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**THE STATE OF ART OF THE WORK ON SECURITISATION IN THE EUROPEAN SYSTEM OF  
CENTRAL BANKS**

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*This paper does not necessarily reflect the views of the European Central Bank. It has received valuable comments from Steven Keuning, Caroline Willeke, Stefano Borgioli and Paolo Poloni, .Any remaining mistakes or inaccuracies are those of the author*

*This document has been prepared by Jean-Marc Israel, ECB and will be presented under item 2 of the draft agenda*

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## **THE STATE OF ART OF THE WORK ON SECURITISATION IN THE EUROPEAN SYSTEM OF CENTRAL BANKS<sup>1</sup>**

### **Abstract**

Statistics produced by the ECB and European System of Central Banks (ESCB) focus on providing timely and reliable information to support the analysis of monetary and financial developments within the euro area and in their interaction with other economies. In this respect, securitisation transactions and the role of securitisation vehicles have been identified for long as an important topic. As new or enhanced statistics are developed following a merits and costs procedure, it has taken some time for related user requirements to trigger the reporting of new data. In the mean time, the financial turmoil starting in August 2007 has further increased the importance and relevance of these statistics as a means to support Central Banks' analysis of this market and to enhance its overall transparency. The paper outlines the phenomenon at play (largely based on market data), the main user requirements for these statistics, the procedure followed for their development and the content and presentation of the forthcoming data.

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## Introduction

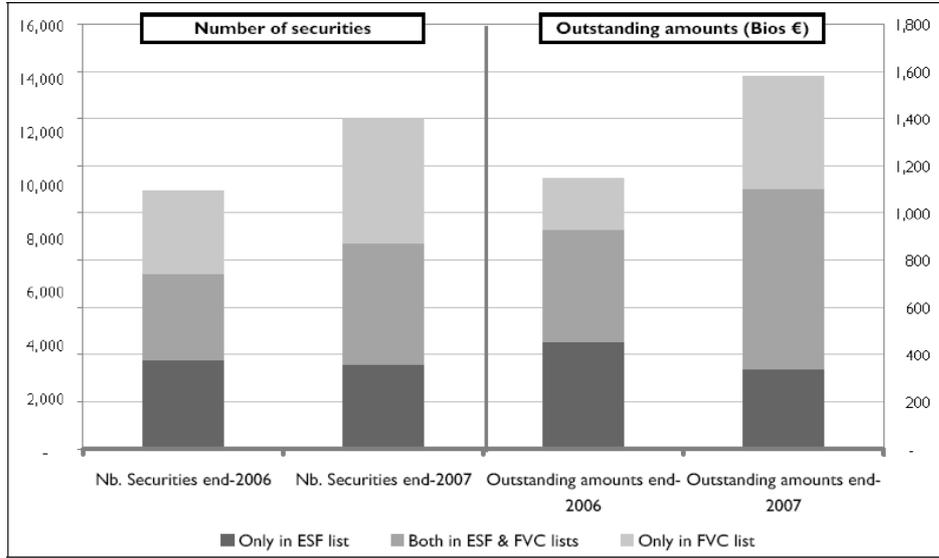
1. The recent turmoil in credit markets has highlighted how securitisation has changed in only a few years from being a relatively niche market in the euro area to being a major force behind capital market developments. This increasingly influential role of securitisation is of interest to central banks for a number of reasons. From a monetary policy perspective, securitisation, through its effect on the funding of banks and credit markets, not only impacts on the transmission mechanism via the supply of loans, but also affects monetary analysis. In addition, the recent turmoil in credit markets has strongly highlighted the significance of securitisation markets from a financial stability perspective. Lastly, securitisation has been at the forefront of financial innovation and has contributed to financial integration in the euro area.
2. In this light and initially mainly to enhance monetary analysis, the ECB and ESCB have considered the development of new, harmonised statistics on securitisation vehicles, so-called “Financial Vehicle Corporations” (FVCs). In conformity with the ‘merits and costs’ procedure for new or enhanced statistics, this procedure has been run for FVCs as a sub-sector of the *1995 ESA* ‘other financial intermediaries’ (S.123) sector.<sup>2</sup>
3. Since the new harmonised statistics will be available by end 2010, the ECB is using data existing within the ESCB, or from the industry and commercial data providers. By combining granular data provided by the ESCB and European Securitisation Forum (ESF), an enhanced data set broken down by country of issuance, sector of issuance, asset type, coupon frequency and type, currency, is made available. As a result, Chart 1 shows that the outstanding amount of structured securities reached at end 2007 €1.1 trillion for the euro area and €1.6 trillion for the EU.<sup>3</sup>

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<sup>2</sup> Another merits and costs procedure was run for another sub-sector of S.123, namely investment funds that led to the adoption of Regulation ECB/2007/8 on statistics on assets and liabilities of investment funds – OJ L 211, 14.8.2007, p. 8.

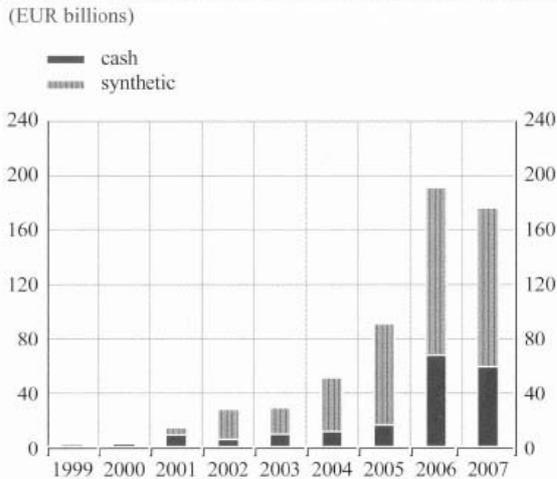
<sup>3</sup> For more details on what can be achieved in the short-term, see paper from P. Poloni and J. Reynaud “How to measure credit risk transfer in the EU”, presented at the Fourth IFC Conference on "Measuring financial innovation and its impact" (August 2008).

**Chart 1 – Coverage (left-hand scale) and outstanding amounts (right-hand scale) of structured securities issued in the EU**



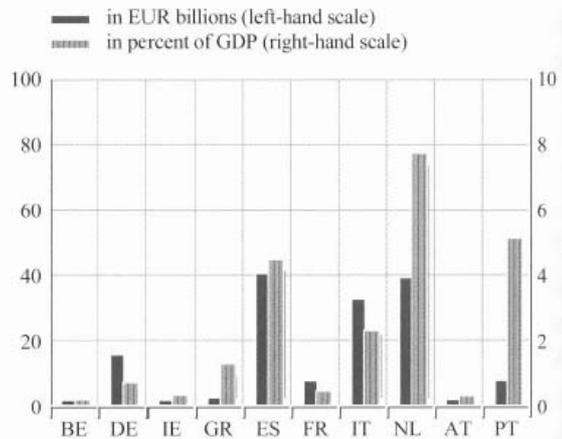
Source: ESF, ECB and ECB calculations

**Chart 3 Issuance of euro-denominated cash and synthetic CDOs**



Source: Creditflux.  
Note: Data for 2007 refer only to the first three quarters.

**Chart 4 Securitisation in the euro area by country of collateral in 2006**



Sources: European Securitisation Forum and Eurostat.  
Note: CDOs and synthetic securitisation are not included.

- The user requirements for the securitisation statistics are reported in section 1 of the paper. The running and outcome of the merits and costs procedure and main features of the new statistics are summarised in section 2. Some steps ahead are outlined in section 3.

## 1 The requirements for statistics on securitisation<sup>4</sup>

5. For monetary analysis, statistical information in securitisation contributes to an improvement in the analysis of monetary and credit developments, in particular with respect to possible substitution of monetary financial institutions (MFI) loans by loans granted by non-monetary financial intermediaries (including through securitisation transactions). The absence of comprehensive and harmonised statistics on securitisation could compromise the quality of the analysis supporting monetary policy decisions. For instance, the analysis of credit development may on occasions be hampered if large securitisation transactions or lending by other financial intermediaries are overlooked. Timely data on FVCs, e.g. to measure substitution between FVCs and MFIs in respect of their assets and the liabilities, may have important consequences for the monetary analysis.<sup>5</sup>
6. From a medium-term perspective, this statistical information is necessary to capture trends in the financial structure of the euro area economy, which in turn provide important background information for monetary and financial stability analysis. As, in normal circumstances, securitisation ensures a greater liquidity of instruments such as bank loans, and a spreading of the associated risk on a potentially wide range of investors, securitisation transactions benefit from financial integration and may, in turn, foster a further integration of markets.
7. The recent turmoil in credit markets has highlighted the significance of securitisation markets from a financial stability perspective. The volume of issuance of various instruments (asset-backed securities (ABS), collateralised debt obligations (CDOs)<sup>6</sup>, residential mortgage-backed securities (RMBS), etc.), the complexity of some of them, in particular CDOs, with several tranches and the relative illiquidity of the markets, has led to a large reliance on credit ratings and on valuation methods that were not tested in difficult market conditions. A better measurement of the market volumes for each type of instruments, and of the exposure of domestic sectors to these instruments would be useful for financial stability analysis.
8. In order to integrate the securitisation statistics in a consistent statistical framework, the breakdown of financial assets and liabilities complies with the 1995 ESA sectors and instruments classification.
9. Overall, from a euro area perspective, securitisation statistics are of importance for purposes of monetary policy (analysis of credit developments), financial structures (monitoring a process of possible disintermediation) and operations (eligible asset classes), market integration and financial stability analysis (redistribution of credit risk across sectors).
10. In order to get a comprehensive picture of MFI securitisation activity, one convenient way might be to address reporting requirements directly to MFIs. However, addressing euro area FVCs directly also provides information from a different perspective: first, it captures securitisation activity undertaken in the euro area and for which the originator is located in a non-euro area country. Second, it captures securitisation undertaken by different sectors of originator (it is estimated that two-thirds are originated by MFIs while the remaining one-third of the securitisation activity is originated by non-financial corporations and general governments). It is important to monitor how the entire securitisation market evolves in the euro area. FVCs can be seen as the main source of information for the securitisation of non-financial corporations.

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<sup>4</sup> A broad overview of “Securitisation in the euro area” is given in an article of the ECB Monthly Bulletin of February 2008, p. 81.

<sup>5</sup> For example, Box 2 of the above mentioned article in ECB Monthly Bulletin of February 2008, or Box 3 of the ECB Monthly Bulletin of September 2008 show the impact of bank loan securitisation on monetary analysis.

<sup>6</sup> See Box 1 of the above mentioned article in ECB Monthly Bulletin of February 2008.

11. There is clear need to monitor this market as securitisation is quickly broadening the types of financing sources available and affects corporate finance. It should be noted that one of the most impressive financial market developments in the euro area since the introduction of the euro has been the expansion of the corporate bond market. This applies in particular to debt securities issued by non-monetary financial corporations, which are also related to securitisation.<sup>7</sup> This market segment has grown at an average annual growth rate of 38% from January 1999 to June 2007, compared with only 11% during Stage Two of EMU (1994-1998).
12. In terms of geographical breakdown of counterparts, the identification of liabilities and the holdings of assets following the split on domestic/other participating Member States/rest of the world is required in order to build accurate euro area aggregates. It would also allow the analysis of cross-border activities of the FVCs. Furthermore, the availability of a sector breakdown of counterparts following *1995 ESA* breakdowns should allow capturing the origination of FVCs activities by different sectors of economy. The following breakdown MFI / Non-Financial Corporations / General Government will allow a better analysis of the cross-sectional loans and credit risk transfer.
13. Financial transactions data and separately revaluations are essential to report the effective transactions of the FVCs. This is also important to better analyse the FVCs behaviour and to better relate these statistics to other statistics based on flows (MFI balance sheet statistics and Securities issues statistics; or more granular information available in the ESCB Centralised Securities Database).
14. Statistical requirements to FVCs will mainly allow underpin a comprehensive overview of traditional (true-sale) securitisations, but a more fragmented view for monitoring synthetic securitisation. A particular element regarding credit risk transfer relates to credit default swaps which are better captured in a more global approach.<sup>8</sup> Moreover, by collecting data on securities issued in euro area not the whole scope of securitisation activities undertaken by originators resident in euro area will be captured. Instead of using FVCs located in euro area, they may use or create FVCs resident in an off-shore centre or in a third country with a more favourable securitisation environment. However, on the other hand, the envisaged steady-state approach would capture securitisation activities of originators from non-euro area countries, for purposes of whom the FVCs were located in the euro area. In addition, both to complement the information obtained from FVCs and reduce the overall reporting burden on them, the ESCB Statistics Committee agreed to develop an integrated approach, whereby originating banks (MFIs) will report on loans they continue to service.
15. Balance sheet and transaction statistics, with an instrument, maturity, geographical and sector breakdown will be required at quarterly frequency.

## **2 The merits and costs procedure**

16. The ECB Governing Council adopted in 2000 a procedure whereby the merits of new or enhanced ESCB statistics as assessed by users are weighted against the costs incurred.<sup>9</sup> Costs are assessed for

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<sup>7</sup> See for example: 1) De Nederlandsche Bank (2003), Growing importance of securitisation and special purpose vehicles (SPVs), Statistical Bulletin, December, 31-35; 2) ECB (2003), Securitisation and the activity of special finance vehicles, Monthly Bulletin, Box in: Recent developments in financial structures of the euro area, 47-49; 3) de Bondt, G. and Lichtenberger, J-D. (2003), The euro area corporate bond market: where do we stand since the introduction of the euro?, European Business Organisation Law Review, 4,4, 517-539.

<sup>8</sup> One possible source could be the BIS statistics. A project is currently under way at the BIS to enhance the collection of statistical information on credit derivatives.

<sup>9</sup> See:  
<http://www.ecb.europa.eu/pub/pdf/other/ecbstatisticsqualityassuranceprocedure200804en.pdf?eb834a78cd3bb88132eccf6371e469fb>

reporting agents and compiling agencies, and cover both the one-off implementation and regular production.

17. In respect of securitisation statistics, two merits and costs procedures were run. A standard one was launched in 2005 and concluded by the Statistics Committee in September 2007. However, in the wake of the financial turmoil that just started, the Statistics Committee also agreed to further assess its possible impact on the user requirements for securitisation statistics; complements to the merits and costs were added in June 2008. A second procedure was launched in the context of a review of Regulation ECB/2001/13 on the consolidated balance sheet of the MFI sector;<sup>10</sup> here, the assessment of new requirements included the impact where MFIs are servicers.
18. Following the merits and costs procedures, the draft FVC legal texts (new draft Regulation addressed to reporting agents and part of the Guideline addressed to national central banks (NCBs) for the more procedural aspects) were discussed by the Working Group on Monetary and Financial Statistics (WG MFS) between January 2008 and September 2008. The European Securitisation Forum (ESF), a representative association of the industry, was involved in the preparation and provided comments on a draft of the FVC Regulation. Two meetings were held with the ESF (in April 2008 and September 2008) involving key FVC managers and NCBs involved in the implementation of the future FVC regulation. The ESF expressed its commitment to support measures to improve the market transparency and the implementation of the draft Regulation, and provided various technical comments regarding the definition of FVCs, their identification and the future regular quarterly reporting. The WG MFS also discussed in September 2008 the draft recast and amended Regulation on the consolidated balance sheet of the MFI sector, including the part related to securitisation transactions.
19. The FVC definition (see Annex) should ensure a comprehensive coverage of all resident securitisation vehicles regardless of the structure of the securitisation transactions. For the purpose of the securitisation definition elements of the securitisation related definitions contained in Article 4 of “*Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast)*”<sup>11</sup> were adopted. It was also agreed that the definition of securitisation should cover not only the securitisations whereby credit risk is transferred, but also other types of securitisations such as securitisations of tax credits, or other future (government) revenues, or whole business securitisations.
20. The draft FVC legal texts provide some flexibility concerning the data collection method. This approach aims at minimising the reporting burden by taking also account of the various national circumstances. NCBs have the possibility to derive the data required by the FVC Regulation from other statistical, public or supervisory sources as long as the data meet certain minimum quality standards. Flexibility is also achieved by the possibility for NCBs to collect data from MFIs instead of from FVCs, concerning loans originated by euro area MFIs and if the MFIs continue to service the securitised loans (so-called *integrated approach*).
21. Further cost reducing measures have been introduced in the draft Regulation. NCBs may allow FVCs to report data falling on a date within a quarter instead of the end of the quarter, if the data are comparable and if significant transactions until the end of the quarter are subsequently taken into account. The draft Regulation also contains a cutting-off the tail provision which will allow exempting small FVCs from most reporting requirements.

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<sup>10</sup> OJ L 333, 17.12.2001, p. 1. See also: [http://www.ecb.europa.eu/ecb/legal/pdf/l\\_33320011217en00010046.pdf](http://www.ecb.europa.eu/ecb/legal/pdf/l_33320011217en00010046.pdf)

<sup>11</sup> OJ L 177, 30.06.2006, p. 1. See also: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:177:0001:0200:EN:PDF>

22. Accounting principles are either those of the International Financial Reporting System, or national Generally Agreed Accounting Principles. However, as FVCs may not compile their accounts at quarterly frequency, nor in a very timely fashion, some departures may be authorised. E.g. NCBs will likely be entitled to exempt FVCs from certain reporting obligations that would cause unreasonably high costs compared to the statistical benefit of these obligations (for example mark-to-market reporting of financial derivatives on a quarterly basis). Moreover, only total write-offs/write-downs on securitised loans (i.e. no breakdowns by counterpart area/sector) may be reported and other relevant information – e.g. principal deficiency ledger as shown in investors' reports – could be used as a proxy.
23. Traditional (e.g. true-sale) and synthetic securitisation will be separately reported. This will enhance the value for analysis of the data.

### **3 The next steps**

24. The Regulations on FVC statistics and the update for MFI consolidated balance sheet will follow the procedure for their adoption by the ECB Governing Council. This is expected to take place around end-2008. The related Guideline (a binding text for the ECB and NCBs only) will be prepared in parallel and adopted in the first half of 2009. It will further clarify in particular how the ESCB Register of Institutions and Assets Database and Centralised Securities Database should be used to ensure better data consistency, or how the integrated approach should work where FVCs and originating MFIs are not resident in the same country. Also Manuals (non-binding methodological recommendations) will be prepared in 2009.
25. The first reporting of data is planned to take place in mid 2010 with quarterly data from end 2009.

**Annex: draft definition of Financial Vehicle Corporations and of securitisation**

‘FVC’ means an undertaking :

whose principal activity meets the following criteria:

- (a) it intends to carry out, or carries out, one or more securitisation transactions and is insulated from the risk of bankruptcy or any other default of the originator; and
- (b) it issues, or intends to issue, securities, other debt instruments and/or financial derivatives and/or legally or economically owns, or may own, assets underlying the issue of securities that are offered for sale to the public or sold on the basis of private placements; and

who is constituted pursuant to national or Community law under one of the following:

- (i) contract law as a common fund managed by management companies;
- (ii) trust law;
- (iii) company law as a public or private limited company;
- (iv) any other similar mechanism.

Neither of the following is included in the definition of FVC:

- MFIs within the meaning of Article 1 of Regulation ECB/2001/13.;
- Investment funds (IFs) within the meaning of Article 1 of Regulation ECB/2007/8 of 27 July 2007 concerning statistics on the assets and liabilities of investment funds

‘Securitisation’ means a transaction or scheme whereby an asset or pool of assets is transferred to an FVC and/or the credit risk of an asset or pool of assets, or part thereof, is transferred to the investors in the securities, other debt instruments and/or financial derivatives issued by an FVC, and:

(a) in case of transfer of credit risk, the transfer is achieved by:

- the economic transfer of the assets being securitised to an FVC. This is accomplished by the transfer of ownership of the securitised assets from the originator or through sub-participation; or
- the use of credit derivatives, guarantees or any similar mechanism;

and

(b) where such securities, debt instruments and/or financial derivatives are issued, they do not represent the originator’s payment obligations;