, debt instruments and/or financial derivatives are issued, they **do not represent the originator's payment obligations**.

Two definitions of securitisation

- **Reconciliation between 2 definitions**
 - **ECB definition narrower than the one in the *Handbook of Debt Securities***
 - **ECB definition corresponds to Type 2 and Type 3 securitisation schemes**
 - **Type 1 securitisation schemes are by definition outside the scope of the ECB regulation on statistics**
- **Reconciliation between 2 definitions**
 - **Type 1: on-balance sheet securitisation**
 - **Types 2 and 3: off-balance sheet securitisation**

6. Data collection on securitisation

- Handbook on Securities Statistics’ recommendation
 - Collection only on the issuer side
- Data collection
 - Type 1: Monetary institutions’ balance sheets
 - Other financial institutions’ balance sheets
 - Types 2 and 3: specific statistical reporting templates

Extended presentation table: types 1 to 3

Market, currency, maturity, and interest rate		Residents				Non-residents	All issuers
		Non-financial corporations	Financial corporations	General government	Households and NPISH		
1. Domestic market	1.1 Currency						
	1.2 Maturity						
	1.3 Interest rate						
	1.4 Memo item: securitisation debt securities						
2. International markets	2.1 Currency						
	2.2 Maturity						
	2.3 Interest rate						
	2.4 Memo item: securitisation debt securities						
3. All markets	3.1 Currency						
	3.2 Maturity						
	3.3 Interest rate						
	3.4 Memo item: securitisation debt securities						
		Residence of issuer					

Location of issue

Extended presentation table: types 2 and 3

Market		Residents							Non-residents	All issuers	
		Non-financial corps	Financial corporations			General government		Households and NPISH			Memo item: public sector
			Central bank	Other money – issuing corps.	Securitisation corps.	Other financial corps.	Central government				
1. Domestic market											
2. International markets											
3. All markets											

SECOND PART

TRYING TO COLLECT INFORMATION

THE NEW ECB STATISTICAL FRAMEWORK FOR SECURITISATION

*Antonio Matas Mir
European Central Bank*

1. User needs at the Eurosystem

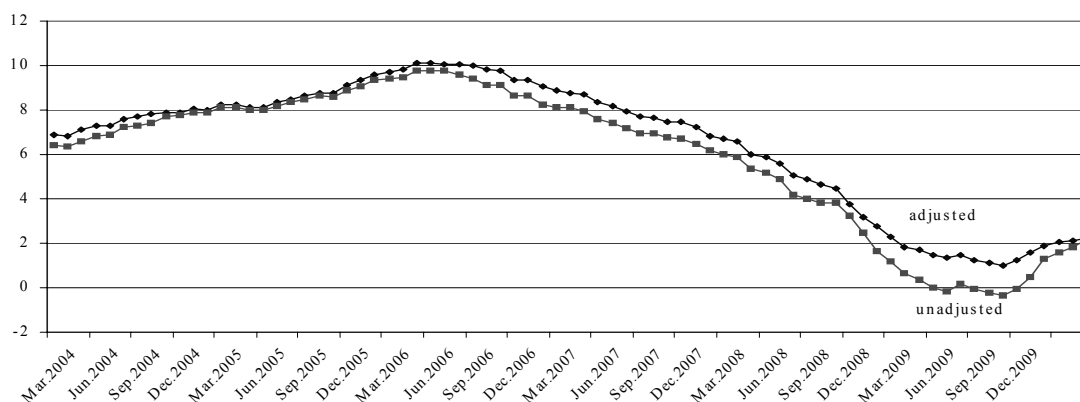
1.1. Data on securitisation are needed for a reliable interpretation of MFI credit data:

- Correct for negative financial transactions when loans are securitised
- Follow loan redemption and repayment patterns irrespective of securitisation
- **Both of the above could arguably be met through consolidated reporting by originator**

1.2. But data are also needed to monitor securitisation process itself and its impact on:

- The creation of money and credit
- The capital markets
- Financial stability
- The incentives at play to use it as funding source, risk diversification, regulatory capital management, etc.
- **Most of the above best fulfilled by treating FVCs as separate entities**

Example: loans to households, adjusted vs unadjusted for securitisation and other loan sales, annual percentage changes

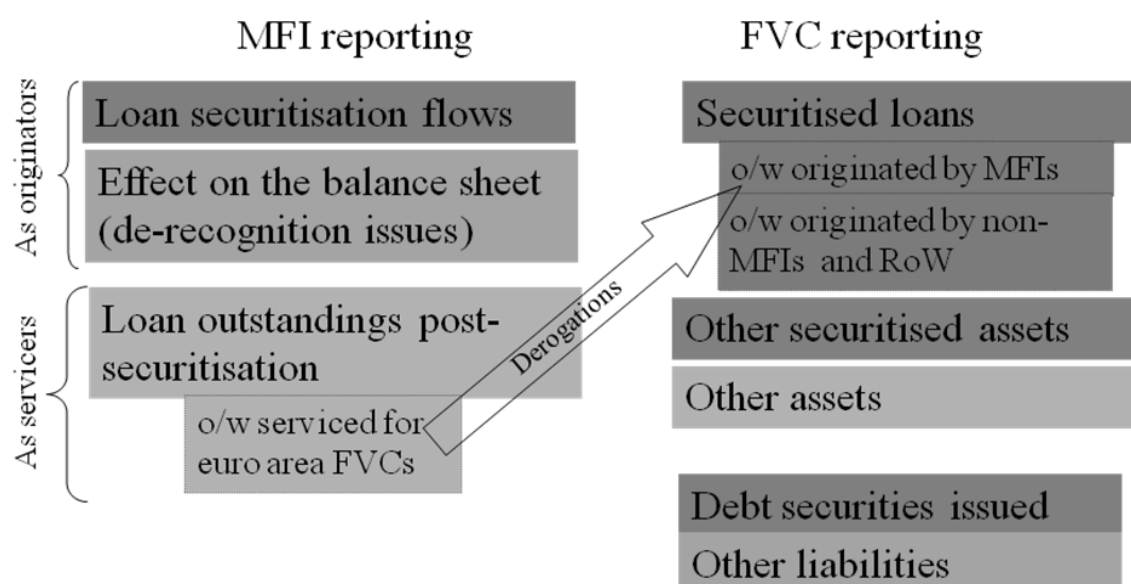


2. Situation prior to the new framework

2.1. Data were insufficient:

- Non-harmonised definitions and compilation approaches;
- Different availability and coverage across euro area;
- Highly sensitive to different national accounting rules on asset derecognition;
- No sectoral detail available;
- No coverage of re-intermediation (FVC securities bought by the MFI sector, unwinding of securitisations)

3. The ECB 'integrated approach' at a glance



4. New statistical requirements for MFIs

- New statistics on MFI loan securitisation and other loan transfers are an extension of existing statistical requirements on MFIs.

Cover:

1. Traditional MFI loan securitisation (including via non-resident vehicles).
2. Other MFI loan transfers to/from non-MFIs.

Do not cover:

Synthetic loan securitisation (covered by FVC statistics)

First reporting July 2010 (ref. June) with data provision back to Dec 2009.

4.1. Net flows of loans securitised or otherwise transferred [Net flows = loan disposals minus acquisitions]

- At monthly frequency, by
 - Residency of the transferee (FVC, o/w euro area, other entities)
 - Residency of loan's debtor (domestic, other euro area, RoW)
 - Sector of loan's debtor (Gen Gov, OFIs, IC&PF, NFCs, HH)
- At quarterly frequency, by
 - Loan's purpose (consumer credit, housing loans, other, sole proprietors)
 - Loan's original maturity (NFC loans only)
 - **Reporters must distinguish transactions with impact on the balance sheet from the rest**
- For MFIs acting as servicers in a loan securitisation:
 - Outstandings of loans being serviced for all items in (a), distinguishing total and 'of which' serviced for a euro area FVC → data used in 'integrated approach'
- For MFIs adopting IAS39 (or rules with similar effect):
 - *Outstandings* of loans securitised but not derecognised by originator (control for double-counting when combining MFI and FVC statistics)
- Other requirements :
 - Holdings of FVC securities (including retained), deposits placed by FVCs (including collateral in synthetic securitisation)

5. Reporting scheme for MFIs

5.1. Monthly

Table 5. Securitisations and other loan transfers

(a) Data required at monthly frequency

BALANCE SHEET ITEMS	A. Domestic (other MUMS identical)						C. Rest of the world
	General govern*ent (S. 13)		Other resident sectors				
	Total	Other Gen. Gov't	Total	OFis & financial auxil. (S.123 + S.124)	Ins. corp & pension funds (S. 125)	NFC (S.11)	
1. Net flows of loans securitised or otherwise transferred : transactions with impact on the statistical balance sheet calculated as disposals minus acquisitions							
1.1 Counterparty in the transfer is an FVC							
1.1.1 o/w counterparty in the transfer is a euro area FVC							
1.2 other counterparties in the transfer							
2. Net flows of loans securitised or otherwise transferred : transactions without impact on the statistical balance sheet calculated as disposals minus acquisitions							
2.1. All counterparties in the transfer							
3. Outstanding amounts of loans serviced in a securitisation ¹							
4. Outstanding amounts of securitised loans not derecognised ²							
4.1 Total							
4.1.1 o/w securitised through a euro area FVC							

5.2. Quarterly

BALANCE SHEET ITEMS	A. Domestic (other MUMs identical)							C. Rest of the world	
	General government (S. 13)		Other resident sectors						
	Total	Other Gen. Gov't	Total	OFIs & financial auxil. (S.123 + S.124)	Ins. corp & pension funds (S. 125)	NFC (S.11)	Households (S.14 + S.15)		
							Consumer credit	Housing loans	Other loans excl. to SP ²
1. Net flows of loans securitised or otherwise transferred : transactions with impact on the statistical balance sheet calculated as disposals minus acquisitions									
1.1 counterparty in the transfer is an FVC									
Loan purpose									
Maturity =< 1 year									
Maturity > 1 year and =< 5 year									
Maturity >5 year									
1.1.1. o/w FVC resident in euro area									
Maturity =< 1 year									
Maturity > 1 year and =< 5 year									
Maturity >5 year									
1.2 Other counterparties in the transfer									
Loan purpose									
3. Outstanding amounts of loans serviced in a securitisation									
3.1 Loans serviced: all FVCs									
Maturity =< 1 year									
Maturity > 1 year and =< 5 year									
Maturity >5 year									
3.1.1 Loans serviced : of which euro area FVCs									
Maturity =< 1 year									
Maturity > 1 year and =< 5 year									
Maturity >5 year									

6. Statistical requirements for FVCs

6.1. *A new statistical ECB Regulation addressing the vehicles in the euro area directly*

- Includes a requirement of self-identification
 - **Publication of FVC list in February 2010**
- First reporting of balance sheet data: February 2010
 - First reporting of financial transactions data + data on write-downs or similar information: May 2010

6.2. *Each NCB may choose one of three compilation approaches, or combination thereof:*

- Direct reporting by the resident FVCs
- Direct reporting by the resident FVCs complemented by reporting of loans serviced by MFIs ('integrated approach')
- Compilation of FVC data using other statistical, public or supervisory data sources

6.3. *All cases, quarterly frequency, timeliness t+28 days*

6.4. *If direct reporting by FVCs:*

- Derogations for FVCs making up to 5% of national total assets
- Derogations from mark-to-market accounting for difficult to value items (e.g. bespoke CDS)
- Deviations of reporting period from natural quarter allowed provided large transactions within natural quarter are included

6.5. *Data to be compiled separately for traditional, synthetic and other FVCs*

6.6. *Stocks and financial transactions of:*

- Securitised loans :
 - Fully sectorised wrt to borrower if MFI-originated
 - Only totals for other originators
- Debt securities: MFIs/non-MFIs/FVCs/RoW
- Sufficient information on inter-FVC positions to consolidate sector
- Write-downs only for total assets (compiler assigns to most likely asset class)

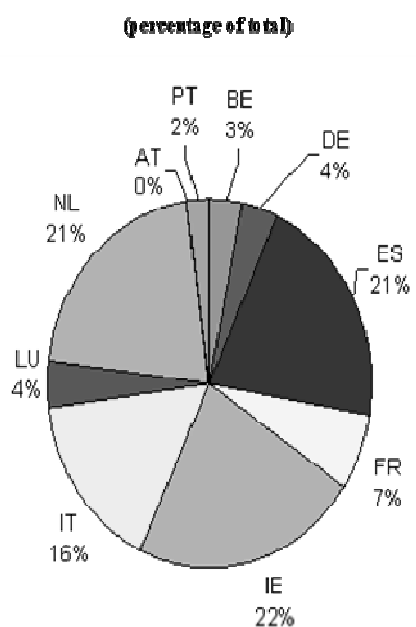
7. Reporting scheme for FVCs

Table 1: Outstanding amounts and transactions

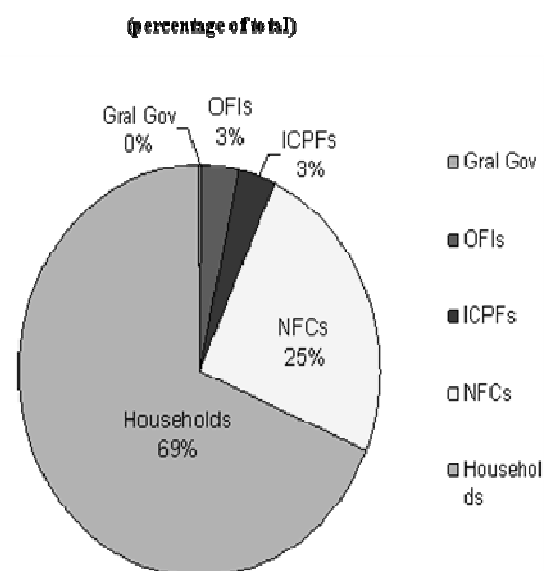
	A. Domestic / B. Other participating Member States										C. RoW	D. Total
	Total	MFIs	Non-MFIs - Total	General Gov't	Other residents							
					Total	Other financial intermediaries + financial auxiliaries (S.123+S.124) o/w FVCs	Insurance corporations and pension funds (S.125)	Non-financial corporations (S.11)	Households + non-profit institutions serving households (S.14+S.15)			
	[a]	[b]	[c]	[d]	[e]	[f]	[g]	[h]	[i]	[j]	[u]	[v]
ASSETS												
1 Deposits and loan claims												
2 Securitised loans												
2a euro area MFI as originator												
up to 1 year												
over 1 year and up to 5 years												
over 5 years												
2b euro area General Government as originator												
2c euro area OFI and ICPF as originator												
2d euro area NFC as originator												
2e non-euro area originator												
3 Securities other than shares												
up to 1 year												
over 1 year and up to 2 years												
over 2 years												
4 Other securitised assets												
euro area General Government as originator												
5 Shares and other equity												
6 Financial derivatives												
7 Fixed assets												
8 Remaining assets												
LIABILITIES												
9 Loans and deposits received												
10 Debt securities issued												
up to 1 year												
over 1 year and up to 2 years												
over 2 years												
11 Capital and reserves												
12 Financial derivatives												
13 Remaining liabilities												

8. Some preliminary figures (2009Q4)

Country share of total EA FVC assets (largest countries are IE, NL, ES and IT – accounting for 80% of total FVC assets)



Securitised loans by sector of borrower (largely Households 69%, followed by NFCs 25%)



9. Summary

- Harmonised and complementary MFI and FVC data on securitisation for the euro area beginning 2009Q4
- MFI data covers also securitisations via non-resident vehicles
- FVC data restricted to euro area vehicles (plus some EU countries, but not UK)

THE ABS SECURITISERS COLLECTION

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1. Introduction

Australia has a history of securitisation as a form of financing dating back to the mid 1980s, with a time series of official statistics dating back to 1988. This paper outlines: a brief history of the Australian securitisation market; the development of the Australian Bureau of Statistics (ABS) Survey of Securitisors and the key issues addressed in that process; an overview of the data released; and some of the current issues in the Australian securitisation market.

2. Development of the Australian Securitisation Market

Securitisation began in Australia in the mid 1980s with a number of state government agencies establishing special purpose vehicles. These vehicles were set up primarily to enable more effective management of the financing of public housing and other public services. The resulting securities were targeted at pension funds, typically through fund managers, both domestically and offshore.

In the early 1990s, falling interest rates and a deregulated lending market encouraged non-bank mortgage originators to enter the market, competing with the banks in the mortgage market, leading to a small increase in the issuance of asset backed securities. However, as Australia emerged from the 1990-91 recession, and interest rates fell, public housing mortgage holders were able to renegotiate their fixed rate loans for variable rates, which led to a reduction in the participation by government agencies.

Initial securitisation guidelines were issued by the banking regulator in 1992. Up until this point, securitisation volumes were relatively low, typically short term and were backed by residential mortgages, receivables from public services such as water rates, rental streams from public housing and store charge card debts. These guidelines were revised in 1995 and, although more detailed than the initial guidelines, were less restrictive. The 1995 revisions to the regulatory guidelines specified, among other things, the conditions under which assets are considered to have been transferred, requiring the establishment of a Special Purpose Vehicle (SPV) and a "clean sale" of assets.

Steady growth occurred in the Australian market from this point, particularly from the banking sector. Demand for quality securities also increased from pension funds and the fund management industry as government debt decreased. Banks became warehouses for substantial new mortgages that were held only until marketable parcels were accumulated.

From the early 2000s the Australian market was characterised by rapid growth and very large issuances until 2007, although the growth eased from 2003. At this time, credit default swaps emerged as an additional credit enhancement instrument, and some activity in "low doc" (sub-prime) loans began to emerge, but not nearly to the extent experienced in the USA.

⁵⁶ Prepared by Wendy Raedt, Director, Financial Statistics - International Accounts & Financial Statistics Branch

From the second half of 2007, the activity of the Australian securitisation market has declined significantly, with very little activity other than government supported issuances to date.

3. ABS Securitiser Survey

The ABS compiled rudimentary statistics on the activity of securitisation vehicles, primarily from media reports, public announcements and accounting reports for stocks and flows data in the financial accounts. In 1993, this informal synthesised collection was formalised under the *Census and Statistics Act 1905*. This required a more rigorous definition of securitisation and a more formal application of statistical unit, scope, coverage and data item standards. With no benchmark or other examples of securitisation surveys to provide guidance, this was a difficult exercise.

Several key determinants were identified by the ABS in line with the System of National Accounts (SNA) and the Australian prudential guidelines in force at that time. The primary determinants were; the SPV structure should be independent from the asset originators, trustee companies and trust managers; and the assets transferred to an SPV complied with the SNA defined change of ownership. Much of the initial investigation was supported by detailed discussions between market participants and ABS staff.

3.1. Statistical unit

The statistical unit was defined as a single trust, however consolidated reporting by trusts under one manager was, and still is permitted.

3.2. Scope

The scope of these statistics is all resident SPVs which securitise any type of asset (including mortgages, credit card receivables, lease receivables, short and long term debt securities) and which are not regulated or registered with the Australian Prudential Regulation Authority (APRA) and therefore are not required to report to APRA under the Financial Statistics (Collection of Data) Act.

3.3. Coverage

Coverage is limited to those SPVs which are independently rated by a recognised rating agency. The ratings agencies are used as a means to identify new issuances and therefore new issuers.

Internal securitisation is excluded from this survey, although a measure of this is included in the financial accounts.

3.4. Frequency

Securitisers report data quarterly to the ABS to align with the frequency of the Financial Accounts.

3.5. Data Items Collected

Data is collected through the quarterly Survey of Financial Information: Securitiser. The survey form was designed so that the data aligned with SNA instrument and sector classifications. Data collected includes balance sheet information, income and expense data and derivative information. See Appendix for the current survey form.

The structure of the forms is as follows:

- PART 1 General Information: Reporting period and employment details.
- PART 2 Income and Expenses: Interest income by instrument, fee income, Realised capital gains/losses and all other income, interest expenses, issuance expenses, fees, wages and salaries and all other expenses.
- PART 3 Balance Sheet: Assets and liabilities split by counterparty and instrument.
- PART 4 Derivatives in net asset and net liability positions with residents and non-residents.

The survey requests that data be reported at market value where possible.

3.6. Data Quality

Response rates for the survey are generally, approaching 95% received within the reference quarter, and the quality of the survey results are considered to be good.

4. Release of Data

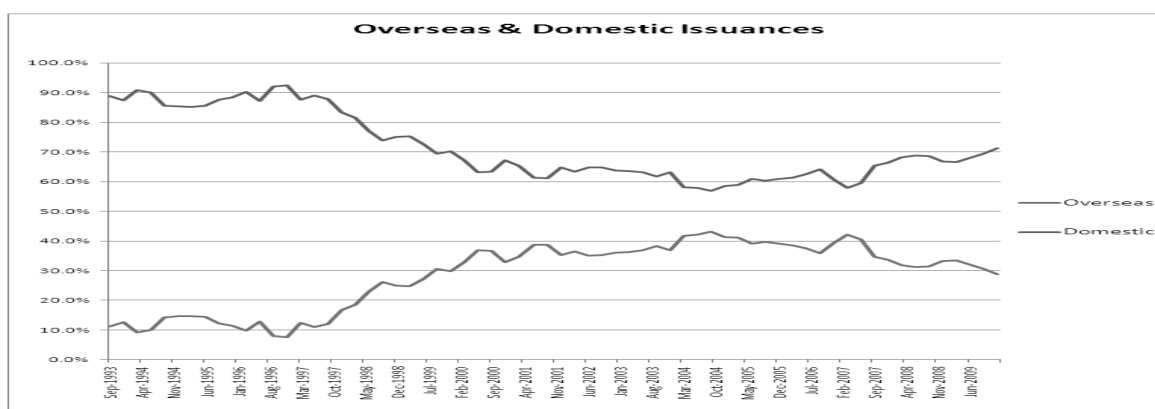
The data collected from the Survey of Securitisers was originally collected for completeness of the financial accounts. Following the ABS implementation of SNA08 from the September quarter 2009 release, securitisers are published as a separate sub sector, whereas previously they had been included in the Financial Intermediaries n.e.c. sector. This data is published in *Australian National Accounts: Financial Accounts* (ABS cat.no. 5232.0).

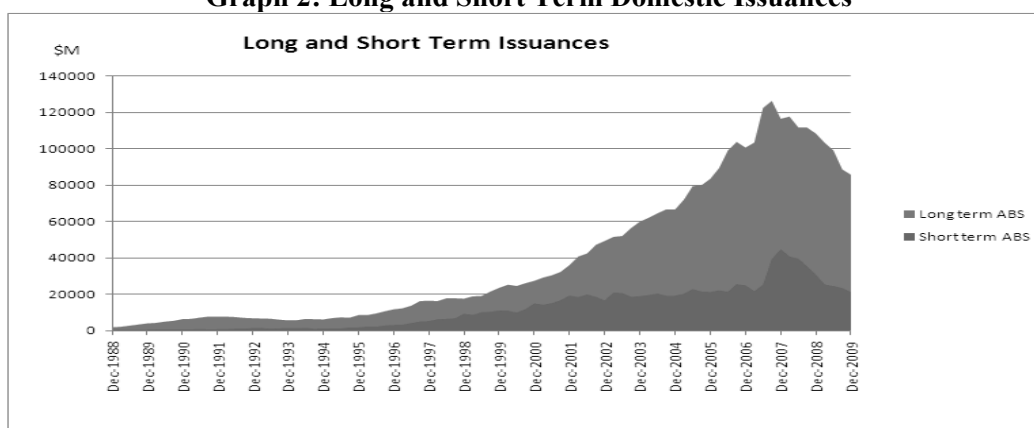
The ABS also releases a stand alone electronic publication with the results of the survey in *Assets and Liabilities of Australian Securitisers* (ABS cat. no.5232.055.001), which provides quarterly information on the assets and liabilities of securitisers.

The following graphs from the publication highlight some of the features of the Australian market since the survey began.

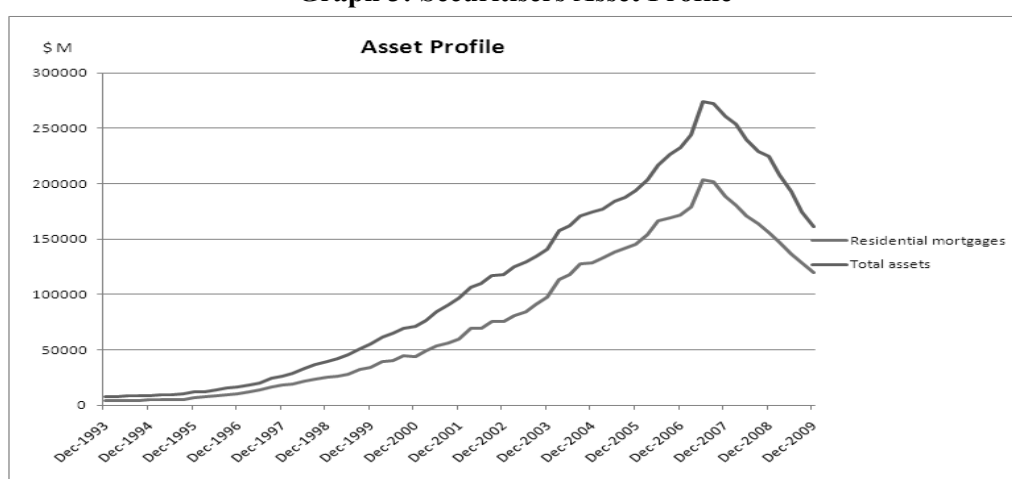
Graph 1: Overseas versus Domestic Issuances

From the early 1990s, issues into offshore markets as a percentage of total issues grew steadily from a low level of about 10 per cent, to a high of just over 40 per cent in mid 2007. With the onset of the GFC this has been eroded to below 30 per cent of a shrinking total volume of issuances.



Graph 2: Long and Short Term Domestic Issuances

The early years of securitisation was characterised by very low levels of long term issuances and almost no short term issuances of asset backed securities. The graph illustrates the rapid growth in both long and short term issuances, particularly from the late 1990s as the Australian banks increased their participation in the market. The sudden falls in issuance occurring as a result of the GFC are also evident.

Graph 3: Securitisers Asset Profile

The graph above highlights the predominance of residential mortgages of the total assets of securitisers. While assets other than residential mortgages have increased over the last 15 years, they still represent only a small component of the total assets, now valued at just over A\$160 billion, after peaking at A\$274 billion in June 2007.

5. Recent and Current Developments

The impact of the Global Financial Crisis was immediate on the Australian securitisation market, with issuers unable to issue new securities as investors reassessed risk. Many warehouses, including banks, were left with unmarketable mortgages which had been funded by short term borrowings. The rapid decline in the market prompted various forms of government support.

5.1 Internal Securitisation

Australia's Central Bank, the Reserve Bank of Australia (RBA), widened the criteria for securities accepted in repurchase agreements (repos) to include residential mortgage backed securities. This led to the creation

of "internal" or "self" securitisation by Australian banks. This is a process in which an originator sells a pool of assets to a related special purpose vehicle (SPV), and the SPV in turn issues debt securities, which are held entirely by the originator.

5.2 Australian Government Support

Additional government support was provided through a Commonwealth Government agency which was funded to purchase up to \$16 billion of asset backed securities. Developments in international capital markets since mid-2007 have had an impact on the Australian RMBS market, reducing liquidity in the RMBS market and constraining the ability of lenders to access funding from this source. The Australian Government decided to invest temporarily in Australian RMBS to support competition from a diverse range of lenders during the present market dislocation. To this end the Australian Office of Financial Management (AOFM) has been directed to invest in Australian RMBS, with at least \$4 billion being allocated to issuers/originators that are non-authorized deposit taking institutions.

Investor sentiment has improved in Australian RMBS markets since the inception of the program, especially in recent months. Some RMBS issuance has been possible without AOFM support. However RMBS markets continue to be affected by the fallout from the global financial crisis and will need to improve further to support affordable new issuance from a broad range of lenders.

5.3 Covered Bonds

To date, Australian financial institutions have not been able to issue covered bonds because provisions in domestic legislation relating to banks requires them to place depositors above all other creditors in their claims on assets. However, explicit depositor guarantees were introduced in 2008, reviving interest from the major banks and the Australian industry body for securitisers.

6. Statistical lessons

The ABS was very quick to recognise the emergence of securitisation and develop a survey with appropriate SNA based measurement. The lesson learned from the rapid rise of this market is that it is imperative to keep on top of market developments and innovate data collection as markets develop.

A very significant lesson arose from the ABS decision to measure securities activity from surveys of assets. This was particularly important for the measurement of RMBS, as the face value of bonds reported from the liability side failed to reflect the true market value. By measuring the value of the loans, a more accurate measure was achieved.

In the Australian context, it was quickly evident that Indirect measurement via issuance activity was not sufficient, nor was it possible to survey only regulated institutions as this did not provide comprehensive coverage of market participants. In Australia, the regulatory authority is not legally able to measure schemes designed to circumvent regulatory boundaries such as bankruptcy remote trust structures such as SPVs. This final, and perhaps most important lesson, was highlighted by an action by the Reserve Bank of Australia (RBA) when it changed the components of credit aggregates for housing in August 2005 to include securitised loans, as data from the regulated financial institutions did not reflect the real indebtedness of the household sector. (When pasted, the URL address below will take you to the RBA website, and provide an explanatory note on this change.

<http://www.rba.gov.au/publications/bulletin/2005/sep/3.html>

DEVELOPING DATABASE ON SECURITIES HOLDERS INFORMATION: THE CASE OF JAPAN

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Abstract

Identifying the exact holder or the holding sector of securities is always one of the most challenging tasks for statistical compilers. Recently, some central banks and statistical authorities have started projects to build up securities databases in which securities holders' information is incorporated. This paper introduces the Bank of Japan's recent exploration of the central securities depository (CSD) data as a statistical source of securities holders' information. First, it explains the features of the CSD in Japan. Second, it introduces the improvement in the flow of funds accounts statistics achieved in March 2010. Third, it argues challenges for the development of CSD data as a statistical source to identify final holders of securities. This paper concludes that using CSD data is an approach to data gap problems.

Key words: CSD, security by security, data gaps

1. Introduction

Identifying the exact holder or the holding sector of securities is always one of the most challenging tasks for statistical compilers. In macroeconomic statistics such as the flow of funds accounts, a balance sheet provides useful information on the holding amount of securities. But aggregating balance sheets does not always provide a full picture of the economy. Balance sheets of non-financial corporations and some of other financial institutions, for example, are not always available, and households do not make balance sheets on the same basis as that of business accounting. Even if they existed, a complete aggregation of the total economy is impossible.

Under such constraints, some central banks and statistical authorities have started projects to build up securities databases in which securities holders' information is incorporated. The ECB (2009) explains its intention to establish a single authoritative data source, the centralised securities database, to meet the needs for the ECB itself. The BIS, ECB, and IMF (2010) argue the holding side of securities statistics. This kind of movement is gaining ground especially after the recent financial crisis where securitised products incurred a considerable amount of financial losses to their holders, whereby risks are transmitted in the financial system. The Financial Stability Board (2009) advocates the importance of knowing where risks actually lie across institutions.

This paper introduces the Bank of Japan's recent exploration of the central securities depository (CSD) data as a statistical source of securities holders' information. This paper is organized as follows. Section II explains the features of the CSD in Japan. Section III introduces the recent achievement as a result of applying the CSD data to the flow of funds accounts statistics. Section IV argues general challenges

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pertaining to CSD data as a statistical source to identify final holders of securities, sometimes referring to the result of the survey the Bank of Japan conducted for six OECD countries in April and May 2010. Section V concludes.

2. Features of the CSD in Japan

CSD data in general are considered to have at least two advantages in data collection. One is the centralisation of information, which is elaborated in this section, and the other is a wider universe than that of the administratively collected data. Administratively collected data are correct, powerful, and quick in order to see the conditions of a specific sector, but they are apparently weak in the sense that a data gap may exist outside the scope of authorities.

2.1. One and only platform of book entry transfers except for central government bonds

The book-entry transfer services of securities except for central government bonds are provided by one CSD in Japan, which is the JASDEC, Japan Securities Depository Center, Inc. The book-entry transfer services of central government bonds are provided by the Bank of Japan. This paper concentrates to discuss the former.

The JASDEC is a privately owned stock company licensed under the Act on Transfer of Bonds, Shares, etc (“the Law” hereafter). It operates the book-entry transfer system for general securities such as corporate bonds, stocks, commercial paper, investment trusts. Since the JASDEC is the one and only platform of book-entry transfers for those securities, the information is centralised to this system on a security-by-security basis, whereby it has the potential for collective gathering of securities holdings information.

The Law stipulates its book-entry transfer business but does not require data supply for statistics. So far there is no data exchange contract between the JASDEC and the central bank or statistical authorities.

The book-entry transfer system has been in operation since 2002. The usage rate of the system in CP transaction is almost 100%. Those of other securities transactions are regarded to be close to 100%.

2.2. Chain of accounts

The JASDEC system takes a cascade structure of accounts. As illustrated in the attached Chart, an investor who would like to make a transaction opens its customer account at either a direct account management institution (DAMI) or an indirect account management institution (IAMI). When there is a deal, the transactional information is transferred from the institution at which the investor holds its account to the institution keeping an account of its transactional counterparty. If the investor indicated as “Participant (i)” in the Chart sells securities to the investor indicated as “Participant G,” the information on a deal goes up through institutions E, A, the JASDEC, and down finally to C where sold securities are entered into the book at the customer account of G (Case I). Similarly, if “Participant (i)” sells securities to “Participant (ii),” the transactional information is processed within E. IAMI E transfers the transactional amount from Participant (i)'s account to Participant (ii)'s account, and the transaction is completed within E (Case II).

The DAMI or IAMI, usually banks or securities companies, can also hold their own accounts. They are called self accounts which are separated from customer accounts in this system. As of May 2010, there are 89 DAMI and 407 IAMI in the book-entry transfer system for corporate bonds.

2.3. Finality of ownership (direct system vs. indirect system)

One of the features which may be distinct from the CSDs of some other countries is the finality of the ownership of securities. In the JASDEC system, neither DAMI nor IAMI takes over the ownership of

transacted securities at customer accounts even though the process itself happens in chains of accounts held by such intermediate institutions. Kanda (2009) describes the system as the “direct system.” An account management institution is just keeping an investor account and providing book-entry transfer services. The legal ownership of securities still exists at the investor level and does not move to any other institution.

As opposed to the direct system, there are some countries in which an account management institution legally holds assets and an investor keeps equitable interest to these assets, or a securities entitlement is moved from an investor to an account management institution. In this indirect system, it may become somewhat difficult to detect the final holder of securities.

2.4. Security by security

All data are handled on an individual issue basis in the book-entry transfer system. Information available for each issue includes the name of issue, name of issuer, face value, maturity, etc. The current outstanding amount is also available. For example, with regard to corporate bonds whose data are required to be open to the public, one can obtain detailed information by searching the JASDEC website using the name of the issue or the ISIN code as an identifier. This security by security nature will enable compilers to sort data in accordance with the System of National Accounts and it also has the potential to be used for multi-purpose securities databases.

3. Application of CSD data to flow of funds accounts

The Bank of Japan started discussing the possible usage of data as a statistical source with the JASDEC in late 2009. This was primarily motivated by the need to secure more accurate source data for the flow of funds accounts statistics. Some statistical improvements have been made in the data revisions of the statistics in March 2010 thanks to efforts by the JASDEC to respond to the Bank of Japan’s inquiry on data definition. Some of these improvements are summarized as follows.

3.1. ABCP

Asset-backed commercial papers (ABCP), a part of structured-financing instruments, have had no reliable data source before the revision. Figures for the ABCP were once estimated by assuming that it was a part of other structured-financing instruments (Sato [2009]). Through the aforementioned process of discussions on the data, we confirmed that some data released by the JASDEC were consistent with our ABCP definition and decided to use them as new source data. As a result, the market size of the ABCP was more accurately reflected in the flow of funds accounts statistics.

3.2. Local government bonds

The information on the outstanding amount of local government bonds was not centralised. Before the dematerialization started in 2006, the total outstanding amount had been estimated based on registered bonds. There were problems on the frequency of the data which was once a year and on the existence of non-registered bonds (held in certificate) of which the amount had not been deemed negligible.

As the dematerialization proceeded, a majority of local government bonds have shifted from registered bonds to those in the book-entry transfer system. Since the system is open on the web everyday and the data are stored security by security, we are able to confirm whether each issue is within the definition of our statistics at any date. Further, we successfully found out that the amount of non-registered bonds still exists but not as significant as to make estimation impossible. By conducting a series of examinations, we then concluded that the CSD’s aggregate data were the most centralised and reliable primary data source at present to describe the total market size of local government bonds.

3.3. Privately placed asset-backed securities

Although we have improved the quality of the ABCP, the remaining part of structured-financing instruments such as privately placed asset-backed securities are still under examination. Classification of these issues by type of collateral (e.g. financial assets or real estates) is required to decide the transaction item, either securitised products or another kind of corporate bonds.

We expect further improvement of the flow of funds accounts statistics by incorporating information about privately placed asset-backed securities from CSD in March 2011.

4. Challenges for statistical development of CSD data

While CSD data have a distinct advantage in data collection because of its electronically processed centralised system, there are things to overcome for the development of the data as a source of final holders. In this section, we argue general challenges pertaining to CSD data as a statistical source to identify final holders of securities, sometimes referring to the result of the survey the Bank of Japan conducted in April and May 2010 asking central banks and statistical authorities about whether they use CSD data for compiling financial statistics. Six countries (the U.S., the U.K., Australia, Germany, Spain, and Chile) responded to the survey. The result of the survey is summarized in the Table.

4.1. Cascade structure of accounts

The most important reason why it is difficult to identify final holders from CSD data is a practical one that exists in a cascade structure of accounts. The transactional information is transferred from one institution to another as explained in II-2. However, detailed information on an investor such as the sector in which it is statistically classified is held only by the account management institution at which the investor holds the account. In other words, detailed information on the investors is decentralised among account management institutions in the book-entry transfer system. Participants of the system know the name, characteristics and the amount of individual securities in the accounts they offer, but they do not have information about the ultimate owners of securities in case the account is a customer account. For instance, CSD and DAMI, which are located upstream in the chain structure, do not know the change of ownership of the securities when a transaction is completed within IAMI as Case II in section II-2. Therefore, for statistical purposes, compilers should take another measure to obtain the entire market information.

In order to overcome the cascade account structure problem, most countries have access to supplementary source data other than CSD. In the countries where there is said to be an indirect system and it is deemed to be difficult to detect final holders, CSD data is either selectively used or not used for compilation. In the U.S., CSD data are used along with private vendor data for bonds and stocks issued by non-financial corporate businesses. The amount of asset-backed securities issued is measured as the assets removed from the balance sheet of originators. CSD data are used selectively for ABCP, which is calculated deducting the amount of asset-backed corporate bonds from the asset-backed securities and covers 100 percent of the market. In the UK, the CSD data are used as part of quality assurance process but not for data compilation. Instead, data collected from London based issuing and paying agents are used for published securities issues statistics.

Even in the countries where there seems to be a direct system, data given by intermediate institutions are also used for financial statistics. In Spain, for Balance of Payments and International Investment Position, the CSD data are used for debt securities issued by residents and held by non-residents. The data incorporates the country of residency of the first-known counterpart but not the final holder. If there is a resident custodian between non-resident and CSD, it is the resident custodian who has the information and CSD data do not cover the transaction. The information provided by the resident custodians is also used, on

an aggregated basis, to identify the holdings of securities by non-financial corporations and by households. In Germany, the CSD is one of about 2000 reporting agents.

In Chile, Banco Central de Chile does not currently use information given by CSD for the compilation of yearly financial accounts statistics. Nevertheless, it is working in a project of quarterly financial accounts, where CSD data will be used intensively, including the securities holders' information.

In Japan, one thing to be a measure for overcoming the same CSD data problem is to obtain supplementary information about customer accounts in DAMI. Currently the accounts of which the JASDEC manages the outstanding amount are basically limited to those set up within the JASDEC itself, as accounts for A, B, and C illustrated in the Chart. Ideally, the data should cover all the participants of the book-entry transfer system including both DAMI and IAMI. Most of major financial institutions participate in the system as DAMI. If owners' information of securities in DAMIs' customer account becomes available with a cooperation of JASDEC and DAMIs, the information can be applied to the composition of customer accounts in IAMI to estimate the amount of each type of securities held by each sector. The estimation could be conducted with certain accuracy because all DAMIs and IAMIs are registered at JASDEC and it is known that the chain structure does not extend to more than a few layers.

4.2. Confidentiality of customer accounts

The other reason why it is difficult to get accurate information is the confidentiality of customer accounts. Even if the cascade account structure problem is technically solved, the confidentiality problem arises next. There are self accounts and customer accounts as explained in II-2. We can identify, in our direct system, relatively easily whether an account held by an account management institution is a customer account or a self account. But detailed information on a customer necessary for compiling statistics is usually hard to obtain. It is partly because custodians or account management institutions are commonly required to keep the accounts confidential under contracts with customers, making them reluctant to provide customers' information.

In order to overcome the confidentiality problem, central banks or statistical authorities will need a contract with CSD or with custodians that states they will receive just aggregate data and will not share individual data. In the U.S., the Federal Reserve receives data from the CSD on a contract with a confidentiality clause that says it cannot share data of individual firms. From the statistical point of view, compilers do not need firm level information. They just need aggregate data classified according to institutional categories of holders of securities. Such data will not need to be security by security as far as they are correctly reported.

4.3. Cooperation with CSD and with securities related industry

The third factor is the cooperation with CSD and with securities-related industry. According to our survey, all of the four countries using CSD data (the U.S., Australia, Spain, and Chile) are confirmed to have a contract or an agreement with CSD in obtaining data, which implies securities-related industry agrees with the use of CSD data in principle. Germany goes further to have an official central bank regulation that stipulates mandatory data collection scheme. Therefore, it seems that there is general understanding for the statistical value of CSD data in the economy.

Also in Japan, it is understood that the development of financial and securities statistics is an important issue and will contribute to the growth of the securities market. Based on such understanding, a conference was held in late 2009, being Japan Securities Dealers Association as the bureau, with members of securities-related industry and with the Bank of Japan as an observer. Participants discussed that the availability of additional CSD data could increase understanding about securities market.

5. Concluding remark

This paper introduces the Bank of Japan's recent exploration of the CSD data as a statistical source of securities holders' information. The CSD in Japan has several features suitable for data collection; the one and only platform for book-entry, finality of ownership, and security by security nature. Through communication with the CSD, we have achieved statistical improvement in our flow of funds accounts statistics mainly for the market size; the ABCP and local government bonds, and we can expect further improvement by incorporating privately placed asset-backed securities to the CSD data next year.

While CSD data has a distinct advantage in data collection because of its electronically processed centralised system, there are things to overcome for the development of the data as a source of final holders. General challenges are to be a cascade structure of accounts, confidentiality of customer accounts, and cooperation with CSD and with securities-related industry.

Approaches to data gaps considered upon the recent financial crisis should relate closely to the possibility of developing a wider and more reliable source of information. Although there are many challenges, CSD data will continue to be a strong candidate to shed light on sectors such as households, non-financial corporations, or some other financial institutions.

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ANNEX

Chart : Accounts structure of the JASDEC

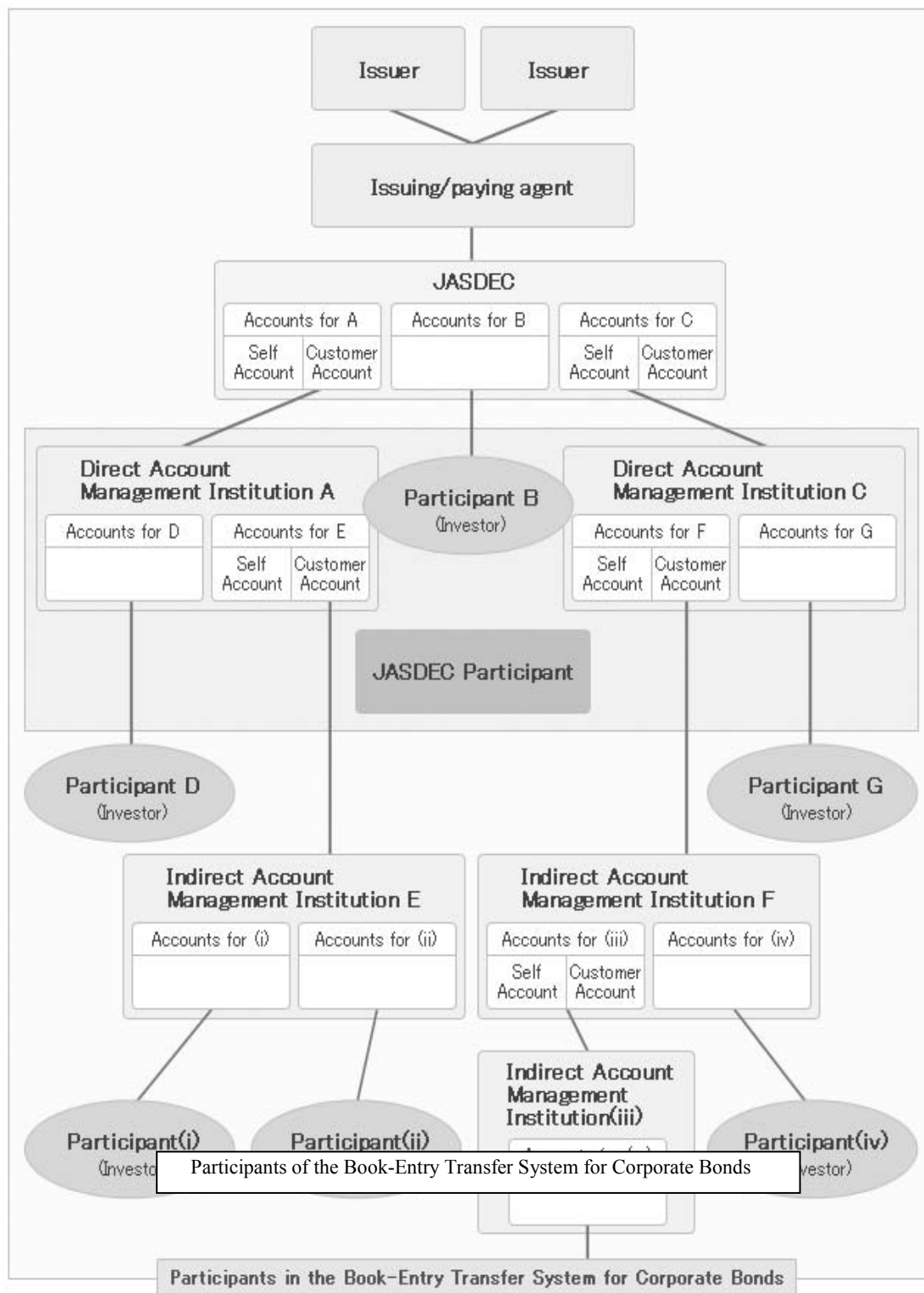


Table. CSD data usage in financial statistics

	Respondent	CSD				Data used other than CSD (i.e. custodians)
		Data usage	Holder's information	Coverage	Contract/agreement	
U.S.	Federal Reserve	○ 1)	×	Low (ABS) High (ABCP)	○	
U.K.	Bank of England	×	—	—	—	○ (London based issuing and paying agents)
Australia	Australian Bureau of Statistics	○	×	Low (voluntary registration)	○	○
Germany	Deutsche Bundesbank	○	△ (Not in all cases final holders)	Low	○	○
Spain	Banco de España	○	△ (debt securities issued by residents and held by non-residents)	Low (if between the non-resident and the CSD there is a resident custodian, it is the latter who declares.)	○	○ (custodians, used to identify the holdings of securities by Non-financial corporations and by Households.)
Chile	Banco Central de Chile	× → ○ 2)	— → ○	—	— → ○	
Japan	Bank of Japan	○	× → ○ (e.g. Local government bonds held by non-residents) 3)	High	×	×

Notes: 1) CSD data is used for bonds and stocks issued by non-financial corporate businesses along with other private vendor data. CSD data gives inadequate coverage for asset-backed bonds (probably less than 20 percent of the market), while CSD data on asset-backed CP is 100 percent of the market.

2) Currently, the Banco Central de Chile does not use the information given from the CSD for the compilation of yearly financial accounts statistics. Nevertheless, it is working in a pilot of quarterly financial accounts, where CSD data will be used intensively, including the securities holders' information.

3) It is identifiable by aggregating the amount of the tax exempt accounts which are specially allowed for non-residents. The figure is released by JASDEC.

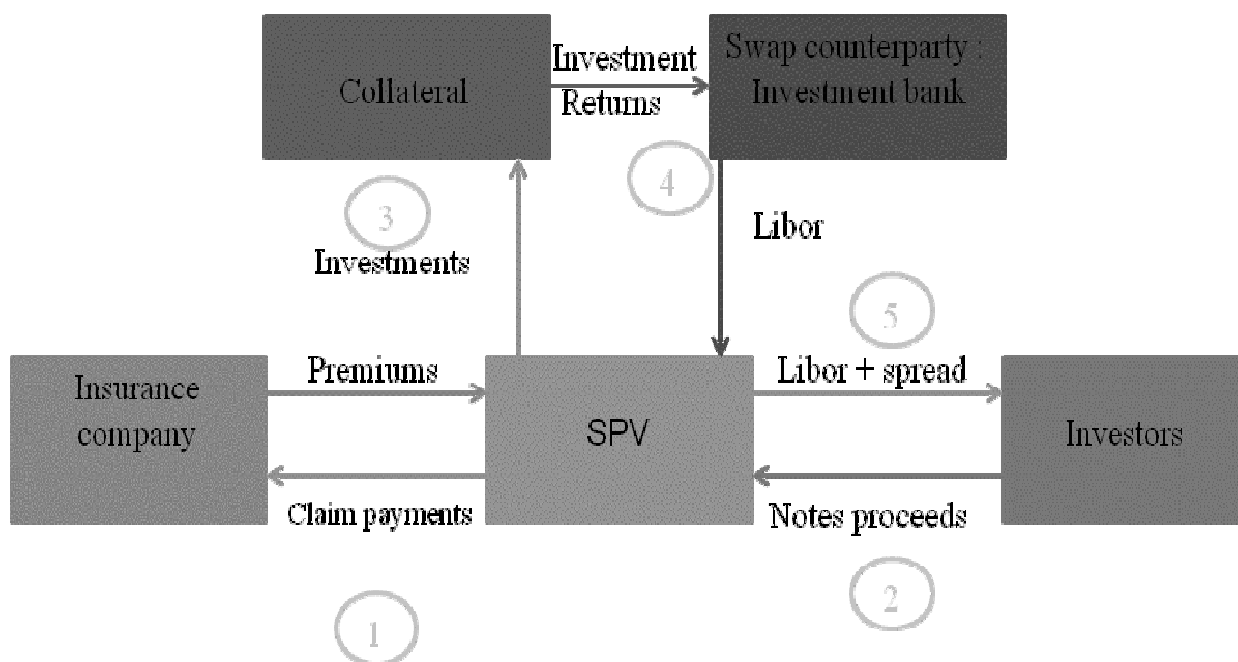
SECURITISATION OF INSURANCE-RELATED RISKS

*Dominique Durant and Omar Birouk
Bank of France*

1. Mechanics of Insurance-linked securities (ILS)

The Insurance-linked securities (ILS) are a means of selling insurance-related risks to the capital markets by using synthetic securitisation techniques.

- The selling insurance company enters into a financial contract with a Special Purpose Vehicle (SPV) where the former transfers premiums to the latter in exchange of claim payments (1)
- The SPV issues notes to investors in the capital markets (2)
- Proceeds from the notes are invested in high-quality securities and held in a collateral trust (3)
- Investment returns from the collateral are swapped to a LIBOR-based rate by the Swap Counterparty (4)
- Investors receive a stream of coupon payments that compensate them for the use of their funds (LIBOR) and their risk exposure (spread financed by the premiums) (5)



2. ILS Typology

ILS can be issued for two main purposes:

- a) To transfer Insurance risks to financial markets
- b) To finance insurance activities

2.1. ILS used as a risk transfer instrument :

- Include catastrophe bonds, life bonds linked to extreme mortality risk.
- Are alternatives to:
 - traditional reinsurance:
 - Risk carried by financial institutions while ILS transfer risk to financial markets.
 - Different types of risk sharing: proportional contracts, excess of loss contracts, stop loss contracts.
 - derivatives:
 - No financing while ILS provide upfront funding.
 - Example: Industry loss warranties (ILW) of which the pay off depends not only on the insured loss of the buyer but also on an industry loss index.

2.2. ILS used for their financing function

- Include life bonds linked to regulatory arbitrage (regulation XXX/AXXX in the US), life bonds used to finance payments in advance (fees to brokers) or receivables (future profits).
- Are an alternative to:
 - “Finite reinsurance” where only a limited amount of risk is transferred to the reinsurer,
 - “Side-cars” where investors finance a new fenced activity and obtain a return based on premium earned.

3. Regulatory perspective of ILS

3.1. Accounting treatment of ILS under IFRS and US GAAPs :

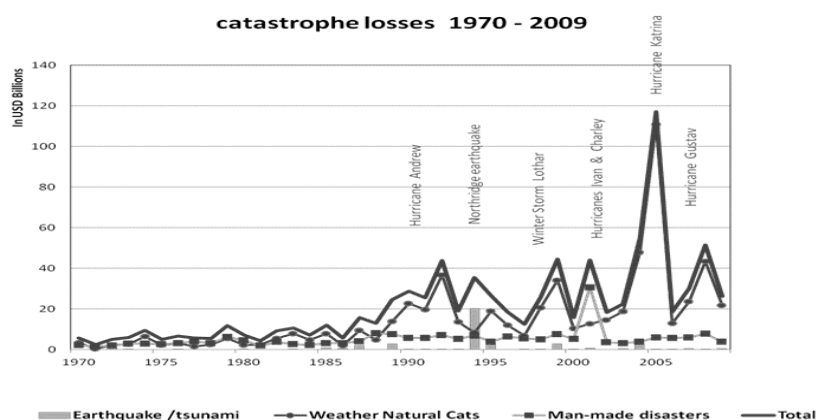
- Are treated as assets covering technical provisions:
 - ILS with indemnity based trigger, not with index trigger (IFRS 4).
- Are not treated as assets covering technical provisions:
 - Reinsurance contracts with insufficient risk transfer (finite reinsurance),
 - Derivatives (except ILW under US GAAPs since they have dual trigger: indemnity based-trigger and index trigger).

3.2. Solvency treatment of ILS:

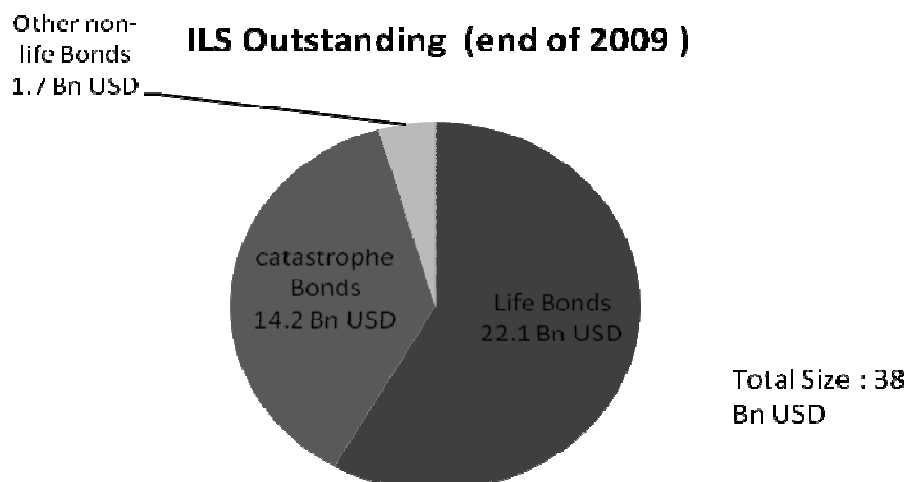
- Under Solvency I, claims against an SPV with its head office in the European union (EU) can be treated as assets covering technical provisions.
- Solvency II sets out a new framework supporting the development of ILS:
 - Stress on the economic transfer of risk, not on the nature of the risk transfer tool : securitisation, derivatives and reinsurance are equally eligible to cover technical provisions.

4. The ILS market at a glance

ILS were issued for the first time in the early 1990's while the reinsurance market reached its limits because of major natural catastrophes like Hurricane Andrew (1992) or earthquakes in California (1994). At inception, they were Cat bonds.

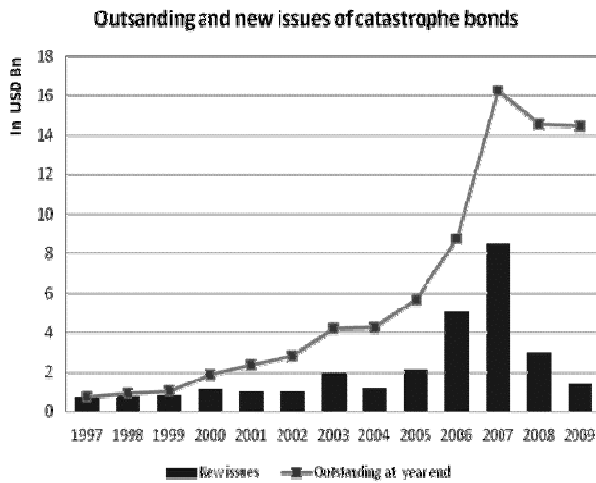


- The ILS Market with an outstanding of USD 38 billion is very small compared to the credit securitisation market and represents only 1% of all securitisation business.
- The ILS outstanding are composed essentially of life bonds (mainly financing instruments) because of their long maturity.

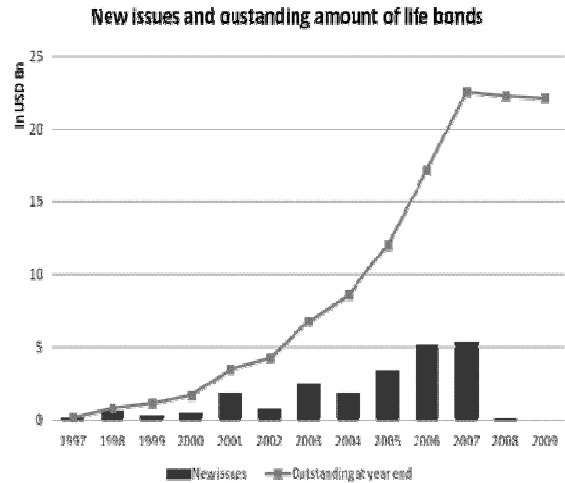


4.1. Life Bonds

- Cat Bonds are issued for their risk transfer function.
- There were still issues in 2009.
- Life Bonds have mainly financing function.
- No issues in 2009 due to liquidity shortage.



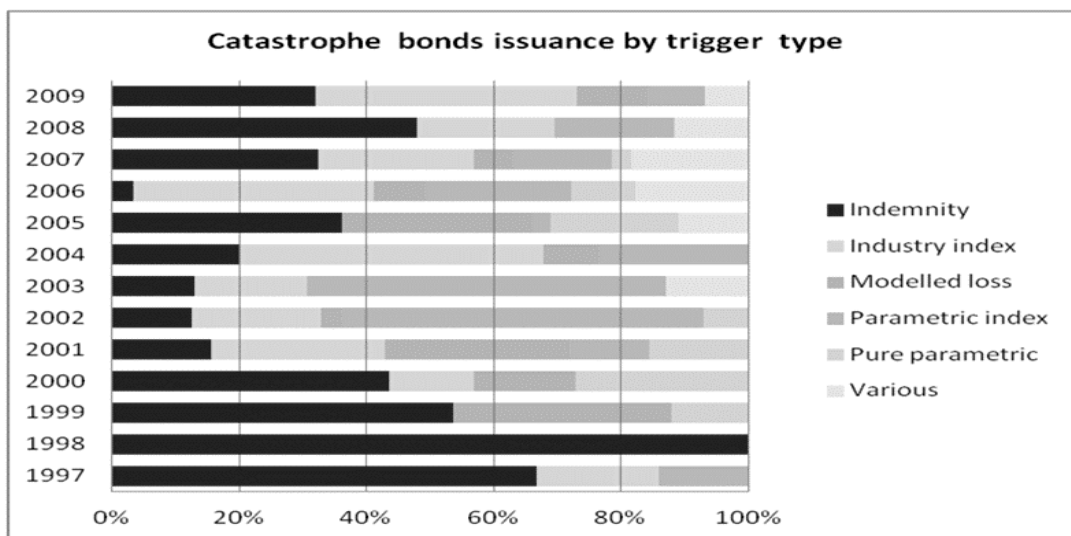
Source: Aon



Source: Munich Re

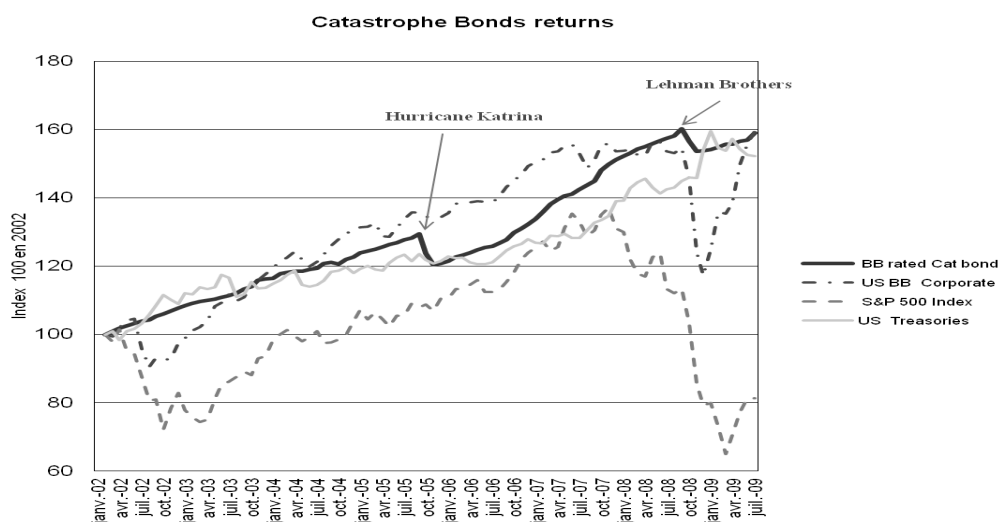
4.2. Non-life Bonds

- Cat Bonds with indemnity trigger are considered as reinsurance contracts.
- They represent only 32% of the total issuance in 2009.

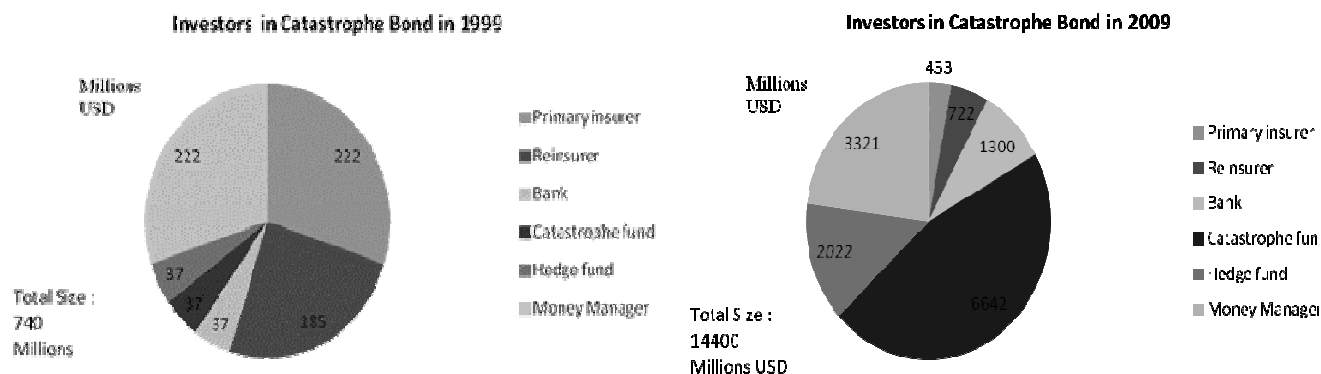


5. ILS from investors' point of view

- Investors are interested essentially in Cat Bonds which show an exceptional risk/return profile and are weakly correlated with other financial assets.
- However, for insurers and reinsurers, holding cat bonds may increase the risk as asset and liability may be correlated.

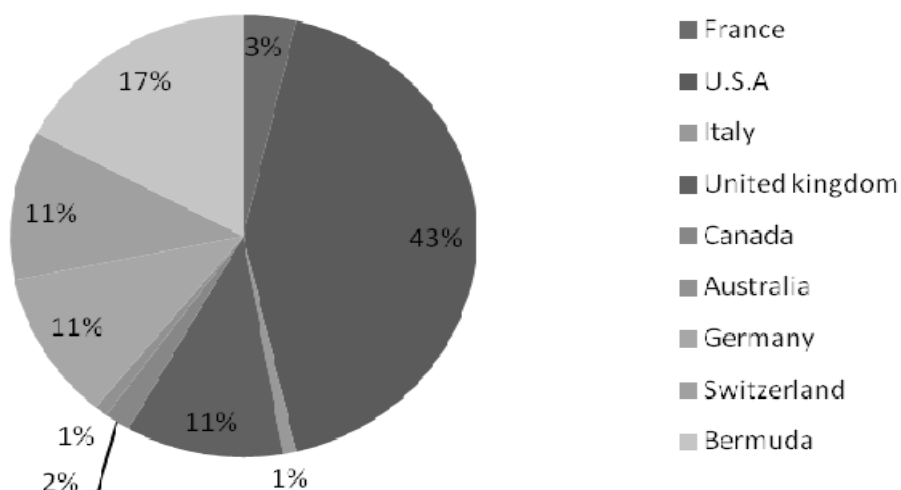


- Primary Insurers and Reinsurers were the largest investors in Cat Bonds in 1999.
- In 2009, Catastrophe Funds hold 46% of the total outstanding.



- Investors in Cat Bonds are essentially located in the United States.
- Bermuda's investors represent 17% of the total outstanding for tax reasons.

Investors By contry in Cat Bonds in 2009



6. Insurance securitisation in OECD countries

- Most of the operations are located in the US.
- In Europe, insurance securitisation operations were observed in the UK (cat bonds, mortality bonds), France, Ireland, and Luxembourg.
- Cross-border initiatives: Axa securitisation of mortality risk in Ireland (Osiris plc), Irish life insurance ceding risk to a SPV in Luxembourg (Avondale).
- No specific regulation in Europe for insurance securitisation, except in France.

7. Insurance securitisation in France

- In France, according to the 13 June 2008 law, a SPV can buy Insurance risks.
- 3 SPVs holding insurance risk had been created under the previous French law:
 - FCC Sparc (€ 200 million): created in 2005 and closed in 2009, dealt with the securitisation by AXA of its French automobile risk.
 - 2 FCC securitising the same underlying portfolio: Europe Sparc Senior (€ 411 million) and Europe Sparc Junior (€ 115 million) were created in 2007 to deal with the securitisation by AXA of its pan-European automobile risk.

FCC Sparc Senior & Junior Balance Sheet as at end 2009

<i>Assets</i>		<i>Liabilities</i>	
Deposits in resident IFM : 597.42 M€		Debt securities > 2 years : 597.64 M€	
Debt securities < 1 year issued by resident IFM : 5.33 M€		Other liabilities : 4.38 M€	
		Cash deposits : 0.73 M€	
Total	: 602.75 M€	Total	: 602.75 M€

8. Insurance securitisation in ECB statistics

- ECB regulation 24/2009 on statistics on securitisation vehicles defines securitisation in a way that may exclude insurance securitisation from the scope of the reporting (art.1. paragraph 2):
 - Synthetic securitisation is included only for credit risk
- This may impede collection of data on a still (very) limited but potentially increasing activity. However, many countries may also collect data for the implementation of ECB regulation on the basis of national law for SPVs.
- This is not consistent with the development of statistics on insurance corporations (ITIP statistics) and for macro-prudential analysis.
- Where such financial intermediaries should be classified in national accounts if they are not Financial Vehicle Corporations (FVCs)?
- This may create gaps in the identification of holders of bank deposits as these entities may invest in such deposits.

THIRD PART

**INTEGRATING THE INFORMATION COLLECTED INTO THE FINANCIAL ACCOUNTS
AND OTHER STATISTICS**

THE EFFECT OF FAS 166/167 ON THE UNITED STATES FINANCIAL ACCOUNTS

Susan Hume McIntosh and James Kennedy
Board of Governors of the Federal Reserve System

The views in this presentation are those of the authors; they do not indicate concurrence by other members of the Federal Reserve's staff or of the Board of Governors.

On June 12, 2009, the U.S. Financial Accounting Standards Board (FASB) published Financial Accounting Statements No. 166, *Accounting for Transfers of Financial Assets*, and No. 167, *Amendments to FASB Interpretation No. 46 (R)*, which changed the way entities account for securitisations and special purpose entities. Work on these accounting issues has been going on for the past decade. However, given the tumultuous market conditions in recent years FASB received requests from investors, the Securities and Exchange Commission (SEC), and The President's Working Group on Financial Markets to address the issue of special-purpose entities (SPEs) and publish new standards.

Robert Herz, chairperson of the FASB described the necessity of the new standards in this statement:

“These changes were proposed and considered to improve existing standards and to address concerns about companies who were stretching the use of off-balance sheet entities to the detriment of investors. The new standards eliminate existing exceptions, strengthen the standards relating to securitisations and special-purpose entities, and enhance disclosure requirements. They'll provide better transparency for investors about a company's activities and risks in these areas”.

The outline of our presentation is as follows:

First, we provide an overview of the growth of the securitisation market in the U.S. over the last forty years. Second, we describe briefly what FAS 166 and 167 require financial institutions to report on their balance sheets. Third, we quantify the effects of these new standards on data reported for various financial sectors in the first quarter 2010 Flow of Funds Accounts of the United States. Fourth, we discuss some of the data issues we are dealing with because of FAS 166/167. Finally, we present future challenges for financial account compilers due to a changing accounting landscape.

1. Overview of the Securitisation Market in the United States

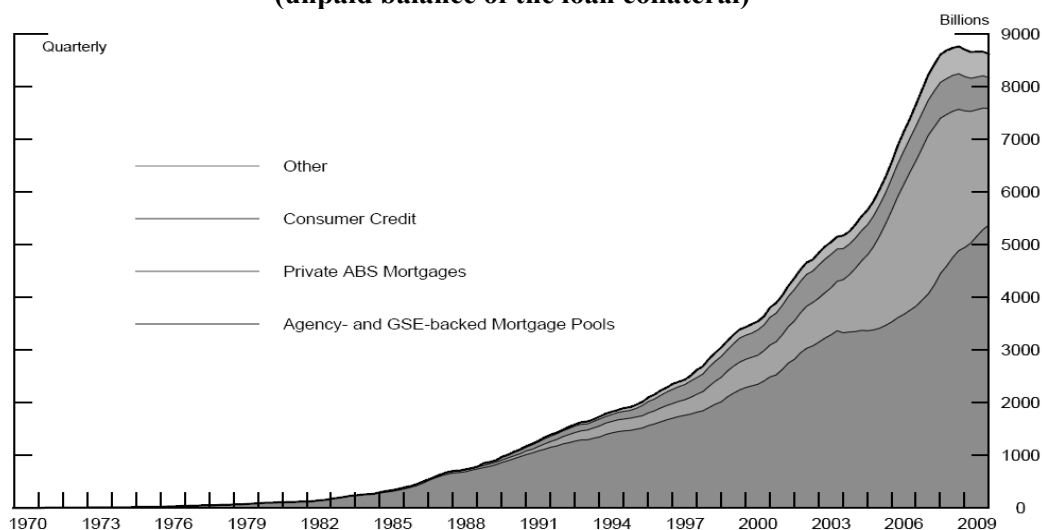
First, it is important to define the various types of asset-backed securities (ABS).

- Agency- and GSE-backed mortgage pools include Ginnie Mae securities (which comprise mortgages guaranteed by the Federal Housing Administration (FHA) and the Veterans Administration) and pools guaranteed by Fannie Mae and Freddie Mac. Single-family homes are the collateral for almost all of the mortgages in these pools.
- Private ABS mortgages are backed largely by single-family first liens; some closed-end junior liens and home equity lines of credit also are securitised. The first liens are usually subprime (that is, the borrower's credit rating is low), Alt-A (which includes loans with little documentation), or jumbo

mortgages (loans too large to be purchased by the GSEs, whose limit is currently \$625,000 in high-end markets). Also included are multi-family and commercial mortgage-backed securities.

- Securitised consumer credit; for example, credit card debt, auto loans, and student loans.
- Other primarily consists of trade credit (for example, securitisation of royalties).

Securitisation Market in the United States (unpaid balance of the loan collateral)



Source: Flow of Funds Accounts published March 11, 2010

Through the mid-1980s, virtually all of the securitised assets in the U.S. were agency- or GSE-backed mortgage pools. With the rise of private securitisation, that share fell to 80 percent in 1990, and less than 50 percent in 2006. The agency- and GSE-share moved back up to a little over 60 percent at the end of 2009.

Private ABS securitisations doubled their share of the market from around 25 percent in 1993 to 52 percent in 2006. For the past few years, private ABS issuance has been almost nonexistent and foreclosures have resulted in substantial charge-offs. As a result, the outstanding balance of private ABS has declined, and its share of the market has fallen to under 40 percent.

For mortgage loans of all property types, both securitised loans and those held on-balance sheets, mortgage debt declined about 1-1/2 percent in 2008 and 2009. The sharpest decline has been in private MBS backed by single-family homes, which fell almost \$650 billion, or about 30 percent over those years. Securitised consumer credit declined about 15 percent 45 percent.

However, this was more than offset by an increase in the outstanding balance of Ginnie Mae, Fannie Mae, and Freddie Mac pools, underscoring the important role the federal government has played in the mortgage market during the recent crisis.

2. Description of the New Accounting Rules and changes in requirements

2.1. Description of FAS 166 and FAS 167

The new accounting rules are from the Financial Accounting Standards Board (FASB or FAS): FAS 166 and 167 change the way financial institutions account for securitisations and special purpose entities (SPEs). SPEs are bankruptcy-remote entities.

- FAS 166 considers whether to treat securitisations and other transfers of financial assets as sales or financings. It effectively eliminates special purpose entities (SPEs) that previously had been used to securitise assets and move them off balance sheet.
- FAS 167 governs the consolidation of SPEs. It addresses whether certain legal vehicles often used in securitisation and other structured-finance transactions should be included in the consolidated financial statement of a financial institution with an interest in the securitisation. In other words, FAS 167 provides standards to determine whether a company may securitise assets and moved them off its balance sheet.

Previously, financial institutions used SPEs to account for most of their securitisations, allowing them to move assets off balance sheet. The consolidation of SPEs used to move assets off balance sheet means that the assets in the SPE move back onto balance sheets as if they had never been de-consolidated at all.

The standards take affect for reporting periods beginning after November 15, 2009; for most financial institutions, this is 2010:Q1. Fannie Mae and Freddie Mac consolidated all their single-family mortgage pools at the beginning of 2010. Pools of FHA and VA loans guaranteed by Ginnie Mae are not required to consolidate.

2.2. Changes Under the New Accounting Standards

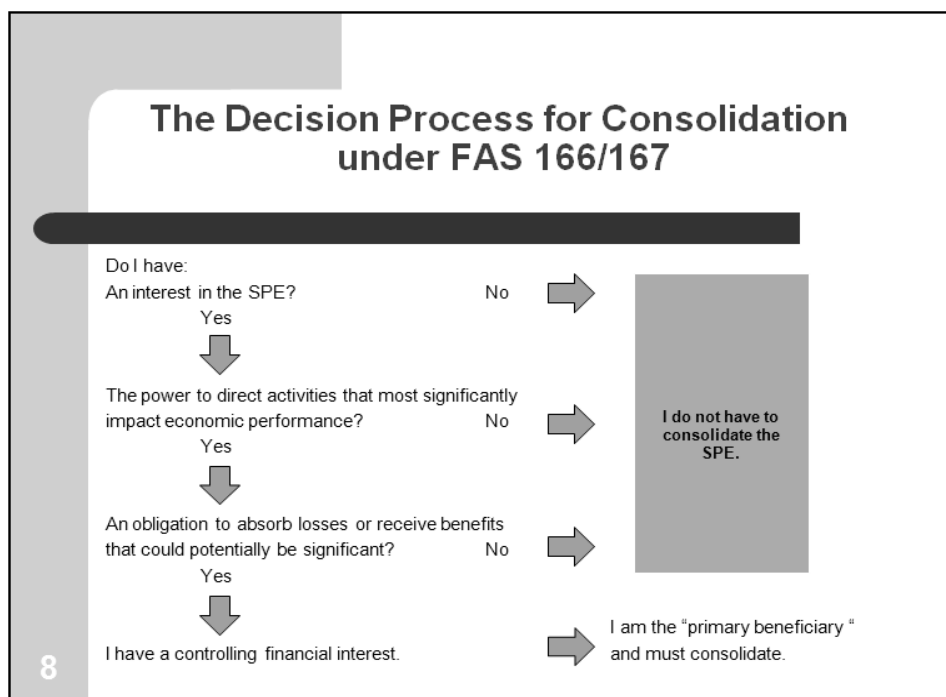
Prior to 2010, most securitisations in the U.S. were structured as SPEs and treated as “true sales” for GAAP purposes. A sponsor’s balance sheet showed only a portion of the fair market value of the loans in the SPE. For example, the sponsor usually retained a residual interest or an equity tranche in the deal. In addition, the sponsor would record the fair value of the servicing rights as an intangible asset on its balance sheet if it retained the servicing rights. The sponsor also might purchase some of the bonds used to finance the SPE.

Under the new standards, entities with an interest in an SPE must determine whether they are the “primary beneficiary.” The “primary beneficiary” will now be required to “gross up” its balance sheet and include the underlying securitised assets, not just its proportionate interest, on the asset side, and include the securitised debt as liabilities. The expectation is that only one entity, if any, will be the “primary beneficiary” of each SPE. For financial institutions, the types of vehicles affected include (1) SPEs associated with asset-backed commercial paper (ABCP) programs, (2) master trust revolving securitisations, including credit card and home equity lines of credit, and (3) mortgage loan securitisations.

Banking organisations affected by the new accounting standards generally will be subject to higher risk-based regulatory capital requirements. The regulatory agencies announced at the beginning of 2010 a two-quarter implementation delay, followed by an optional two-quarter partial implementation, of the effect on risk-weighted assets that will result from FAS 166/167.

As indicated in the diagram below, under the new standards: if a financial institution has an interest in an SPE and meets both of the following characteristics then it must consolidate:

1. The power to direct the activities that most significantly impact the entity's economic performance, and
2. The right to receive benefits or absorb losses that are significant to the entity.



Who has the power? Power is the ability to direct the activities of an SPE that have the greatest potential impact on its economic performance. For example, in the case of residential mortgage-backed securities the activity that is most important in determining the performance of the assets is typically the servicer's ability to manage delinquencies and defaults.

Who receives the benefits or absorbs the losses? The standard that has developed seems to be that if a financial institution has an interest of less than five percent, it does not meet the "significant benefits" criterion; if it has an interest greater than ten percent, it does meet the criterion. Between five and ten percent is a grey area.

3. The Effects of the New Accounting Standards on the Flow of Funds Accounts

As shown in the first line of the table below, banks and finance companies consolidated about 60 percent of their securitised consumer credit, but less than 2 percent of their securitised mortgage debt (second line) at the beginning of 2010. Typically, servicers actively manage SPEs comprised of credit card debt; as individual accounts are paid down, new accounts are added to the pool. Home equity lines of credit (included in mortgages) also are managed actively. These types of securitisations meet the "power" criterion, mentioned above, as a necessary condition for consolidation.

Effects of FAS 166/167 on Banks and Finance Companies in 2010:Q1

Effects of FAS 166/167 on Banks and Finance Companies in 2010:Q1				
	Banks	Finance Companies	Issuers of ABS	
	Shifts	Shifts	Shifts	Level 2009:Q4
Assets:				
Consumer credit	322.1	27.1	-349.2	579.4
Mortgages	28.0	3.7	-31.7	2215.6
C&I loans	35.4	11.2	-46.6	345.4
Liabilities:				
Commercial paper	132.5	0	-132.5	292.5
Corporate bonds	253.0	42.0	-295.0	3103.8
Billions of U.S. dollars				

By contrast, servicers almost never actively manage SPEs comprised of fixed-term loans, such as thirty-year mortgages, closed-end home equity loans, commercial mortgages, auto loans, and student loans. As the outstanding balance of the loans in those types of pools shrinks, the servicer does not add new loans to the pool.

Turning to the GSEs, Fannie Mae and Freddie Mac purchase residential mortgages, pool them, and provide a guarantee to investors. At the end of 2009, the unpaid balance of their outstanding pools totaled about \$4.2 trillion. All of their single-family mortgage pools, and the GSE-issued debt used to finance them, moved onto their balance sheets in the first quarter.

Effects of FAS 166/167 on GSEs in 2010:Q1

Effects of FAS 166/167 on GSEs in 2010:Q1			
	GSEs	Agency- and GSE-backed Pools	
	Shifts	Shifts	Level 2009:Q4
Assets:			
Agency- & GSE-backed securities	-475.1	--	924.9
Mortgages	4212.9	-4212.9	5383.0
Liabilities:			
Agency issues	3738.0	-4212.9	5383.0
Billions of U.S. dollars			

Although Fannie Mae and Freddie Mac do not service their pools, they exert substantial control over their activities; for example, they can decide when to remove troubled loans from the pool or can help cure loans that are delinquent or in foreclosure. They also receive benefits and, as we have seen during the past few years, take substantial losses owing to their guarantee. For these reasons, Fannie Mae and Freddie Mac concluded they were the “primary beneficiaries” of their SPEs and that they must consolidate.

Fannie Mae and Freddie Mac used to hold some interests in their own pools as assets on their balance sheets (the “Agency- & GSE-backed securities” line in the table below). Upon consolidation of their pools, they removed these interests from the asset side of their balance sheet, matched by a reduction of an equal amount in outstanding agency issues on the liability side.

As mentioned earlier, Ginnie Mae is exempt from FAS 166/167 and did not consolidate its \$1.2 trillion agency pools.

4. Data Issues deriving from FAS 166 and FAS 167

Beginning in 2010, regulatory reports filed by depositories showed loans moved from SPEs onto the balance sheets of depositories. Regulatory reports files by depositories have comprehensive coverage; by contrast, we only have partial source data for the non-agency MBS sector in the Flow of Funds Accounts. Thus, the shift of loans and securities from the ABS sector to depositories should improve the accuracy of the Flow of Funds accounts.

Moreover, because the household sector is the residual sector for many instrument categories in the accounts, we should be better able to measure household net worth.

However, this benefit comes with some complications. First, the source data we use to estimate loans held by the private MBS sector do not distinguish between loans held on- or off-balance sheet. We have incorporated judgmental adjustments in order to avoid double counting loans moved back onto balance sheets in the private MBS sector.

Second, we have had some difficulty in matching the instrument categories to make the adjustments. For example, the regulatory reports lump commercial paper and corporate bonds together on the liability side, while in the ABS sector reports these items separately. We have had to dig into micro data in order to split the adjustment to the ABS sector liabilities between commercial paper and corporate bonds.

5. Challenges Posed by the New Accounting Rules

In general, entities that move assets back onto their balance sheets most likely will have to hold additional capital since capital requirements are greater for assets on-balance sheet than those in an off-balance sheet SPE. However, for a number of reasons, the assets moved onto balance sheets in the first quarter do not appear to have lowered capital ratios for the largest banks sufficiently to require them to raise additional capital. One reason is that, as mentioned earlier, few mortgages were consolidated. A second reason is that at the end of 2009 most banks had substantial excess reserves.

Looking ahead, it will be interesting to see whether FAS 166/167 will limit future securitisations by private firms. However, even as we study the effects of those standards, changes to laws or new rulings may be coming soon.

The U.S. Congress is working on “financial reform” legislation, and the current bills in both the Senate and the House contain provisions that pertain to securitisation. In addition, both the SEC and the FDIC are considering new rulings on securitisations.

Due to the uncertainty of what the final laws and rulings will be, the future of securitisation in the U.S. is hard to predict.

6. Conclusion: final thoughts

A few final thoughts: FAS 166/167 should improve the accuracy of the Flow of Funds Accounts by providing us with a more complete reading of securitised loans moved back onto balance sheets.

In addition, as stated before, we should have a better measure of the household balance sheet and net worth, given the residual nature of the estimates of many of its asset and liability categories.

Moreover, it is possible that there will be future adjustments to FAS 166 and 167 in order to move more assets onto balance sheets. Note that there has been a string of precedents to provide increased transparency: new accounting rules dealing with securitisation were issued in 1996, 2000, and 2003. For example, the 2003 ruling, FIN 46, dealt with the obfuscations that led to the meltdown of Enron. This history of regulatory actions and reactions underscores the complexity of the issues.

Looking ahead, both the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are working together to bring their rules for derecognition and consolidation into alignment. For this reason, as well as those mentioned previously, changes to the U.S. rules could be on the horizon.

SECURITISATION AND THE EURO AREA ACCOUNTS, THE INSTITUTIONAL SECTOR FRAMEWORK TO FINANCING

*Andreas Hertkorn
European Central Bank*

Overview

Part I: EAA – full presentation of non-MFI financing

- Full coverage of financing and investment
- Coverage of all financial intermediaries
- Consistent presentation of security and loan markets

Part II: EAA and the financial crisis

- Securitisation not related with origination of new loans
- Difficulties to reconcile security issues and purchases

Part III: Integration of new statistics into the EAA

- Securitisation (FVC) statistics, Security holding statistics (SHS)
 - Who is financing whom – counterpart sector matrixes?

1. Full presentation of non-MFI financing

1.1. Introduction

- **EAA are a complete set of financial accounts and non-financial accounts by institutional sector**
- **Early main use of financial accounts: non-MFI financing to Households (HH) and Non-financial corporations (NFCs):**
 Since 2003: financing of HHs and NFCs from non-MFIs: loans from Other Financial Intermediaries (OFIs) and Rest of the World (RoW)
- **Since 2007: Full coverage of financing and investment of all sectors:**
 - Comprehensive and consistent presentation of **intermediated financing** (loans), **security markets** (debt securities and shares) and **other financing** (e.g. other equity and, accounts payable/trade credits):
 Loans granted (by MFIs, OFIs, Row ...) = Loans received (HHs, NFCs...)
 Securities issues (by MFIs, OFIs, Government...) = Sec. purchases (HHs, RoW...)

1.2. Challenges

- **Full, consistent coverage of non-MFI financial intermediaries and interactions with the Rest of the World proved difficult**
- **Other financial intermediaries sector is heterogenous**
Other corporations engaged in lending (financial leasing). investment funds, financial holdings/subsidiaries, special purpose vehicles (SPEs)‘ ...
- **Accounting treatment of SPEs differs between countries**
 - Consolidation with MFIs?
 - Coverage of non-resident units?

1.3. Analytical needs

Available information (e.g. metadata from countries):

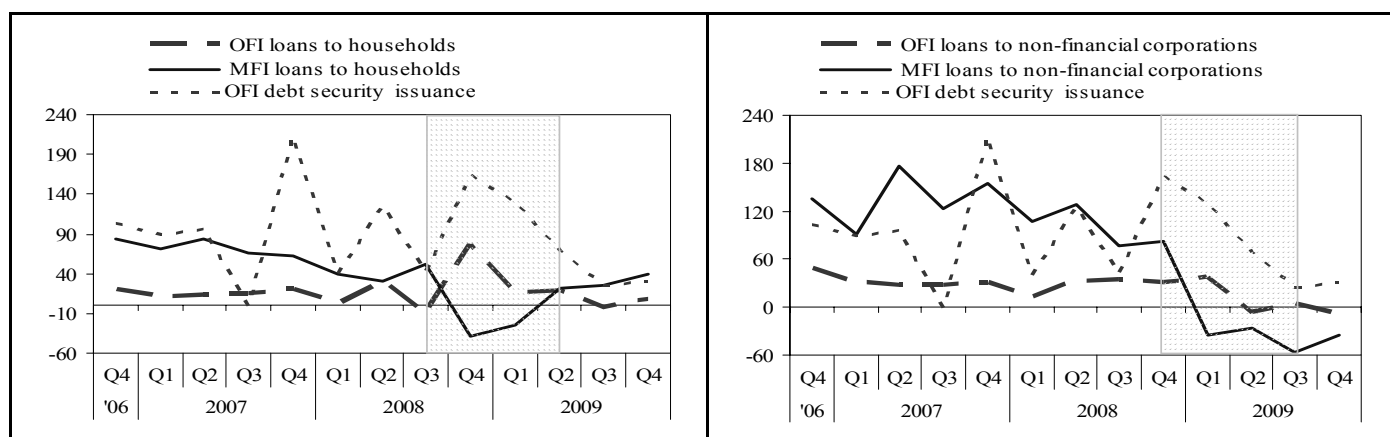
- **Developments in OFI financing to HHs driven by**
 - Financial Vehicle Corporations engaged in securitisation (FVCs) (securitisation of mortgage loans to households)
- **Developments in OFI financing to NFCs driven by**
 - Financial subsidiaries (issuing debt securities on behalf of NFCs) and
 - Financial Vehicle Corporations engaged in securitisation (FVCs)
- **Large off-balance sheet activities of MFIs**
 - **Increased user interest in FVCs**
 - **Reporting requirements for FVC coordinated with enhanced reporting requirements for MFIs (integrated reporting approach)**

2. EAA and the financial crisis

2.1. NFS financing

Decline in MFI loans in 2008q3/09q2 partly offset by OFI loans

**Loans to the private non-financial sectors
Quarterly transactions (EUR bn)**



- **OFI loans not due to real economic activity/new loan origination**
- **Securitisation of old MFI loans**
- **But who purchases FVC's security issues?**

2.2. Debt securities

EAA's complete presentation of financial markets became increasingly difficult for debt securities: Initial imbalances between debt security issues and purchases

Average absolute imbalances for transactions (EUR bn)

	Initial imbalances for debt securities	
	Short-term debt securities	Long-term debt securities
1999Q1-2006Q4	19	18
2007Q1-2009Q3	39	38

Largely due to different treatment of retained securitisation

- Recording of security issues by FVCs
- Non-recording of security purchases by MFIs (in some countries before harmonisation of MFI BSI statistics)

2.3. Record of ABS

If MFIs retain (large parts of) ABS issued by FVC

- IFRS: - no de-recognition of loans in MFI balance sheet
 - Proceeds of securitisation recorded as deposits
 - ⇒ No recording of ABS holdings by MFI

Opening Balance-Sheet						
	MFI			OFI		
	Assets		Liabilities	Assets		Liabilities
<i>Loan to be sold</i>	10	AF4				
Transactions						
	MFI			OFI		
	Assets		Liabilities	Assets		Liabilities
<i>Proceeds from the securitisation</i>	10	F2				
<i>Financing from SPV</i>		F2	10	10	F2	
					F33	10
						<i>Financing to MFI</i>
						<i>Financing through debt securities</i>
Closing Balance-Sheet						
	MFI			OFI		
	Assets		Liabilities	Assets		Liabilities
<i>The loans is still on balance-sheet</i>	10	AF4				
<i>Proceeds from the securitisation</i>	10	F2				
<i>Financing from SPV</i>		F2	10	10	AF2	
					AF33	10
						<i>Financing to MFI</i>
						<i>Financing through debt securities</i>

➤ **lessons**

➤ **Increased data needs for monetary/financial, economic and financial stability analysis**

- Financial links between sectors – who is financing whom? How is the risk distributed? Who bears holding losses?
 - ⇒ EAA: counterpart sector information for loans
 - ⇒ EAA: holding losses/gains for securities
 - ⇒ **Securitisation: integrated reporting of MFIs and FVC engaged in securitisation**
 - ⇒ Development of counterpart sector information for securities: Security holding statistics (SHS)

➤ **Need for harmonised and comprehensive coverage of securitisation**

- ⇒ **BSI regulation: harmonised treatment of securitisation**
- ⇒ **FVC regulation**
- ⇒ **New ESA:**
 - Description of securitisation
 - FVCs explicitly part of OFI sector

Important for the compilation of EAA using national financial accounts:

FVCs are separate institutional units irrespective of whether set-up domestically or in other member state

3. Integration of new statistics into the EAA

- New integrated MFI/FVC reporting of securitisation will increase coverage, consistency and detail for OFIs:
 - Consistent recording of domestic and cross border securitisation
 - Consistent recording of (de-recognised) loans and securities
- Counterpart sector information for loans needs to be complemented by counterpart sector detail on securities

This will then allow answering questions like

- Which sector holds what kind of securities issued by FVCs backed by loans to households?
- How are holding losses by sectors matched by their capital?

SESSION 3

ROUNDTABLE TO DISCUSS THE MAIN TOPICS

ROUNDTABLE TO DISCUSS THE MAIN TOPICS DRAWING THE SUMMARY AND CONCLUSIONS FROM IT

The last part of the Workshop consisted of a roundtable on specific questions addressed to four participants: *Allan Thomas* (Statistics Canada); *Jochen Henn* (Deutsche Bundesbank); *José María Cartas* (IMF) and *Stephen Lumpkin* (OECD).

A. Need to harmonise terms regarding operations, agents and practices. Should any international organisation take the lead on this?

Is there a need to harmonise terms?

According to *Allan Thomas*, the data must be comparable in order to be relevant. By increasing comparability and relevance the quality of the information will be enhanced. The Workshop clearly showed that there is a strong need to harmonise definitions and terms regarding operations, parties and agencies involved in common and specific kinds of securitisation. Terms do not always mean the same. However there are many similarities on which we can build amongst all the countries here, for example, residential and commercial mortgage backed security programs.

According to *Stephen Lumpkin*, there are two motives for securitisation: (i) transforming the risk, and (ii) financing. It is done through an entity that is managed or passive and it is not complicated in this sense. The accounting profession has taken the view of the investors in the OECD area while statisticians try to compile the data to some level of aggregation or disaggregation.

It is also clear for *Jochen Henn* that the discussion showed the need for a clarification of concepts and that the common understanding should be enhanced. For instance we could come up with guidance with a set of clear examples.

Regarding this aspect *José María Cartas* said that the Handbook on securitisation is an example of how different international organisations come to a common ground and make progress. The Handbook goes beyond securitisation. That is also a good example to have common language between different parties.

Allan Thomas expressed that any work done on harmonisation will provide more details to users related to the methodology and documentation. It will also enhance the research with the goal to promote a better functioning of the global financial system and overall global stability both domestically and internationally.

According to *Jochen Henn*, there is a need for more transparency and more information and we have to keep a good balance between benefits and costs. *José María Cartas* also expressed that is necessary to do a cost-benefit analysis because it will affect the industry. There is a cost for the reporters, cost for the compilers and sometimes too much information is not useful. When lot of information is provided, it becomes difficult to compare.

Finally, according to *Stephen Lumpkin*, harmonisation does not mean doing the same thing but having practises being close enough in order to be meaningful.

Should any international organisation take the lead on this?

According to *José Maria Cartas*, it is preferable to talk about coordination between international organisations rather than to have one organisation taking the lead. Here, he referred to the example of the Handbook on securities.

According to *Allan Thomas*, work relating to international frameworks needs to be captured, such as the international standards SNA 2008, BPM6, the upcoming ESA and the BIS-IMF-ECB Handbook on securities. The ECB noted the importance of monitoring the securitisation process itself and its impact on the creation of money and credit. It also noted the importance of having information on funding the expansion of credits and of understanding the interrelations and functioning of capital markets. The ECB new statistical framework can serve as part of the basis for harmonisation of terms and operations. A lot of excellent work has been done. *Jochen Henn* expressed the same views.

B. Need to have harmonised legislation or at least a certain common methodology and uniform dissemination of statistics

Allan Thomas wondered whether all the countries can break down the data within their macroeconomic statistics to get information on Covered Bonds (CB). So there is the topic of structured CB and it is pretty challenging to harmonise the definition.

According to him, there is a need to have harmonised legislation, at least a certain common methodology and uniform dissemination of statistics. In term of legislation, it is best left to regulators of each individual country. It will be important to have harmonised accounting rules. Here we are talking about IFRS and FAS in the US. Canada has moved to IFRS and the goal is to have IFRS and FAS in line. We will have harmonised accounting rules and also harmonised surveys such as the coordinated portfolio and investment surveys used for the balance payment purposes. According to him, we need to harmonise the rules in place to ensure international comparability of the statistics in order for them to be as relevant as possible.

Jochen Henn qualified the requirements of harmonisation, saying that cross-country comparability is important but enough room for flexibility for national practices should still remain.

On the dissemination of statistics, *Allan Thomas* explained that we have to try to take into account stocks and flows, cross border transactions and positions as well as considering activity within the institutional sectors.

The goal and objective to meet the need of harmonisation will be challenging because of a multitude of users of financial statistical data. There are many users such as tax men, insolvency lawyers, regulators, rating agencies, economists, academic, who all are looking for a lot of different things. One of the specific uses is the macroeconomic accounts including those accounts that monitor the mechanisms and in relation to the financing of economic activities which are the financial accounts and the balance sheets.

José Maria Cartas added that three levels of data are needed:

- Market participants: information on credit risk and market risk.
- Monetary statistics: information on the credit and the money.
- Financial accounts: information on who is financing whom and it is more demanding than for monetary statistics.

According to *Allan Thomas*, the presentations of the Workshop noted the importance of bringing the demand and supply views together when looking at the ABS market. That is what financial accounts do in macro-context. There is also the use of academic micro-research and for that, it will be a challenge to look

to the effect of secured security. For example some countries have a lot of mortgage security programs such as the US and Canada.

Right now, there are some issues around the margin determining whether some vehicles are inside or outside the FVC definition. Covered Bonds are a part of the Handbook on securities but they are not a part of the ECB regulation. There is a new topic to meet the differences between the two sources here. The wider issue of credit risk transfer is also important. It is possible to track each micro loan with the modern technological advances, but how to process this large amount of data?

Stephen Lumpkin stated that the ECB is trying to track a certain exposure and certain risks. It is important to have information on these risks. All these views have to overlap where they can overlap.

According to *Jochen Henn*, the discussion showed that there is a need for a clarification of concepts and that the common understanding should be enhanced. We could, for instance, come up with guidance giving examples. When we talk about harmonisation, cross-country comparability is important but enough room for flexibility for national practices should remain.

C. Need to exchange information among countries, in particular regarding difficulties met to collect information, and how this exchange of information could take place (Bilaterally? Through International Organisations? Such as the ECB for the EU countries, another IO for other OECD countries?)

On the question of what elements are contained in the exchange of information, *Allan Thomas* thinks that the OECD proposal of a new financial subsector would be efficient when collecting data.

Jochen Henn added that we have to distinguish between experience and data. The exchange of experience is essential and can be done bilaterally as well as in international fora (like the WPFS). The exchange of data is less clear-cut. In case of the euro area, it also depends on the decisions taken in ESCB committees and working groups on the publication of the MFI securitisation data and FVC statistics. According to *Allan Thomas* electronic discussion group may be beneficial. We have to develop a way to exchange the examples that we have seen.

According to *Stephen Lumpkin*, the difficulty of reporting comes from the linkage between entities, the tracking of which is going to demand some effort. In national accounts and financial accounts, we are trying to track certain concepts. Each transaction that involves a financial obligation should fit into the financial accounts in some way. Being micro prudential regulator or macro prudential overseer, there is a need for information contained within the accounts.

According to *Allan Thomas*, there is the issue of capturing non-publically rated securitisation and he wonders whether all countries face similar challenges. The ECB noted that it was interesting to have requirement of self identification.

In Canada, there is not a specific requirement. They focus more on banks or on securitisation entities and therefore, it is less obvious to have requirements in place. Synthetic structures are very complex to most investors and economists and also for the statisticians, especially when it comes to identifying the collateral.

D. Need for OECD to collect/disseminate securitisation data for a selected group of countries, in line of the ECB request

According to *Allan Thomas*, especially amongst the Euro area, harmonisation is very important for bilateral and international comparisons and here an agency like the OECD may take the lead together with the group working on the Handbook on securities.

The OECD is working in a comprehensive fashion. The Handbook focuses primarily, at the moment, on securities but combining the experiences can be fruitful. OECD has some experience in capturing securitised receivables and the group formed by the BIS, IMF and ECB has expertise in securities. They should complement each other, and the organisations should work together. The OECD, headed by Bank of Spain, has undertaken the methodological surveys on country practices and will focus on the collection of data as well.

There should be some subsectors in the OECD financial accounts submission or even a new institutional investor subsector as a part of the OECD institutional investor database or a submission of a kind of supplementary table as part of other financial institutions.

Allan Thomas also appreciated the objective of being consistent with SNA 2008 and BPM6. Work remains to be done and some strong and different views still exist, even within the same institution. There will also be challenges in harmonising and capturing the data issued, such as on the balance sheet third party securitisation.

Finally, according to *José Maria Cartas*, it will be helpful for the Handbook on securities that other international organisations like the OECD participate.

E. Securitisation after the crisis

According to *Stephen Lumpkin*, there was a time when very few banks were highly rated because banks are inherently very instable and periodically they got it wrong. Investors did not invest in a bank. Long ago, the entities created under the common law (which was influenced by Roman law) were called trusts. These trusts had some advantages because we could stick securities to them and separate these securities from the entity they are coming from. It also had certain tax advantages that proved to be very useful. These vehicles also had the advantage to allow bank's assets to be rated higher than the bank itself. This concept of trust does not exist in the Napoleon code, so we needed a special law to create such entities and to incorporate them in the civil codes.

According to *Allan Thomas*, before the crisis, securitisation has been before the crisis an extremely powerful form of financing that no doubt had contributed to economic growth. However, it was also responsible for the severity in the transmission of the financial crisis. Both these aspects warn about the importance of statistical data. Monetary policy institutions such as the ECB, IMF or the OECD member countries central banks have been in agreement that securitisation needs to healthy resume and go forward as the global economy emerges from the financial crisis. The Bank of Spain and others have noted the importance of spreading credit risk funding sources for new loans, for SME financing and the wider type of collateral options that are available through securitisation. It will require statistics to monitor securitisation.

On the question of how to measure the performance of securitisation and its effect on the economy if we do not have harmonised statistics, *Allan Thomas* affirmed the importance of identifying securities. Surveys should be designed to avoid any possibility of double counting to properly track the financial instruments involved for both assets and liabilities.

In many countries, we have also seen securitisation activity revert back to its foundation types such as mortgages back securities and away from synthetic types in many cases.

Major issues are going to be changing the accounting for securitisation. There are new accounting standards and regulations and possible consolidations but how can we deal with this without losing the details? There has been much discussion about institutional units and legal entities. As a statistician, it is still possible to choose the data in the way it should be chosen. So long as the legal entity is still in place, we can adopt this angle for securitisation.

The market valuation is also very important especially regarding synthetic securitisation that is not traded and depends on the underlying exposure. In this regard, getting market information is always a challenge.

According to *Jochen Henn*, the securitisation market will in the near future not likely see the amounts of issuance we had before the crisis. There will be a competition between securitisation in the narrow sense and the covered bond market. It seems that after the crisis it is useful to perceive the risks and the change in profile.

SUMMARY REPORT

Introduction

In 2006, the OECD Working Party of Financial Statistics (WPFS) decided to begin working on securitisation. It did so in view of the increasing significance of this phenomenon, its growing impact on financial credit and monetary analysis, and the lack of systematic information with some degree of homogeneity. Since 2006 the WPFS has always included this topic on the agenda of its meetings in an attempt to better understand the different features of the securitisation process, its development in the various OECD countries and the best means to collect information on it. The outbreak of the financial crisis revealed the tremendous complexity of securitisation processes and highlighted the need to better understand it and thus compile data on a country-comparable basis. As a consequence, after three years of working regularly on this issue, it was considered appropriate to reflect in greater depth on this subject by means of a Workshop on securitisation. The Workshop took place at the end of May 2010. The Banco de España hosted it at its headquarters in Madrid and actively collaborated with the OECD in its organisation. The Workshop was chaired by Beatriz Sanz, (Banco de España Statistics Department) member of the WPFS bureau since 2001, with Michèle Chavoix-Mannato (OECD) acting as Rapporteur.

Organisers of the Workshop thought it should offer the opportunity to share experiences in this complex field among different experts from different perspectives. Therefore, users, supervisors, the industry, the related European associations and the international organisations were invited to participate together with statisticians. All those asked to contribute to this workshop showed great interest from the outset, contributing substantially to most fruitful discussions.

1. The work on securitisation at the OECD. Where do we stand? Reasons for this workshop

Miguel Angel Menéndez (Banco de España. Statistics Department) referred firstly to the reasons that lead the OECD WPFS to start working on securitisation in October 2006 and the method of work followed to better understand this phenomenon and to collect information in the different OECD countries. He reviewed the development of securitisation that began with financial institutions, mainly credit institutions, that monetise their loans by issuing securities collateralised by these loans. The complexity of the process increased with the emergence of financial intermediaries specialised in these transactions issuing securities collateralised by credit institutions assets, the so-called asset backed securities.

A variety of ways of carrying out securitisation transactions and a great variety of intervening agencies using different terminology for the same agents and transactions added to this complexity. The important impact of securitisation on the analysis of financial flows, monetary analysis, financial stability, transfer of risk and completion of financial accounts were other challenges that reveal the lack of systematic information with a certain degree of homogeneity. This situation illustrated clearly the room for statistical work to try to fill the information gaps. Other international organisations also considered the need of working on securitisation, such as the ECB (since 2004), as had been referred to by *Eduardo Rodríguez-Tenés*.

The method of work to collect information from the OECD countries was organised through the completion of subsequent questionnaires, whose results were considered and discussed at several WPFS

meetings. Thus, the first questionnaire, launched after the October 2006 meeting, included questions referring to the existence of securitisation processes in OECD countries, the type of securitisation carried out through special purpose entities (SPE) or financial vehicle corporations (FVC) (in terms of ECB terminology) and questions related to the sources of information and data available.

In the 2007 meeting, the responses to the first questionnaire were summarised in a document from the OECD. The main conclusions of this meeting were that, giving the implications of some securitisation operations for monetary and financial analysis, there was a clear demand for more information, both quantitative and qualitative, on the business of SPEs or FVCs. Therefore, an agreement on a new questionnaire to further understand the process in the different countries was reached. The contribution of the ECB relating to the statistics on FVCs in the system of national accounts and that of the Bank of England on the statistical treatment of securitisation vehicles in the UK were also discussed at this meeting. One of the most important results of the meeting was to get, for the first time, some quantitative information. The data presented referred to the assets of SPEs as a percentage of the total assets of financial corporations in the respective countries as well as outstanding securitisation amounts issued by SPEs as a proportion of all securities issued by financial corporations. This provided an idea of the varying importance of the securitisation process in the various OECD countries.

In the 2008 meeting of the WPFS, a proposal for a new questionnaire to better understand the phenomenon was approved. Its main points referred to accounting issues, main counterparties and problems of double counting; references to the synthetic securitisation; details of the structure of SPE-liabilities and questions related to the role that international organisations should play in trying to homogenise terminology, and to define involved entities, transactions and instruments. Some other questions related to the valuation of assets and liabilities linked to securitisation, the treatment of write-downs and write-offs and more detailed quantitative information than that obtained from the first questionnaire which mainly included the SPE balance sheets for the period 2004 to 2008. In this meeting, the ECB updated WPFS delegates on the work done so far in the European System of Central Banks related to statistical data on securitisation by means of a Regulation.

In the 2009 meeting, the results of the second questionnaire were summarised. The main conclusions were as follows: i) studies and reports on how securitisation was being developed in each country should be one of the avenues to be pursued; ii) as the WPFS meets only once a year, a workshop should be held in 2010; iii) in the future, the WPFS should work on a following up of the securitisation process in the OECD countries, taking note of the new ECB Regulation; and iv) cooperation with all the international organisations should be strengthened and countries should encourage them to write guidance notes, manuals and practical examples.

Having in mind the work done so far, the main reasons to organise this workshop were to discuss remaining issues, among others, the following: securitisation of insurance risk; the identification of holders of securities issued by FVCs through securities databases in order to complete securities statistics; getting some details on new statistical frameworks; the integration of available information on securitisation into the financial accounts to deal with the question of consolidated versus non consolidated statistics; the consequences of the financial crisis on the development of the securitisation process; considering the need of harmonised terms referring to definitions of agents, practices and regulations. Finally, one of the most important aims of the workshop was to exchange ideas between statisticians, analysts, supervisors and agencies in this industry.

2. The securitisation process from the standpoint of analysts, regulators and the industry

The presentations in this section illustrated the reasons behind the significant surge in the securitisation industry, the main explanations for its ensuing sharp decline and the steps taken to cope with the major deficiencies related to conflicts of interests, disclosure and transparency.

The presentations aimed at setting out why and what kind of information is necessary for analysts, how supervisors see the need to regulate this activity, and how tight regulation should be, but also what the consequences of the securitisation process are for the credit channel of banks, if any.

2.1. The boom in securitisation (*The pre-crisis period, 2000-August 2007*)

The expansion in securitisation market

Roberto Blanco (Banco de España. Monetary and Financial Studies Department) illustrated the noticeable growth of securitisation taking the Spanish market as an example. In Spain, the issuance of Asset Backed Securities (ABS) increased considerably during the period 2000 to 2007. These increases had made Spain an important country on the European market for ABS, the second after the United Kingdom with 13.2% of the European outstanding in June 2007, and the third country with 13.5% of total outstanding covered bonds.

Driving factors of the expansion of the securitisation market:

- From macro-financial perspective the global imbalances (plus demographic factors) caused a global “savings glut” according to *Oscar Arce* (National Securities Market Commission, CNMV, the Spanish supervisor for securitisation funds and companies). Indeed, emerging countries and oil exporters registered since the early 2000s a trade surplus in their current balance while developed countries saw their trade deficit widening. Those surpluses created a demand for high quality assets that the financial system of those countries could not absorb.

For *Stephen Lumpkin* (OECD) it is not clear to what extent all of these assets fall in this category of safe assets. It may be that the extremely long period with very low rates and an absence of the inflation gave everybody a comfort level which facilitated the borrowing rates and this explain why all this debt was created.

The other thing was what we call banking, in general, was extremely instable in the sense that they were financing long term assets by callable assets. The fact that these assets were financed by other sources like securitisation played a good role but this structure became very complex. The subprime mortgages represented a tiny fraction of securitisation but it triggered the whole market. Here, the role of the statisticians becomes interesting if they can implement a tool that would detect this type of events. By imposing capital ratios to limit loans, the lending activity has been able to increase only by the use of securitisation.

- For the case of Spain, the funding factor was considered important. The financing of the economy was the main reason for the expansion of the ABS market. Net flows of loans exceeded the net flow of deposits so a financing gap could be observed that only the issuance of ABS solved. The Spanish market showed some different characteristics compared with same markets in other countries. In Spain, credit risk was not transferred. *Roberto Blanco* asserted that ABSs were issued in different tranches with different risks. The risk is concentrated in the equity tranche. The first one is like an insurance because it absorbs the first losses. The other tranches have less risk. The fact that the originator keeps the equity tranche means that he keeps the bulk of the risk. For this reason, most of the assets securitised in Spain have not been derecognised.

2.2. The crisis period (since August 2007)

Anna Zennaro (Associate at the Association for Financial Markets in Europe, AFME), which represents the shared interests of a broad range of global and European participants, provided data which add context to the collapse of the securitisation market. According to AFME figures, the European securitisation issuance during 2009 amounted to 414 € bn, compared to more than 700 € bn in 2008. The retained issuances accounted for about 99% of total issuance in 2009 and 98% in 2008, compared to about 24% in 2007.

Dominique Durant (Banque de France) raised the issue of the differences observed between the outstanding of securitisation in the AFME statistics and the national figures according to the ECB survey on FVC statistics. *Anna Zennaro* explained that the data published by AFME take into account the country of the underlying collateral. SPVs may be located in a different country with respect to the collateral for many reasons including the relevant legal and tax frameworks. For certain transactions, information which is not available in some databases could be found in others, therefore, AFME alongside the Securities Industry and Financial Markets Association (SIFMA) crosscheck data from a range of different sources to improve the accuracy of the securitisation issuance and outstanding figures.

For *Oscar Arce*, although the amount of subprime defaults was not large compared to the size of the US mortgage market, the fact that around 75% of these loans had been securitised caused a slump in investor confidence in this kind of structured products and was sufficient to trigger a global debacle in securitisation markets with sharp falls in prices, vanishing private demand and causing secondary markets drought. Another reason for the collapse was the fact that credit rating agencies underestimated real risks and the complex structures of ABS gave rise to multiple problems of incentives and conflicting interests.

In Spain, there was a drop in ABS issuance after the summer of 2007. However, another type of program replaced the old emissions and it consists of retained issuance. Indeed, they serve as collateral for refinancing operations at the ECB.

Factors for the collapse of the ABS market were, according to *Roberto Blanco*:

- Lack of investor confidence for ABS due to the lack of transparency regarding underlying assets caused by the complexity of the products and the conflict of interests between originators and investors.
- Disappearance of structured investment vehicles (SIVs) and asset-backed commercial paper (ABCP) conduits which played a crucial role in transforming maturities in ABSs.
- Lower market liquidity.
- Uncertainty over the credit quality of the underlying portfolio.

From the point of view of market participants, supervisors and regulators, the financial crisis has brought asset information to the centre of concern and controversy. There is a wide agreement on the benefits of enhancing information and disclosure at all levels. According to *José Antonio Trujillo* (Intermoney Titulización SGFT, one of the main securitisation management companies in Spain), the opacity of certain financial instruments, such as ABS, may have contributed to the collapse of markets but it was not the main cause.

2.3. The distinction ABS market / Covered Bonds market

There is a major difference between the asset backed securities and the covered bonds that was pointed out.

Roberto Blanco pointed out that ABSs differ from covered bonds in several ways:

- First, their average maturity is not the same. The ABS has an average maturity of 23 years while it is 8 years for the covered bond.
- There is no maturity mismatch for ABS while there is one for covered bonds. This is because the maturity of the ABS follows that of its underlying assets which is not the case for covered bonds.
- ABS allows the transfer of risk (although it was limited in practice in Spain) while covered bonds does not permit the issuance of tranches that allows different combinations of performance and risk.
- ABS can have all sorts of underlying assets while covered bonds only have mortgages or loans to the government as collateral.
- Finally the structure of ABS can be rather complex, while it remains simple for covered bonds.

According to the representatives from the industry, the ABS market will disappear in favor of the covered bonds market for the following main reason given by *José Antonio Trujillo*:

- First, transferring credit risk by means of securitisation and consequently reducing capital consumption has become more difficult.
- Secondly, rating agencies have modified their criteria giving more importance to counterparty risk and commingling risk. The wave of massive downgrades was due to a change in rating methodologies. More than 50 % of the changes were based on methodologies changes.
- The lack of homogeneity of ABS, even within the same class of collateral, reduces the possibility of liquidity.

There are also institutional initiatives that *José Antonio Trujillo* decries such as the SEC amendment to Rule 17 g-5 which complicates ABS rating processes and increases its costs. Also, the ECB triple-A rating requirement for ABS penalises this kind of instruments. The double triple-A requirement, the higher haircut compared to the rest of discountable bonds and the opacity of the ABS valuation criteria, draw a gloomy perspective for ABS market.

2.4. Special role of the securitisation in the economy

Securitisation is also a tool to support Small and Medium Enterprises⁵⁸ (SME) financing. This role of securitisation is played through the European Investment Fund (EIF), as explained by *Helmut Kraemer-Eis* (EIF, part of the EIB Group).

SMEs account for a large proportion of Europe's (and not only Europe's) economic activity. Securitisation is important to support the financing of SMEs because it transforms illiquid SME loans into a more liquid asset class and represents an alternative source of funding for the originating banks.

The general purpose of EIF's credit enhancement operations is to support new SME financing. EIF guarantees senior and/or mezzanine tranches of risk, typically with a minimum rating equivalent to BB/Ba2. The guarantees are provided in different forms, such as note guarantees, bilateral guarantees, credit default swaps, etc. EIF guarantees facilitate the execution of securitisation transactions, allowing financial institutions to diversify their funding sources and/or to achieve economic and regulatory capital relief via credit risk transfer.

⁵⁸ According to the EU definition, SME have less than 250 employees and have a turnover less than 50 M€ or less than 43 M€ of assets.

On the question “*Is there any rating in the case when EIF gives a guarantee to a deal?*”, it was stated that the EIF does internal analyses and calculates the expected losses of the relevant portfolio and the necessary fees related to that. With regard to the internal analyses, the EIF acts in a way similar to rating agencies. The EIF also voluntarily applies the Basel rules and builds up reserves in order to be able to pay guarantees calls.

EIF may conduct its activities in the territory of the Member States of the European Union, in candidate and potential candidate countries to the European Union and in the European Free Trade Association (EFTA) countries.

2.5. Accounting treatment of securitisation

By means of the securitisation of a portfolio of assets an institution basically looks for cheap funding or risk transfer. However, a legal transfer does not automatically imply removing the assets from the transferor’s balance sheet. In the accounting terminology, the issue is referred as “derecognition” of assets and may involve intricate prudential issues affecting financial institutions. Accordingly, only through careful analysis of the derecognition rules can the accounting treatment of securitisation be explained. Pablo Pérez Rodríguez (Banco de España, Financial Institutions Department) and Fernando García Martínez (Universidad Complutense de Madrid) presented the state of art on this topic, the current proposals for the revision of the derecognition principles and some examples on the accounting treatment following the derecognition flowchart provided by the International Accounting Standards Board (IASB) in IAS 39.

In this respect, *Stephen Lumpkin* pointed to the pass-through certificates in the past. SPEs were created to hold securities. There was a true sale and securities were registered off the balance sheet. The entity did not do anything. Until we have the same conditions, we will still have true sale determination which cannot happen if we have any type of management or tranching that changes the pass-through effect and consequently also reduces the true sale effect.

Fernando Garcia stated that the main problem is to consider a transaction as a true sale. Jurisdictions treat true sales differently. So meeting the pass-through arrangements remains quite difficult.

On the question of *Susan H. McIntosh* (US Federal Reserve Board) if the Spanish accounting works with the rules of the IASB, *Fernando Garcia* stated that, basically, the requirements tend to be the same: they stem from a conceptual framework using the same definitions for assets. The rules are to be adopted on a consolidated basis. If the originator controls the vehicle, he has to consolidate. From IASB and FASB perspectives, the SPV has to be consolidated before applying derecognition rules on a consolidated basis. As regards the revision of the IASB’s rules, the US proposal additionally requires that transferred assets are bankruptcy remote.

However, *Antonio Matas* (ECB) stated that individual accounts are of interest for three types of users: the tax man, the insolvency lawyer and the statistician. Legal entity level accounts are important for the compilation of macro-statistics.

Concerning the derecognition *José Antonio Trujillo* prefers the old rules of Basel I where there was 8% for everyone because the new rules which are more detailed allow more freedom and are partly responsible for our current situation. He supported a simple rule where A-rated securities are kept in the balance sheet and B-rated securities are derecognised because it is a transfer of risk.

For *Fernando Garcia* Basel II perspective is to give thicker rules. Although the IASB and the FASB are bound by their conceptual framework, they permit to make the definitions be applied for all countries.

2.6. Initiatives for the recovery of securitisation

Regarding the initiatives, the importance of enhancing the information in the ABS market can be noticed.

From Oscar Arce's point of view, there are two main areas for regulatory action: incentives and transparency. In the incentives one can list the minimum retention rules supported by G20, followed by the 5%-rules set by US and EU Governments. This initiative is likely to induce a more diligent attitude by originators and remove incentives for the revival of the "originate-to-distribute" model.

In the transparency field, *Oscar Arce* mentioned the initiative of the International Organisation of Securities Commissions (IOSCO) which provides a set of standards on the information to be included in public offerings and listings of ABS (ABS Disclosure Principles, April 2010). Among this list one can find the identity, functions and responsibilities of the intervening parts; the main characteristic of the pool of assets and the structure of the transaction. Concerning the transparency based on loan by loan data, *Oscar Arce* reports that CNMV has promoted a pioneering framework for public information disclosure on securitisation. From his personal point of view it is necessary to make an evaluation of the tradeoff between the provision of more information and the cost of this information. By becoming more expensive (retention rules, information disclosure) securitisation will not be a profitable activity at all.

On the question of "*How to obtain a high level of transparency?*", *Roberto Blanco* considers that the ECB initiative is a good one. It will be required that ABS should display information at the loan level. This will help to increase transparency. Investors used to rely too much on rating agencies and should do their own analysis.

For the industry, *José Antonio Trujillo* pointed out that a good way to restore securitisation is to require better information at the originator's and cash-flow servicer's levels, to standardise and enhance reporting obligations with some level of aggregation, and to facilitate access to information on a decentralised basis. But he thinks too high expectations have been placed on disclosure and information enhancement as a means of restoring ABS markets. In his view, it is necessary to do a good balance between disclosure and efficiency. In this respect, broad loan-level disclosure of granular portfolios advocated by the ECB and Bank of England is irrelevant for credit risk analysis. The same is true for a unified portal open to all investors to access loan-level.

In this respect, important efforts have been done by the industry, for example AFME regularly publishes information on the market and is trying to enhance four aspects of data disclosure: transparency, accessibility, comparability and granularity.

2.7. Future of securitisation

For the industry, the future of securitisation is not clear. For instance the benefit of matching cash flows within the originating bank cannot be the only justification for securitisation. The concept of secured loan, which is the covered bond concept, can be easily expanded to all types of assets. So Bank funding should concentrate in high rated bonds, with simple financial characteristics, that is: adequately secured bullet bonds, issued in ample and potentially liquid markets where investors are concerned by and properly informed about the cover pools, but do not require loan-level information to evaluate market risks.

For *Roberto Blanco* the pre-crisis levels will not be reached in the medium term because of lower demand (structured investment vehicles -SIVs- and conduits have disappeared and "should not" reappear such as they were in the past) and lower supply: deleveraging of the financial and non-financial sectors. On the opinion of the necessity of the disappearance of SIVs, *Dominique Durant* pointed out that in France conduits still exist. *Roberto Blanco* stated that the conduits and SIVs did not appear in Spain. "Should not" refers to the way they use to be in the past. The conduits were not regulated in some countries and were

part of the shadow industry. They played an important and very risky role of transforming maturities by buying long term securitised assets and issuing short term commercial papers.

According to *Oscar Arce* securitisation can restart if we impose simplification of the securitised products and standardisation of the products to enhance comparability across countries.

The aim would be to have some presentations setting out exactly why and what kind of information is necessary for analysts, how supervisors see the need to regulate this activity, and how tight regulation should be, but also what the consequences of the securitisation process are for the credit channel of banks (if any). Similar questions could be addressed to the industry.

1. The role of statisticians in the process

The aim of this session was to present securitisation activities in various OECD countries and to discuss differences and similarities between countries.

3.1. Trying to delimit the securitisation phenomenon: definitions, agents who intervene (originators, SPVs or FVCs, administrators) and kinds of operations

3.1.1. On the definition of the originator

In the FVC Regulation the originator is defined as "the transferor of the assets, or a pool of assets, and/or the credit risk of the asset or pool of assets to the securitisation structure". It is also assumed that assets have already been created before securitisation.

Eric Klaaijzen (De Nederlandsche Bank) presented four cases of securitisation in the Netherlands which are examples of the difficulties to determine whether some structures come under the FVC regulation.

Case 1: Issuing company pass-through bonds

It is a structure characterised by the issuance of bonds for financing non yet existing loans: no first lender and no transfer of already created assets. Thus, it can be concluded that this does not fall under the FVC regulation because the issuing company is a first lender and a specialised lending corporation rather than an FVC.

Case 2: Funding corporation US and purchasing company NL

This is a structure in which a funding corporation resident in the US issues short-term securities (Asset-Backed Commercial Paper), of which the proceeds are lent in the form of bilateral loans to a purchasing company resident in the Netherlands. This purchase, or asset holding, company uses this money to purchase asset-backed securities issued by Dutch FVCs.

Both entities are FVCs, but the US funding corporation is not included in the FVC population of the euro area, because it is resident outside the euro area.

Case 3: Real estate loan fund

A real estate loan fund has taken over the risk of real estate loans from a bank by means of credit default swaps. The loans are secured by real estate abroad. It has raised capital through private loans (not through issuance of securities) placed with two creditors. The proceeds are put on deposit. The entity thinks about issuing notes if there is sufficient interest from investors.

Since the amount issued is less than 500 M€ and the number of creditors does not reach five creditors, the structure is not included in the statistics under the FVC regulation.

Case 4: Issuing company UK, holding company and originator NL

An issuing company resident in the United Kingdom issued commercial mortgage backed securities (CMBS). Then it lent the proceeds of the note issuance to a holding company (the borrower) who in-turn, lent the loan proceeds to two companies which own a portfolio of UK real estate. The holding company and the real estate owning companies are Dutch residents.

Although the entities are FVCs, this case will not be included in the FVC statistics because the issuing company is a UK resident.

As these and other cases show, it is important to apply uniform interpretations of the definitions of FVCs in the euro area to avoid inconsistency and to strive for harmonization of statistics. It is of utmost importance to be aware of differences between countries and to take into account market practices and economic realities.

3.1.2. On the kind of operations in Ireland

Securitisation in Ireland uses Special Purpose Entities (SPEs). As in other common law jurisdictions, the vehicle is typically set up as a bankruptcy remote company with the beneficial shareholding held on trust by share trustees. The register of FVCs must include the nature of securitisation: true-sale, synthetic, or other FVC. There is not an official register of FVCs, but information is obtained through banks.

True-sale operations stand for 72% of total assets of resident FVCs. Synthetic securitisation represents 19%. The remaining 9% include, in the main, vehicles which are carrying out both true-sale and synthetic securitisations. Thus, FVCs are a very heterogeneous group and the analysis of the sector is being greatly enhanced by additional qualitative information on the vehicle.

The main securitised assets are: Residential MBS, Commercial MBS, Consumer ABS, Corporate ABS, Cash (i.e. true-sale) CDO, Synthetic CDO, ABCP and Multi-Issuance Vehicles (MIVs) and Others.

For *José Antonio Trujillo* the classification is not always clear and relevant. Indeed, structured covered bonds use securitisation to create a vehicle to reinforce the cover pool. It is a sophisticated pledge as far as the issuer does not fail. In this case, it is not securitisation under the issuer default. It is a dormant securitisation like the retained securitisation with a trigger event in the contract.

On this issue *Antonio Matas* asserted that it is covered by the ECB regulation. Covered bonds, nor even structured covered bonds, should be covered by the FVC regulation. In this case we have a “cover pool holding company”. It is a requirement that the securities that are ultimately sold to investors must not be payments obligations of the originator. The investor must not have dual recourse. The investment shall not have recourse to the originator, otherwise it is not securitisation.

Regarding the double counting issue, *José Antonio Trujillo* pointed out that retained ABSs are used as a pledge for covered bonds and we cannot identify whether that is a retained transaction. The bonds are retained to be used as a guarantee. The ABS and Covered Bonds are both registered in Spain at the CNMV so there is a possibility of double counting.

For *Antonio Matas* we already have a fair model experience with dealing with double counting. The amount of double counting that we have to deal with due to retained securitisation in order to create “pledgeable” collateral has been outstanding and it has been difficult to cope with. There is an official kind

of manual that is to be followed: the ECB regulation and the international agreed statistical standards. Indeed, because these standards evolve much lower than market practices, in the case of retained securitisation, we end up with double counting in terms of total assets and total credit to the private sector. The loans are not derecognised according to IFRS but it already has been possible to control that.

3.1.3. *Is the Danish mortgage system a piece of the securitisation landscape?*

Maria José Alvarez (Statistics Denmark) explained the Danish system. The Danish mortgage model has more than 200 years of history and has emerged after the Great Fire of Copenhagen in 1795. In this system the mortgage institutions grant loans (which cannot exceed 80% of the value of the property) secured by mortgages on real property, having only one source of funding: bond sales. According to the balance principle, mortgage institutions do not retain repayment risk and fund their lending activities by issuing mortgage bonds with cash flows that fully match those of the underlying mortgage.

The Danish mortgage bond market is one of the largest in the world with an outstanding amount of 300 Billions € which represents 72% of the total Danish bond market. It has survived all economic downturns thanks to a strong foundation. Therefore it is considered as a key factor in the Danish financial stability.

On the nature of investors asked for by *Dominique Durant*, *Maria Jose Alvarez* responded that they are mainly banks and pensions funds. This can change with the new Basel law because the new definition of liquid assets fail to allow for the fact that Danish mortgage-credit bonds are just as liquid as many government bonds. If the proposal of the new law is adopted, it will undermine parts of the Danish mortgage system.

Regarding the securitisation field, the Danish mortgage model satisfies the OECD's definition of securitisation which is a "process whereby an institutional unit raises funds by issuing securities and enabling the investors investing in these securities to buy directly parcels of specific financial assets" and can be considered as securitisation if we want to do statistics on assets backed securities but not if we want to capture new information on recent development of the securitisation process.

For *Eric Klaaijsen* these types of entities would be MFIs in the euro area and expressed his preference for one definition and not different definitions from the BIS, IMF or OECD. For *Mads Kristoffersen* from Danmarks Nationalbank there is one reason to consider these entities as MFIs: traditionally they are a big part of lending in Denmark and actually there is one law covering all financial acts in Denmark. This law covers both banks and multi-credit institutions, thus, the National Bank does not list this as securitisation.

On this issue, *Beatriz Sanz* thinks that we must do our best to try to gain in clarity. In this vain, we have no other alternative than to nominate both kinds of securitisation in different ways. In Spain, at the beginning of the eighties the securitisation started through covered bonds and this kind of operation has always been called securitisation because the assets are mobilised through the issuance of bonds. Later on, the SPVs appeared and securitisation then referred to a more complicated structure. Thus, we have seen these two kinds of securitisation in very different ways but, it is clear that the regulation of the ECB refers to the securitisation that takes place through an SPE. And the other one is securitisation that is issued by the originator. We can agree on two definitions of securitisation. So, there may be different kinds of securitisation with different degrees of complexity.

For *José Antonio Trujillo*, it would be preferable to use the words securitisation and secured bonds to identify these two kinds of operations. *Antonio Matas* is of the same opinion and asks for having two categories: asset backed security and the other asset covered security.

3.1.4. Nature of FVCs in Portugal

The nature of FVCs was discussed in the context of the presentation “Assessing securitisation activity in Portugal, compilation and measurement issues” made by Ana Margarida de Almeida (Banco de Portugal).

The Securitisation Law in Portugal allows for two types of Financial Vehicle Corporations (FVCs):

- Securitisation Companies (*Sociedades de Titularização de Crédito*, or STCs) which are single purpose, limited liability companies and which finance their activities by issuing equity and securitisation bonds.
- Securitisation Funds (*Fundos de Titularização de Crédito*, or FTCs) which are very similar to those of investment funds and finance loans acquisition by issuing securitisation units. In Portugal, the units issued by resident FTCs are typically acquired by non-resident financial vehicles. In turn, the non-resident financial vehicles issue bonds in foreign securities markets.

Both kinds of FVCs are supervised by the CMVM (the Portuguese securities market commission) which grants activity permission and regulates the securitisation activity.

FVCs and statistics

FVCs do not report statistical data to the *Banco de Portugal* (BdP). Indeed, STCs and FTCs have to submit accounting data to the CMVM, for supervisory purposes and there is a formal agreement between BdP and CMVM, for regular deliveries of those data to BdP: STCs report Audited annual balance sheets and Semi-annual balance sheet data; FTCs report monthly data.

The accounting information is complemented by data collected from the originators (in particular when they are resident MFIs), issuance prospectus and FTC’s management rules and regulations, Balance of Payments data and information from the BdP security-by-security and investor-by-investor database, in order to break down the accounting data into the envisaged categories and to check the quality of primary data.

Ana Margarida de Almeida also mentioned that, conditional on the loans being derecognised or non-derecognised in the originator’s balance sheet, securitisation transactions are recorded differently:

- If the securitised loans are derecognised (off-balance sheet securitisations), the amount of “loans” outstanding in the assets side of the originators’ balance sheet is decreased, together with a matching increase in “cash”. In the FVC’s balance sheet loans are recorded vis-à-vis the original debtor sector.
- If the securitised loans are not derecognised, (on-balance sheet securitisation) in the originators’ balance sheet the amount of “loans” outstanding is kept unchanged; to balance out the increase in “cash” on the assets side of the balance sheet, an additional liability to the FVC is recorded. In order to avoid affecting the money aggregates, the entry on the liabilities side is allocated, by convention, to the category “deposit-like instruments, vis-à-vis OFIs, over two years”. In the FVC’s balance sheet, the loans are recorded vis-à-vis the originator’s sector to circumvent double-counting.

According to the Regulation ECB/2008/30, the *BdP* has submitted to the ECB, since February 2010, harmonised data on the FVCs’ balance sheets. Based on these statistical data, aggregated results are compiled for the following three sub-categories: (1) FVCs engaged in traditional securitisation; (2) FVCs engaged in synthetic securitisation; and (3) other FVCs. Data refer to end-of-quarter outstanding amounts, and financial transactions are provided on a quarterly basis.

In response to the remark of *Eric Klaaijzen* on what makes the difference between mutual funds and the securitisation units, *Ana Margarida de Almeida* pointed out that the issue of the classification of the securitisation units was raised at the ESCB Working Groups on Euro Area Accounts and Monetary and Financial Statistics. Currently, amounts related to securitisation are recorded under the item “other equity” (AF. 513) which is the financial accounts’ terminology deemed most adequate for the amounts related to securitisation, in the absence of a specific financial instrument within ESA95 for this type of units. It is of course a separate entrance from the one of mutual funds shares (AF.52).

Moreover, the revision of the ESA should take into account this issue and the proposal could go in the following direction: there could be a general entrance for amounts issued by funds (other than pension funds) and then introduce sub-categories depending on the nature of the fund, i.e. i) amounts issued by investment funds; ii) amounts issued by securitisation funds; and, iii) amounts issued by other funds. This way, amounts issued by securitisation funds would not be included in “other equity” which is a residual category for shares and other equity and should mainly reflect non-financial small and medium companies (SME) financing. In fact, “other equity” is basically used to record the capital issued by the SME which has nothing to do with the financing of securitisation operations. Another proposition could be the splitting of “the mutual funds share” category in two in order to separately identify the mutual funds shares (*stricto sensu*) and the amounts issued by securitisation funds.

Regarding securitisation in the FVC reporting, *Andreas Hertkorn* from the ECB expressed that the ECB is not in favour of having institutions in the FVC list issuing mutual funds. On this basis, one should keep these two things separated. Economically, the securitisation funds have only one type of liabilities. The other point is that financial vehicles have very limited equity. In the FVC regulation, equity tranches which cover the first losses are classified as securities. For comparability, they have to be recorded as securities.

Clive Jackson notices that these securitisations funds amounts are recorded in Ireland as other assets.

Ana Margarida de Almeida confirmed that amounts issued by securitisation funds are registered as equity but the financing of SME should not be mixed with the financing of banks involved in securitisation. It is why a revision in F52, which is the subcategory of F5 which takes into account securitisation, would be appreciated with the creation of sub-items: one would be for mutual funds shares (*stricto sensu*) and another for amounts issued by securitisations funds. The revision of ESA could provide a window of opportunity in this respect allowing a more straightforward classification between the institutional sector classification of a unit vis-à-vis the type of financial instrument.

On the issue of double counting, *José Antonio Trujillo* stated that since the securitisation funds amounts are purely instrumental, and operations exists across countries such Ireland, the double counting is possible.

Teresa Crespo (Banco de Portugal) mentioned that it is possible to avoid the double counting since in the Irish report to the ECB the amount of securities held by Irish FVCs issued by other MUMs FVCs is indicated.

3.1.5. *The Handbook of securities and definitions of securitisation*

The Handbook of securities has been drafted by the BIS, the IMF and the ECB, and has been set up to improve information on securities markets and to develop a conceptual framework for presentation of statistics on different types of securities issued. It is consistent with international statistical standards and harmonised with 2008 SNA and BPM6. *Christian Dembiermont* from the BIS presented the main characteristics of this Manual.

The Handbook distinguishes three types of securitisation:

- **Type 1** consists of a structure where there is no transfer of the assets to a Special Purpose Entity (SPE) and, in the event of bankruptcy of the originator, the investor have a recourse against the pool of mortgages over which security interest had been created. This mechanism refers to the issuance of secured bonds (commonly called covered bonds).
- **Type 2** refers to an operation in which the underlying assets are transferred to the SPE. This transfer is often assumed to be a true sale. This case corresponds to a cash securitisation.
- **Type 3** is a transaction in which the underlying assets are not transferred in full to the SPE and only the credit risk associated to the assets is transferred to the issuer.

These three types of securitisation lead to an attempt of defining securitisation that, according to the Handbook of securities consists of “*debt securities for which coupon and principal payments are backed by payments on specified assets or future income streams*”.

This definition is not in line with the ECB’s definition of securitisation. Indeed, in the ECB regulation (ECB/2008/30), securitisation is defined as “*a transaction or scheme whereby an asset or pool of assets is transferred to an entity that is separate from the originator and is created for or serves the purpose of the securitisation.*” The securities issued must “not represent the originator’s payment obligations”.

Concerning this point, *Antonio Matas* thinks that this chapter on securitisation in the manual is a worthy effort specially taking into account that the audience is basically global. Thus, we have to think about countries in which securitisation is not developed. But, why defining securitisation, since we can avoid this by defining ABSs with their characteristics and asset covered securities or covered bonds with their characteristics.

The other argument is that if we agree that securitisation is backed by “*future income streams*” we can notice that this argument is very weak because, for example, when the German government issues Bunds, securities are also created here and it is not securitisation.

The other problem in the definition of securitisation is that it includes the covered bonds. In the case of covered bonds, the principal and interests are not derived from the payments of specific assets’ future income streams but it derives from payments obligations of the issuer which is usually a bank. Only in case that the issuer defaults (which is not the usual thing) then you can start to look at the collateral. In Spain, for instance, there was no default for covered bonds. Thus, when we try to reconcile the ECB definition with the broad one in the manual, we face the problem of including covered bonds.

For the aspect on balance sheet and off balance sheet, we come to the issue of recognition/derecognition. Furthermore, in the case of covered bond, we can also have a vehicle involved.

For *José Antonio Trujillo* we are trapped by words because there is no consensus on the definition of securitisation. There is also a difference between ABS and RMBS whereas they are all backed by securities. We cannot define securitisation by securities backed by future flows because it is not an asset but right of flow of something that could be a rental for example. It is not an asset in a corporate balance sheet. Defining securitisation is not worthwhile and adopting a definition for securitisation such the securitisation of type 1 will lead to consider bonds issued by corporations that have a pledge as securitisation. In the case of debt that has a pledge, it is rather secured bonds, and covered bonds are a special case of secured bonds.

Stephen Lumpkin shared the same views and specified that the word mortgage backed security was the first one because it was the first security to be off the balance sheet and when the same technique was used for other assets, the term “assets backed securities” was adopted. For covered bond there is a reference pool

somewhere that is backing bonds, and it is traded and priced differently. The future flows are the way for emerging economies to get access to capital. They securitise future flows of income. But for the definitions, the easier category remains the ABS.

According to *Beatriz Sanz*, really we are faced with a complicated issue. In her view, it is a task that international organisations should tackle with a consultation of the different countries involved in order to come to an agreement. In her opinion, in fact, covered bonds are a special type of securitisation.

Ana Margarida de Almeida, in the same vein, warned that if we drop this concept of securitisation, we will assume that securitisation is linked to FVC (especially regarding the ECB regulation) whereas, in her opinion, securitisation is a larger concept.

For *Dominique Durant* it is a wording problem. If we define securitisation by the necessity of having a FVC we will stick to the ECB regulation regarding FVCs and if we define securitisation in a way that is away from FVC, we will face a problem.

3.1. Trying to collect information

3.2.1. The new ECB statistical framework for securitisation

According to *Antonio Matas* (ECB) data on securitisation are needed for a reliable interpretation of MFI credit data by correcting for negative financial transactions when loans are securitised and to follow loan redemption and repayment patterns irrespective of securitisation. The data are also needed to monitor the securitisation process and its impact on the creation of money and credit, on the capital markets and on the financial stability.

Prior to the *new framework of the ECB*, data were insufficient because definitions were non harmonised. Thus, as for the compilation approaches, there was a different availability and coverage of the phenomenon across euro area. Finally the data were highly sensitive to different national accounting rules on asset derecognition.

The new statistical framework consists of:

- New statistical requirements for MFIs, which are an extension of the already existing statistics and cover traditional MFI loan securitisation (including via non-resident vehicles) and other MFI loan transfers to/from non-MFIs.
- New statistical ECB Regulation directly addressing the FVCs in the euro area. This includes the requirement of self-identification and the publication of a FVCs list since February 2010.

National Central Banks can choose one of three compilation approaches:

- Direct reporting by the resident FVCs.
- Direct reporting by the resident FVCs complemented by reporting of loans serviced by MFIs ('integrated approach').
- Compilation of FVC data using other statistical, public or supervisory data sources.

Eric Klaaijzen stressed that only consolidated data to correct the FVC positions are going to be available but aggregate position would also be of interest for the users. *Antonio Matas* stated that the ECB presents the aggregated MFI balance sheet and the consolidated MFI balance sheet. But referring to FVCs, only the consolidated balance sheet will be presented because it will be hard to interpret aggregate FVC balance

sheet, and we will have to use the micro-data to understand the complexity of the structure. Indeed, FVCs positions allow to have consolidated and non-consolidated data by having the intra-position of FVCs.

3.2.2. *Collection of data on securitisation in Australia*

The Australian securitisation market is predominantly backed by residential mortgages. Its main characteristics were presented by *Wendy Raedt* (Australian Bureau of Statistics). The collection of data is done through an ABS securitiser survey where the single trusts or SPVs are the statistical units. All resident SPVs not reporting to the Australian Prudential Regulation Authority (APRA) and independently rated by a recognised rating agency are concerned.

Securitisation began in Australia in the mid 1980s. Initial securitisation guidelines of 1992 were revised in 1995 with the establishment of the Special Purpose Vehicle (SPV). From the early 2000s the Australian market was characterised by rapid growth and very large issuances until 2007. As a consequence of the global financial crisis, the securitisation market has declined significantly. Among the various forms of government support prompted by the crisis, the Reserve Bank of Australia has included the residential mortgage-backed securities in the list of the eligible assets for the refinancing with the Central Bank. This inclusion has led to the creation of “internal” or “self” securitisation by Australian banks. This is a process in which an originator sells a pool of assets to a related SPV and the SPV in turn issues debt securities which are held entirely by the originator.

On internal securitisation, *Antonio Matas* wondered whether, in such a case, the MFIs retain all the securities or there really is an institutional unit being set up or securities are issued. According to *Wendy Raedt* the internal securitisation is not considered as securitisation in the traditional sense. It is just a mechanism to enable the banks to access to liquidity and these securities have been created solely for the purpose of repurchase activity with the Central Bank only.

3.2.3. *Collection of data through Central Securities Depository*

The need to identify the final holder or the holding sector has increased, especially after the recent financial crisis. But identifying the exact holder is always one of the most challenging tasks for statistical compilers because balance sheets are useful but not always available.

Yoshiko Sato (Bank of Japan) informed on the system set up in Japan. Such data are being collected through the Central Securities Depository (CSD) which is an institution that offers safekeeping and book-entry transfer services of securities in a centralised network. It has two advantages in data collection: i) centralised information; and ii) wider universe than that of the administratively collected data.

The challenges pertaining to CSD data as a statistical source to identify final holders of securities are:

- The problem of the cascade structure of accounts. Indeed, most countries have access to supplementary source data other than CSD. CSD data are selectively used (e.g. for ABCP) or not used.
- The question of confidentiality of customer accounts (there is a clause which allows only to process aggregate data).
- The need for a better cooperation with the CSD and the securities-related industry.

3.2.4. *Incorporating securitisation of insurance risk statistics in the ECB statistics*

Securitisation of insurance risk is a specific type of securitisation, as explained *Dominique Durant* (Banque de France).

By making the assets in banks tradable, securitisation allows to access to new sources of funding and the outsourcing of credit risk related to securitised assets. This dual function of securitisation is also used in the field of insurance. The insurance and reinsurance companies can then transfer insurance risk to financial markets and finance their activities more easily. The large-scale natural disasters such as Hurricane Andrew (1992) and the Northridge earthquake (1994) led insurance companies and reinsurance market to create catastrophe bonds to cover losses by the financial markets. Financial markets are now acting as an insurer of last resort. The securitisation of insurance risk uses a technique similar to that of synthetic securitisation: an insurer transfers the insurance risk to an SPV; it covers the potential losses of the insurer in exchange for receiving a portion of insurance premiums. To finance the coverage of possible losses, the SPV issues securities that will be invested in high quality collateral. The remuneration of these securities is based both on the placement in riskless assets and on the premiums paid.

In France, the Ordinance on the securitisation of 13 June 2008 established a specific framework for the securitisation of insurance risk. The prudential framework of Solvency II also allows the development of insurance securitisation establishing criteria similar to reinsurance and securitisation for their inclusion in the assets covering technical provisions. The new International Accounting Standards (IFRS4) is also taking into account the instruments of securitisation as an alternative to reinsurance provided, however, that they make a genuine transfer of risk.

Regarding the insurance securitisation in ECB statistics, the ECB regulation 2008/30 on statistics on FVCs defines securitisation in a way that may exclude insurance securitisation from the scope of the reporting (art.1. para 2): synthetic securitisation is included only for credit risk. This may impede collection of data on a still limited but potentially increasing activity. However, many countries may also collect data for the implementation of ECB regulation on the basis of national law for SPVs. This is not consistent with the development of statistics on insurance corporations [Implementation Task force on Insurance corporations and Pension funds (ITIP) statistics] and for macro-prudential analysis. Where should such financial intermediaries be classified in national accounts if they are not FCVs? This may create gaps in the identification of holders of bank deposits as these entities may invest in such deposits.

3.3. Integrating the information collected into the financial accounts and other statistics

3.3.1. The effect of Financial Accounting Standard (FAS) 166/167 on the United States Financial Accounts

Susan Hume McIntosh (US Federal Reserve Board), explained how the FAS 166 and 167 has changed the way financial institutions account for securitisation and Special Purpose Entities (SPEs) and has taken effect for reporting periods beginning after November 15, 2009:

- FAS 166 considers whether securitisation and other transfers of financial assets are treated as sales or as financing.
- FAS 167 redefines previous accounting rules on determining when assets may be securitised and moved off the balance sheet.

The changes under the new standard are that prior to FAS 166/167, a sponsor's balance sheet showed only the fair value of the interests that it retained in a securitisation. Now, under FAS 166/167, the "primary beneficiary" will be required to include the entire carrying value of the securitised assets on the asset side of its balance sheet, and include the securitised debt as liabilities. The Banking organisations affected by the new accounting standards generally will be subject to higher risk-based regulatory capital requirements.

On the question of *Antonio Matas* on how the US deal with global financial firms, *Susan H. McIntosh* explained that from the bank data they get, there are weekly reporters. Moreover, what is measured now in the asset-backed securities sector and the Government-Sponsored Enterprises (GSE) pool is derived from the asset side. They are mainly concerned about not making losses on the mortgages the household have taken. The FED is concerned about the borrowing by households. She said they have had the GSE for 40 years.

3.3.2. *Securitisation and the Euro Area Accounts*

Andreas Herthorn (ECB) explained the main characteristics of the Euro Area Accounts (EAA). They are a complete set of financial accounts and non-financial accounts by institutional sector. The main financial items are: non-MFI financing to Households (HH) and Non-financial corporations (NFCs).

Since 2007 there is a full coverage of financing and investment of all sectors by providing comprehensive and consistent presentation of intermediated financing (loans), security markets (debt securities and shares) and other financing (e.g. other equity and, accounts payable/trade credits).

However, EAA's complete presentation of financial markets became increasingly complex due to different treatment of retained securitisation:

- Recording of security issues by FVCs.
- Non-recording of security purchases by MFIs (in some countries before harmonisation of MFI BSI statistics).

On the other hand, there is an increased data needs for monetary, economic and financial stability analysis. The answers to a number of questions, like who is financing whom, how is the risk distributed, who bears holding losses, call for a better information to analyse financial links between sectors, including harmonised and comprehensive coverage of securitisation.

In this regard, *Dominique Durant* wondered whether the FVC is considered an institutional unit and whether the answer can perhaps be different in a different context. The criterion to be able to manage its activities can be tricky.

According to *Andreas Hertkorn*, FVCs are always institutional units. As it is the case of the mutual funds that have no autonomy of decision and are managed by financial auxiliaries who make the decisions, it was decided to recognise mutual funds as individual units in order to have more information on their balance sheet.

For *José Antonio Trujillo*, it is the first time that a comparison between FVCs and mutual funds is made because we do not manage FVCs and we do not make decisions. Decisions come when we have to substitute a loan by another but the influence is very limited. *Stephan Lumpkin* shared the same view because if we are to find a bank that wants to create a mutual fund and wants to put its loans on the balance sheet of the mutual funds, then we will think differently about the mutual fund.

CONCLUSIONS

Beatriz Sanz pointed out that, regarding securitisation, we face what is a typical issue for statisticians, because when something unexpected occurs in the economic area, everybody realises that one of the problems concerns the availability of the appropriate information. For example, going back into the last two decades, 1994 saw the Mexico crisis. At that time, the balance of payments statistics did not clearly show Mexico's short-term positions to finance its current-account imbalances. This brought about the GDDS and SDDS of the IMF. Some years after, the foreign reserves crisis in the emerging countries gave rise to the template for the reserves of the IMF.

In the present financial turbulence, when it emerged that securitisation was the main vehicle through which the crisis had expanded, everybody realised that the information available on these processes was so scant and heterogeneous that it did not allow an accurate assessment of the risks involved and who the final agents were that actually bore the risks.

Throughout the Workshop, some key words have appeared repeatedly: **transparency**, **harmonisation** and **cooperation**. All three pose significant challenges for statisticians and outline the path for our future work in this field. Also, they are closely interconnected: on one hand, harmonisation is necessary to gain transparency; and on the other, given the complexity and the differences across countries in types of operations, agents and practices involved in these kinds of processes, substantial cooperation will be needed among countries and international organisations to be able to progress significantly. We therefore need to broach the three fields simultaneously. But where to start? As in other complex tasks, let us start by trying to understand one another better and let us use a measure of flexibility and common sense.

Beginning with **harmonisation**, we can try to bring terminologies regarding agents and operations fully into line. In doing that, we will realise that the different terms and practices are very well established among the public at large in the different countries. Therefore, let us start rather by trying to make a record of the different uses in each country. In a subsequent step, we could work towards more comprehensive homogeneity. In parallel, some figures would have to be collected, but the different methodologies would have to be made suitably explicit. In this way, important steps can be taken towards **transparency**.

As can be imagined, the work described in the previous paragraph would be much easier and fruitful if it were done through active and efficient **cooperation** between international organisations and the countries concerned. As stated, the drafting of manuals and guidance notes would be of great help.

However, cooperation should go beyond the statisticians themselves. As we have had the opportunity to see throughout this workshop, the exchange of views among analysts, supervisors, accountants, the industry and statisticians is of the utmost importance to clarify concepts, valuations and the need to economise on resources, and to ensure that we are moving in the right direction. We all know that the production of statistics is very expensive in terms of both time and resources, so we must do our best to work in the most useful possible direction.

We, as statisticians, are aware that we are the final link in the chain. When the need to have certain information is identified, statisticians are urged to make it available in a short period and with good quality. Primarily, however, in order to be able to produce good statistics, we have to be able to understand what we are describing. In this respect, we have to understand what securitisation is, and what the role everyone plays in this field is. Undoubtedly, this is a very difficult challenge but, at the same time, a very appealing and rewarding one.

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