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**THE SECURITISATION PROCESS IN SPAIN. DEVELOPMENTS AND PRACTICAL ISSUES**

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## THE SECURITISATION PROCESS IN SPAIN. DEVELOPMENTS AND PRACTICAL ISSUES.

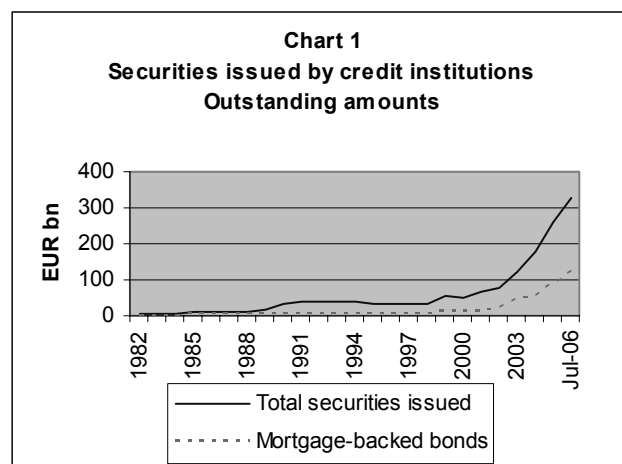
### Introduction

Financial vehicle corporations (FVCs) first appeared in Spain in 1992. Prior to that date, credit institutions securitised their loan portfolios directly, issuing securities backed by their own loans. In the first eight years of their existence, the activity of FVCs was very minor. However, since 2000, these financial intermediaries have recorded something of a boom and have contributed favourably to the development of Spanish securities markets. However, at the same time, they have complicated the analysis of bank lending, both in relation to monetary analysis and in relation to the financial accounts. The purpose of this note is to describe how the phenomenon of securitisation has developed in Spain (Section 2), the features of the FVCs currently existing in Spain (Section 3), the incidence that their activity has had on the growth of credit granted by credit institutions (Section 4) and the way in which the process is recorded in the financial accounts (Section 5). The note concludes with a reference to the available sources in Spain (Section 6) and with a brief summary, in Section 7, of the work that the European System of Central Banks has been carrying out, over about the last two years, to obtain statistics on this phenomenon in the euro area.

### The various types of securitisation.

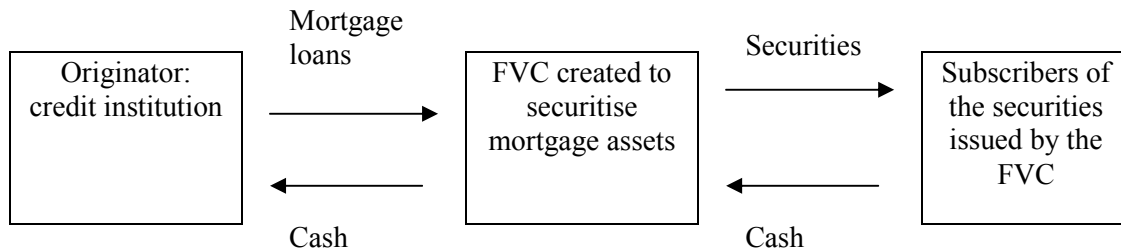
Securitisation began in Spain in 1982 with the regulation of the mortgage market. The new legal framework enabled credit institutions to raise external funds by issuing securities known as “mortgage-backed bonds” (*valores hipotecarios*) backed by their mortgage loans, which remained on their balance sheets. Spanish credit institutions have, since then, resorted systematically to this means of financing, raising funds directly from the subscribers of their issues, without having to resort to a specific financial intermediary specialising in intermediation in the securitisation process.

Chart 1 shows credit institutions’ total securities issuance, as well as their issuance of mortgage-backed securities; that is, without the involvement of any other financial intermediary.



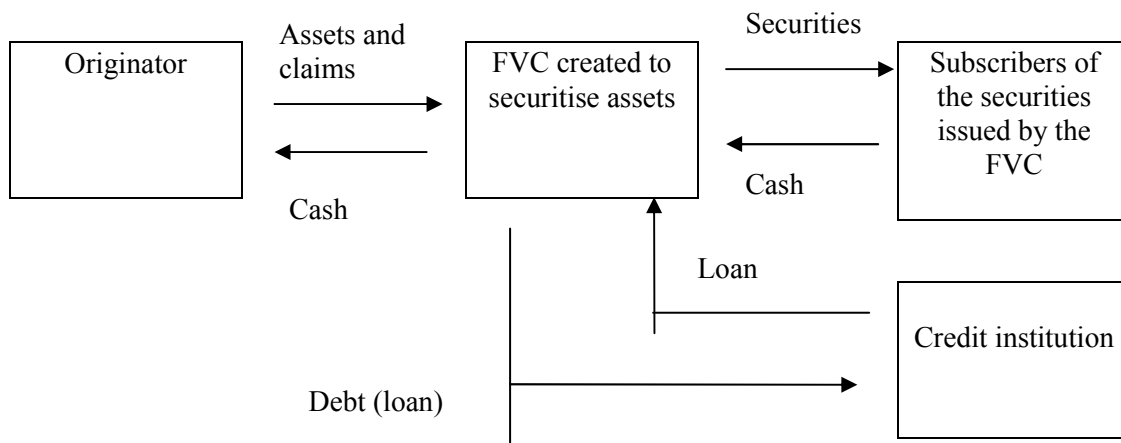
Source: Banco de España, *Boletín Estadístico*

In 1992, an important reform of mortgage market legislation established a new type of financial intermediary known as an “FVC created to securitise mortgage assets” (*Fondos de Titulización Hipotecaria*). Its purpose was to participate in the process of securitising mortgage loans extended by credit institutions. The securitisation process carried out by this kind of FVCs is summarised in the following diagram:

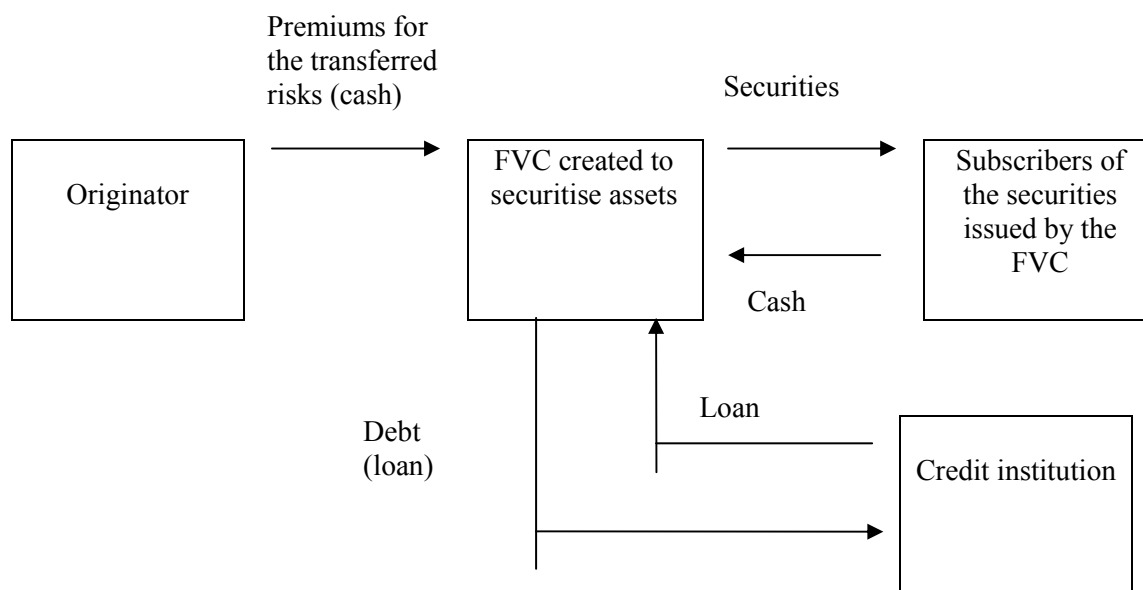


In 1994, the possibility was established of extending the rules envisaged for the securitisation of mortgage loans to the securitisation of other loans and receivables by means of “FVCs created to securitise assets” (*Fondos de Titulización de Activos*). This possibility was used for the first time when the national electricity system was being restructured. It was established that the rights of the owners of nuclear power stations under construction to financial compensation as a result of the moratorium could be assigned through “FVCs created to securitise assets resulting from the nuclear moratorium” (*Fondos de Titulización de Activos Resultantes de la Moratoria Nuclear*).

In 1998, the activity of FVCs created to securitise assets (*Fondos de Titulización de Activos*) was regulated in detail. It was determined that not only could existing receivables in the assets of the assignor be securitised, but also future receivables consisting of estimated income or receipts. The securitisation process carried out by this kind of FVCs is summarised in the following diagram:



Finally, at the end of 2003, FVCs created to securitise assets were authorised to carry out synthetic securitisation of loans and other receivables, assuming all or part of the credit risk of such loans and receivables by selling credit derivatives. The process of synthetic securitisation carried out by FVCs is summarised in the following diagram:



As seen in Chart 1, the appearance of these financial intermediaries, whose activity is to participate in the securitisation of assets, in particular those of credit institutions, has not eliminated the direct issuance of mortgage-backed securities by credit institutions in recent years. However, such issuance has slowed.

### Characteristics of FVCs created to securitise assets

Spanish FVCs are autonomous portfolios of assets, without independent legal status, whose purpose is to assemble groups of financial assets (mortgage loans in the case of FVCs created to securitise mortgage assets) and other receivables that will appear in their assets, for which purpose they proceed to issue fixed-income securities or to receive loans from credit institutions<sup>1</sup>, which will appear in their liabilities. The net asset value of the FVC is zero, so that the flows of principal and interest corresponding to the securities issued and loans received should coincide with those of the group of assets assembled by the FVC (taking into account the differences arising from commissions, management and insurance fee and timing).

The securities issues of FVCs provide for the possibility of early repayment in the event of early repayment of the underlying assets. To launch these issues, an issue prospectus should be prepared that includes the rating assigned by rating agencies of the financial risks associated with the securities. The issue prospectus shall be filed with the National Securities Market Commission, if the securities are being issued in Spain, whether they are marketed to the general public or to institutional investors. Issues shall be traded on organised markets, unless they marketed to institutional investors.

FVCs are set up by FVC management companies (*Sociedades Gestoras de Fondos de Titulización*), which also perform the functions of administration and legal representation of the FVCs. These companies must be entered in a special register kept by the National Securities Market Commission. Prior to the process of setting up an FVC, the management company shall file an information prospectus on the formation of the FVC and on the liabilities with which it will be financed.

FVCs created to securitise mortgage assets are closed FVCs that are dissolved when the assembled securitised mortgage loans have been fully repaid, while FVCs created to securitise assets can be either

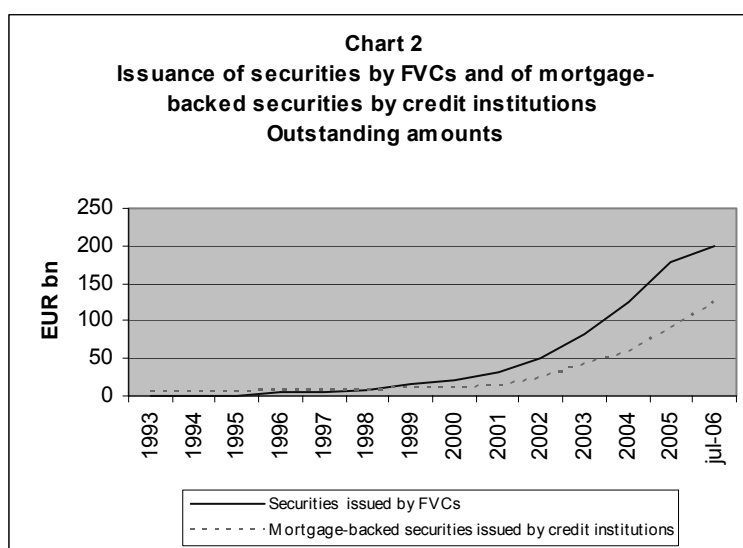
<sup>1</sup> Generally, more than 50% of the liabilities shall be securities financing.

closed or open. Closed FVCs do not modify either their assets or their liabilities until the final maturity of the assets and final repayment of the securities issued, unless the underlying assets are repaid early, in which case the securities issued by the FVC will also be repaid early. Open FVCs can modify their assets and liabilities after their formation, by agreeing new loans and issuing new securities, or when the assets are renewed as the loans are renewable. Open FVCs are normally dissolved at the time specified in the deed of incorporation of the FVC.

With regard to synthetic securitisation, the assets of the FVCs that carry out these transactions may consist of deposits with credit institutions and fixed-income securities traded on official secondary markets, including those acquired under repurchase agreements

As regards the supervision of FVCs, this function is also incumbent upon the National Securities Market Commission. This institution, in addition to performing the functions of registering incorporation prospectuses and, where applicable, issue prospectuses, verifies the information of FVCs and the reports drawn up by their management companies and receives, on an annual basis, the FVCs' audited accounts. Also, the National Securities Market Commission is authorised to issues specific rules relating to the accounting, the format and content of the annual accounts and the reporting obligations of FVCs and their management companies, and also carries out the functions of supervision and inspection of the latter.

Chart 2 shows the issuance of securities by FVCs since they first appeared in the Spanish financial system in 1993, comparing it with the securitisation carried out directly by credit institutions through the issue of their own mortgage-backed securities. The significant growth in recent years in securitisation channelled through FVCs can be seen clearly.



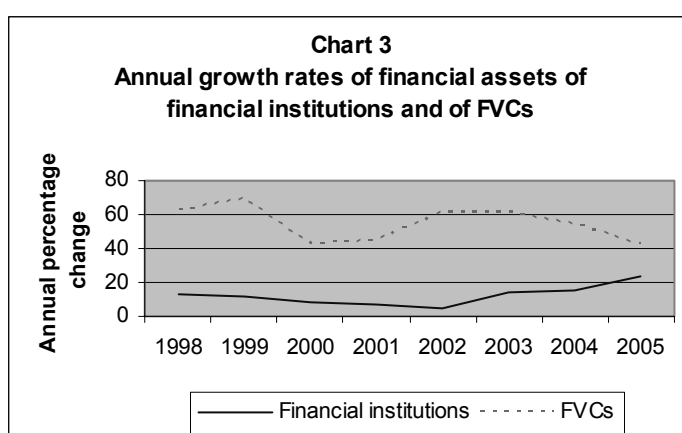
Source: Banco de España, *Boletín Estadístico*

As regards the importance of FVCs in the Spanish financial system, despite the growth in their activity they still do not represent a significant proportion of all the financial assets of Spanish financial institutions, as seen in the table 1. On the other hand, Chart 3 shows the annual growth rates of both series and it can be seen that the growth rates of the activity of FVCs were higher than those of all financial institutions. Additionally, the Annex 1 includes a table that summarize the balance-sheet of the Spanish FVCs since the start of its activity in 1992.

Table 1. Financial assets of financial institutions and of FVCs  
EUR bn and %

	Financial institutions	FVCs	
		Amount	Percentage
1995	974	1	0.1
2000	1,691	22	1.3
2005	3,118	179	5.7

Source: Banco de España; *Financial Accounts of the Spanish Economy and Boletín Estadístico*



Source: Banco de España; *Financial Accounts of the Spanish Economy and Boletín Estadístico*

### Reform of the accounting standards for credit institutions and its effect on securitisation

From when FVCs first commenced their activity in 1992 until the entry into force of new accounting rules in January 2005, the usual practice of credit institutions with regard to the loans they securitised was to derecognise them. However, in some cases, this practice was not followed. Rather, the loans remained on the balance sheet and the securitisation was carried out through the issuance by credit institutions of singular bearer covered bonds that were acquired by FVCs. Because of their characteristics, including notably their negotiability, these bonds have always been considered as deposits of FVCs in credit institutions. That said, this second type of securitisation was much less important compared to the more normal kind in which the securitised loans were derecognised. This gave rise to significant problems for a correct financial and monetary analysis and, in particular, for the measurement of the credit aggregates, since lending to the non-financial sectors of the economy could no longer be followed directly through the balance sheets of credit institutions. Although the financial information that these entities supplied to the Banco de España included data on loans securitised through FVCs created to securitise mortgage assets and through FVCs created to securitise assets, sufficient detail by sector was not available. The Banco de España tried to fill this information gap by resorting to the FVCs' issue prospectuses and assigning the securitised assets to the household, non-financial corporations or general government sector according to the characteristics of the securitised asset (for example, mortgage loans were assigned to households or non-financial corporations according to the distribution between the two sectors of the mortgage loans granted by credit institutions). In this way, the credit variable which was the object of the analysis was made up of the balance of the credit in the balance sheet of the credit institutions plus the outstanding

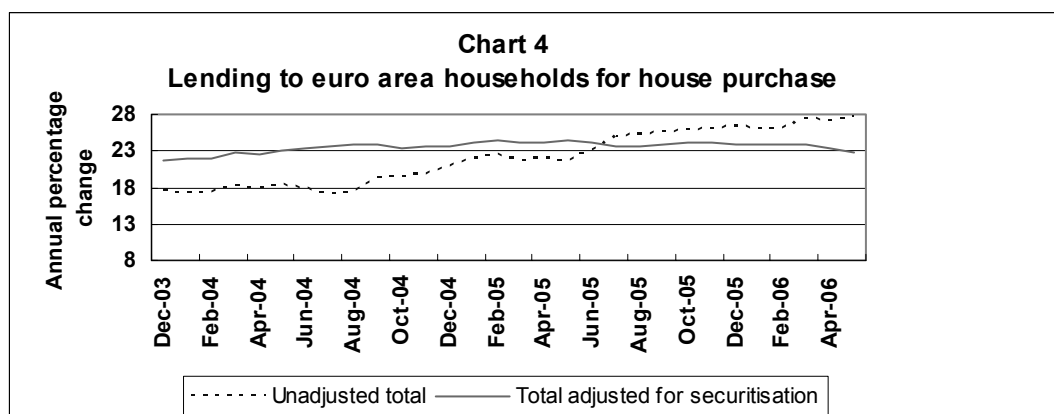
amount of the securitised assets. It is important to point out that this way of assigning securitised credits to sectors through the issue prospectuses of the securities apart from giving rise to potential errors (continuing with the example of mortgage credit, it is clear that the estimated distribution could be incorrect), was very laborious and involved a significant consumption of human resources.

The main aim of the new accounting rules in force since January 2005 was to adapt the standards that credit institutions are required to meet to the International Accounting Standards. These standards include the criteria that must be fulfilled in order to derecognise financial assets and liabilities and, as is known, are compulsory for the accounting statements on a consolidated basis of credit institutions listed on the stock market. In Spain, these criteria have also been incorporated into the accounting standards for individual credit institutions so that transferred financial assets can only be derecognised if their risks and benefits are also substantially transferred or, in the absence of this transfer of risks and benefits, whose control is transferred.

The result of these stricter conditions for the derecognition of financial assets by credit institutions, established by the new accounting rules, has been that most securitisation in Spain since then has been carried out without the credit institution being able to derecognise the securitised loans. In these cases, the counterpart of the financial resources supplied by the FVCs to the credit institutions as a consequence of the securitisation process is reflected in the liabilities of the credit institutions in the form of FVC deposits. As seen in Chart 2, these new regulations have involved a slowdown in the activity of FVCs.

The information that credit institutions are required to send to the Banco de España includes details of the amount of derecognised securitised loans and of the amount of loans that, despite being the underlying assets of securitisation transactions, remain on the institution's balance sheet. This outstanding amount includes, where applicable, repayments and write-downs of the securitised loans since, even if the loans have been derecognised, the credit institution usually continues to administer securitised loans. The sectoral classification of derecognised loans is obtained using additional information that the Banco de España requests from a sample of institutions representing around 90% of the total outstanding amount of securitised loans, adding to the outstanding amount of the on-balance sheet loans to the various sectors, the outstanding amount of derecognised securitised loans. It is important to note that, in the new circumstances, the information obtained from FVCs is no longer valid to make the necessary adjustment to the amount of institutions' on-balance sheet loans for the correct analysis of this variable, since the information on securitised loans provided by FVCs does not enable those that have been derecognised to be distinguished from those that remain on the originator's balance sheet.

The impact of securitisation in Spain has been especially marked in the case of lending to households for house purchase. Chart 4 shows the annual growth rate for the credit granted by Spanish institutions to euro area residents that is included in their balance sheets and the same rate for this variable when the securitised loans that have been removed from their balance sheets are included. As can be seen, over the period December 2003 to May 2006, the first of these variables rose by 10 basis points (from 18% to 28%), while if the loans that have been removed from the balance sheet as a result of securitisation are included, the growth of the aggregate is much more stable, at rates of around 22%.



Source: Banco de España, *Boletín Económico*

### Recording of securitisation transactions in the Financial Accounts of the Spanish Economy

The Banco de España has been compiling the Financial Accounts of the Spanish Economy following the methodology of the European System of Accounts (ESA) since the beginning of 1980. They consist of quarterly series dating back to 1990 and annual series commencing in 1970<sup>2</sup>. In the current version of this System, ESA 95, FVCs are included in the sub-sector other financial intermediaries, which comes within the sector financial institutions. To obtain the data for FVCs it is necessary to determine how the securitisation process works, distinguishing between securitisation in which the securitised loans are derecognised by the sector that initially granted them (the originator) and securitisation that is carried out without derecognition of the loans by the originator. In addition, the inclusion of the information in the Financial Accounts requires information on the counterpart sector of the securitised loans (for example, loans from credit institutions to households) since, in the first type of securitisation, the change in creditor sector should be recorded in the Financial Accounts (in the example, the loan to households vis-à-vis credit institutions must be recorded after the securitisation as loans to households vis-à-vis other financial intermediaries).

The following table summarises the entries that must be made in the Financial Accounts, according to whether the originator derecognises the loans or keeps them on its balance sheet.

<sup>2</sup> The quarterly and annual series for the period commencing in 1990 are compiled using ESA 95 methodology, while the annual series for the period 1970-1989 are currently compiled using ESA 79 methodology.

Entries in the Financial Accounts (financial transactions account and financial balance sheets) arising from securitisation transactions

		Securitisation in which the original lender derecognises the asset	Securitisation in which the original lender keeps the asset on its balance sheet
Sector that originally granted the loans: . Financial institutions . Non-financial corporations . General government	Financial assets	There is a reduction in its financial assets (category F.4, loans) equal to the amount of the loans assigned to the FVC. There is an increase in its financial assets (category F.2, currency and deposits) arising from the delivery of the funds raised by the FVC, which the latter transfers to the assignor of the loans.	There is an increase in its financial assets (category F.2, currency and deposits) arising from the delivery of the funds raised by the FVC, which the latter transfers to the assignor of the loans. In the case of synthetic securitisation there is a decline in assets in the same category arising from the payment of premiums to the FVC, recognising a derivative on the assets side of the balance sheet.
	Liabilities	No entries are made in the originator's liabilities	There is an increase in its liabilities vis-à-vis the FVC (category F.2, currency and deposits) arising from the funds transferred by the FVC, which the latter raised by issuing securities. In the case of synthetic securitisation there are no entries
FVCs	Financial assets	There is an increase in its financial assets (category F.4 loans) equal to the amount of the loans assigned by the originator There is no change in its liquid assets (category F.2 currency and deposits) as the FVC transfers to the assignor the funds it raises by issuing securities	There is an increase in its financial assets (category F.2) equal to the amount of the funds transferred to the originator. In the case of synthetic securitisation, there is an increase in assets (category F.2) arising from the payment of premiums by the originator. There may be an increase in its portfolio of securities other than shares (category F.3) if the FVC invest the funds raised from its issuance of securities
	Liabilities	There is an increase in the FVC's liabilities (category F.3 securities other than shares) arising from the issuance of securities	There is an increase in its liabilities (category F.3, securities other than shares) arising from its issuance of securities. Additionally, In the case of synthetic securitisation the recognition of a derivative in its liabilities, subsequent changes in the value of the derivative will be recorded in its liabilities
Counterpart sector: . Residents or non-residents	Liabilities	There is a reduction in its liabilities (category F.4 loans) vis-à-vis the sector of the originator and there is an increase in its liabilities (in the same category) vis-à-vis the FVC (OFIs)	No entries are made in the liabilities of the counterpart sectors, which continue to record their loans vis-à-vis the sector of the originator

**Sources of information necessary to measure the different aspects of the securitisation process.  
Reference to Spanish sources**

First it is necessary to establish which phenomena relating to the financial flows generated by the phenomenon of securitisation and the balance sheets of the agents involved in the process have to be measured. Then, it is necessary to find sources of information to compile the statistics required for economic analysis.

***The objective is to measure correctly the following:***

- the credit aggregate which are counterparts of monetary variables, i.e. the credit granted to the non-monetary sector of the economy, which is relevant for monetary analysis, the study of the financing of non-financial sectors and compilation of the financial accounts. For this purpose, the credit derecognised by credit institutions vis-à-vis money-holding sectors must be completed with the credit vis-à-vis these sectors of FVCs, to determine their total debt and its growth. Information on credit institutions' lending activity is not, therefore, sufficient for this purpose.
- the activity of FVCs and their role in the process of banking disintermediation and in the transfer of credit risk within the financial system: relevant for financial analysis and for the compilation of financial accounts corresponding to the sub-sector *other financial intermediaries* in which FVCs are included.
- the new financial instruments generated in the securitisation process (securities issued by FVCs) and their trading on secondary markets: relevant for financial analysis, securities market developments and the compilation of the financial accounts for other financial intermediaries and counterpart sectors that acquire securities issued by FVCs.

***In principle<sup>3</sup>, securitisation may generate the following financial flows:***

- financing transactions, relating to the securitised assets, between the FVC and the originator of the securitised credit:
  - purchase of securitised assets.
  - a deposit by the FVC at a credit institution (the latter being the originator of the securitised asset).
  - purchase of bonds issued by the originator of the securitised credit.
- raising of funds (financial transaction) through the issuance of securities or granting of loans by the FVC: financial relationship between the FVC and the securities subscribers or the resident or non-resident credit institutions that grant the loans.
- payments of premiums by the originator of the securitised credit to the FVC when the originator transfers the credit risk through a credit default option (synthetic securitisation).
- flows arising from possible revaluations and changes in the volume of the financial assets involved in the securitisation process: for example, breach of credit obligations and valuation of the securities issued.

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<sup>3</sup> Only the simplest form of synthetic securitisation is considered here, so that this is not a comprehensive list of all the financial flows that can be generated by the securitisation process. Other more sophisticated forms of securitisation complicate the flows of funds generated. Moreover, development of the financial system may in future introduce further complications.

With regard to the balance sheets of the agents involved in the securitisation process, it is necessary to identify:

- the changes that occur, in relation to securitised credits, in the financial balance sheets of the originator of the credit, the FVC and the counterpart sectors of the securitised credits.
- the changes that occur, in relation to the securities issued in the securitisation process, in the liabilities of the issuers of such securities, principally FVCs, and in the portfolios of the securities subscribers and holders.

Taking into account all these elements, the sources of information to which recourse may be had are as follows:

1. The credit originator: if it is a financial institution, regulated by an authority of the country, information may be obtained relating to its participation in the securitisation process, provided that the securitisation is of the type in which there is no derecognition or in which, if there is derecognition, the originator continues to administer the assigned assets. The problem here is:
  - the cost of the information burden imposed on reporting agents by the regulatory authorities. In any case, it should be taken into account that any information that can be obtained from the originator might reduce that which has to be obtained directly from the FVC, and thus might reduce the information burden that FVCs have to bear.
  - the role played by originators not subject to a regulatory authority. If their role is important, for example in securitisation carried out by non-financial corporations, the possibility of measuring the securitisation process through the reporting agents themselves is reduced.
2. The FVC: if it is a resident institution supervised by an authority of the country, information may also be obtained on its participation in the securitisation process. The same considerations of the cost of the information burden are valid in this case. Thus, if the aim is to establish an information system based on, for example, credit institutions and FVCs, it will have to be taken into account for which institution it is less costly to offer the details necessary to fulfil the objective of correct measurement of the securitisation process.
3. The securities markets: they may permit the activity of FVCs to be monitored and, under certain conditions (detailed information on FVCs' incorporation prospectuses and the issue prospectuses for their securities, easy identification of the securitised credits and of the counterpart sectors, low volume of issues abroad, easy identification of FVCs) provide basic information to replace, perhaps with certain assumptions or estimates, that raised directly from the FVC itself.

The following table shows the different sources of information currently available in the case of Spain:

**Information available on the securitisation process in Spain**

Source	Information supplied	Use	Problems
Credit institutions (originators)	1) Outstanding amounts of on-balance sheet securitisation transactions 2) Outstanding amounts of off-balance sheet securitisation transactions, with details of the counterpart sectors	1) To correctly measure the credit aggregates and their path by counterpart sector 2) To measure the development of the securitisation process	1) The measurement of securitisation activity does not consider that arising from originators other than credit institutions 2) Information is only available on outstanding amounts of securitised assets
FVCs	1) Audited annual financial statements 2) FVC formation prospectuses and, where applicable, securities issue prospectuses	1) To measure the activity of FVCs and the development of the securitisation process 2) To include FVCs in the Financial Accounts in the sub-sector other financial intermediaries	1) The accounting information is heterogeneous, since homogeneous financial statements have not been established for supervisory or statistical purposes 2) Difficulties of identifying off-balance sheet securitisation transactions 3) Formation prospectuses are highly summarised 4) Issue prospectuses are not available for FVCs that issue their securities abroad 5) Data is available for the amounts of securities issued but not for changes over time (repayments matched with the repayments of securitised assets)
Securities markets and security-by-security information on securities portfolios	1) Security-by-security data for securities issued by FVCs and traded on organised markets 2) Security-by-security data on the portfolios of institutional investors and of non-residents	1) To measure the activity of FVCs and flows of financing in securities markets 2) To obtain the counterpart sectors of FVCs' securities issues for inclusion in the Financial Accounts	1) This information is not available for FVCs that issue their securities abroad or for issues marketed to institutional investors 2) Security-by-security information is not available for all institutional sectors

**The work of the European System of Central Banks to obtain European Union securitisation statistics**

In order to measure the activity of FVCs and the true path of euro area credit aggregates, the European System of Central Banks (ESBC) has been working for some time on the data currently available at the National Central Banks (NCBs) of the ESCB. These data are used to compile euro area statistics for the sub-sector *other financial intermediaries*, with details of some of its components, in particular mutual funds and FVCs. Given the heterogeneity of the information available across the various EU countries, on the basis of which these statistics are being produced, the ECB is promoting the possibility of a homogeneous statistical framework for the NCBs to report on the securitisation activity in their respective countries to the ECB.

New statistical information projects pass through a "merits and costs" procedure, which compares the usefulness for analysts of the new statistics with their costs of compilation for reporting agents, NCBs (or other supervisory bodies) and the ECB itself. This procedure is already very advanced in the case of mutual funds, and a regulation is being prepared on the information that reporting agents must send periodically to the NCBs (or other supervisory bodies). As regards FVCs, the need for a similar regulation and its content is currently being discussed.

**ANNEX 1**  
**FINANCIAL VEHICLE CORPORATIONS CREATED TO SECURITIZE ASSETS IN SPAIN**  
**BALANCE SHEET**

EUR MILLIONS

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	II													
CURRENCY AND DEPOSITS	13.0	38.2	63.2	149.4	182.6	289.7	685.2	1050.0	6173.2	10948.0	24181.4	43100.0	135990.9	167191.2
SECURITIES OTHER THAN SHARES: LONG TERM	-	-	-	-	-	-	-	-	-	-	-	-	1280.8	1097.2
LOANS	208.0	616.1	1130.8	5155.8	5343.6	8570.1	14405.0	20456.2	25067.0	39583.8	57246.5	82161.9	40169.2	37240.6
OTHER ASSETS	4.0	14.7	24.8	23.2	33.0	161.2	164.5	170.0	195.5	295.0	364.4	475.0	1350.0	850.0
<b>TOTAL ASSETS = LIABILITIES</b>	<b>225.0</b>	<b>669.1</b>	<b>1218.7</b>	<b>5328.3</b>	<b>5559.3</b>	<b>9020.9</b>	<b>15254.7</b>	<b>21676.2</b>	<b>31435.7</b>	<b>50826.8</b>	<b>81792.3</b>	<b>125736.9</b>	<b>178791.0</b>	<b>206379.0</b>
SECURITIES OTHER THAN SHARES: SHORT TERM	-	-	-	-	-	124.2	1115.3	1983.7	2374.3	4082.3	3346.9	5107.3	4314.9	5011.0
SECURITIES OTHER THAN SHARES: LONG TERM	219.0	647.5	1173.4	2257.1	2376.1	5574.4	10563.5	15921.0	25379.1	43028.5	74239.2	117429.7	170176.0	197068.0
LOANS	5.0	14.2	23.0	3049.6	3139.7	3238.6	3408.5	3450.0	3363.0	3380.0	3668.1	3000.0	4000.0	4000.0
OTHER LIABILITIES	1.0	7.3	22.2	21.7	43.5	83.7	167.4	321.5	319.3	336.0	538.1	200.0	300.1	300.0