Ekonomiczne Problemy Usług nr 4/2018 (133) t. 2

ISSN: 1896-382X | www.wnus.edu.pl/epu
DOI: 10.18276/epu.2018.133/2-03 | strony: 29–37

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The Revival of the Securitization Market after the Global Financial Crisis: A Case of Europe

JEL codes: E44, G01, G15

Keywords: securitization, securities, financial crisis, financial market

Abstract. The aim of this study is to assess the post-crisis securitization market in Europe. The presented considerations focus on two fundamental aspects: (1) identification of changes in the regulatory environment of securitization in the European financial system and (2) analysis of changes in the size and structure of the European market for securitization of financial instruments between 1998 and 2017. The analysis is to answer the question of whether the European market for securitization of assets is reviving.

1. Introduction and literature

Securitization is defined as a process during which diversified pool of financial assets, together with cash flow they have generated, are isolated from initiator's balance (company, financial institution, government or local government unit), secured by means of internal and external methods, and made legally independent in the so-called special purpose vehicle (SPV), which then refinances the purchased asset pool through the issuance of debt securities in domestic and (or) international capital markets (Reksa, 2007, pp. 5–6). Securitization is one of the most advanced financing techniques and, at the same time, a mechanism in which the causes of the global financial crisis of the 21*st* century are seen (Baig, Choudhry, 2013; Brunnermeier, 2009; International Monetary Fund, 2008; Keys, Mukherjee, Seru, Vig, 2010). The concept of securitization was born on the field of the American financial system in the late 1970s (Kothari, 2006, p. 112) and permanently changed the face of the modern finance (Chrabonszczewska, Waszkiewicz, 2010, p. 18). In its original assumption, the securitization mechanism was an instrument of asset management of credit institutions with the ability to transform selected items of their low liquidity financial assets in cash, aimed at extending the scale of their activities (Segoviano, Jones, Lindner, Blankenheim, 2013, pp. 54–55). With the evolution of the financial system, the securitization process began to change as well, and with it – the purpose of its use. The technique that constitutes a bridge between the credit market and the capital market has changed into a complicated hybrid form involving an increasing number of entities, taking into account in its structure almost all segments of the financial market (including derivatives market), designed to refinance extremely diverse catalog of assets, and significantly shifted toward unregulated activities shadow banking (Waszkiewicz, p. 1). As a consequence, the essence of the securitization mechanism significantly exceeded the issue of refinancing financial institutions' loan portfolios. In the securitization process, the following options appeared: transfer of risk related to the refinanced assets package, reduction of regulatory requirements or credit rating management of the initiator of the securitization (for more details see: Pawłowski, 2018, pp. 65–66).

The wide applicability and the multidimensional nature of the benefits of securitization have directly translated into increased interest in and popularization of this mechanism. However, the growing and increasingly non-transparent securitization market were not followed by adequate and needed prudential regulation. As a result, the uncontrolled use of the analyzed mechanism was a direct premise and a source of escalation of the 2007+ financial crisis.

Against this background, the aim of this study was to assess the post-crisis market for securitization of assets. The presented considerations focus on two fundamental aspects: (1) identification of changes in the regulatory environment of securitization transactions carried out in the structure of the European financial system and (2) analysis of changes in the size and structure of the European market for securitization of financial instruments between 1998 and 2017. The analysis is to answer the question of whether the European market for securitization of assets is reviving.

2. Research methodology

Analysis and evaluation of the securitization market are based on the secondary data – statistics published by the Securities Industry and Financial Markets Association (SIFMA). The survey covered the characteristic of outstanding and new issuances on the securitization market in the period of time 1998–2017. The selected period was determined by the need to identify changes in the value of the European securitization market both before and after the 2007+ financial crisis. In order to determine the answer to the research question posed in the study, the structure indicators were used to assess the changes in the debt structure on the securitization market and recognize the preferences of the initiators of securitization processes in the assets underlying the new issues.

The data used in the article are sums resulting from the synthesis of local securitization markets operating throughout Europe (the data include: Belgium, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, the Russian Federation, Spain, the United Kingdom, and others). Therefore, the article provides a brief description of the post-crisis securitization regulation in Europe recommended by the European Parliament and the Council of the European Union. The limited scope of the study, as well as the assumed direction of the research, make it impossible to conduct a thorough analysis of the regulations regarding the securitization process in each of the countries covered by the SIFMA.

3. Post-crisis regulation of securitization in Europe

The direct relationship between the global financial crisis and the securitization mechanism has led to securitization being recognized as a financial operation with a high level of information asymmetry and generating moral hazard (see: Beltran, Cordell, Thomas, 2016). The recent financial crisis has revealed that the regulatory and supervisory structure of the asset securitization market is flawed and inadequate to the complexity of this mechanism. According to the International Organization of Securities Commissions (International Organization of Securities Commissions, 2010, pp. 10–11), the global financial stability disruption was mainly due to the following factors:

- the specific business model on which the securitization procedure was based. It was characterized by a lack of proper monitoring and supervision of the quality of securitized assets (especially in the long term) and insufficient disclosure,
- from inadequate securitization risk management practices. Both retail and institutional investors did not have adequate tools to assess the risk of the securitized financial instruments invested in them. As a consequence, and given the limited information available (point 1), investors relied excessively on credit ratings as the main – and sometimes the only – investment risk assessment tool,
- in the absence of a comprehensive legal order relating to securitization transactions.

The painful verification of the imperfections in the regulatory environment of the asset securitization process is reflected in actions aimed at improving the efficiency and security of transactions. The main conclusion of the recent financial crisis is not to end securitization, but to strengthen the regulatory and security framework for this process. This is reflected in the Regulation of the European Parliament and of the Council (2015). The legal act cited believes that the right regulatory environment will revitalize the asset securitization market, which will contribute to the integration of EU financial markets, diversify funding sources and broaden the spectrum of capital release mechanisms, making it easier for financial institutions to dynamize lending to households and businesses.

The post-crisis regulatory framework for securitization is conceptually divided into five key categories and addresses issues (Schwarcz, 2016, p. 121 et seq.):
– increasing the transparency of transactions carried out,
– risk management of the securitization process,
– the new approach of credit rating agencies to the assessment of securitization financial instruments and the need to disclose information on fees charged to clients for assessing the credit quality of securitization financial instruments,
– impose higher capital requirements on investments in securitization financial instruments,
– due diligence requirement – institutional investors, commensurate with the risk incurred, are required to carry out due diligence covering both the assessment of the assets subject to the securitization process, as well as an analysis of the structure of the mechanism itself.

In accordance with the intention of the Regulator, increasing the transparency of transactions is achieved by imposing numerous disclosure obligations on the originator of the securitization process, including the need to present in detail both the structure of the transaction and its further handling. The originator is obliged to present an offer document (or prospectus) announcing the future securitization transaction and providing the group of potential investors with information on the concluded agreements in the scope:
– the transfer of assets,
– handling, administration and liquidity management of assets constituting the basis of the securitization process,
– methods and instruments for hedging transactions,
– any other activity that has a material impact on the assessment of the securitization mechanism.

In addition, the originator of the securitization is required to publish a model of the flow of funds generated by the collateral assets, with particular emphasis on information about past disturbances in their schedule.

In the context of securitization risk management, important restrictions have been introduced in two key aspects. First, it was made clear that the securitized assets must be homogeneous and, at the same time, credible. Thus, securitization of assets of doubtful quality, i.e. those for which in the past there was a disorderly servicing schedule or debtors are at risk of insolvency (or have low creditworthiness), is not allowed. The second aspect of the securitization risk management is the statement that the originator of the securitization is obliged (alternatively) to retain a minimum of 5% of the value of the securitization financial instruments or 5% of the nominal value of each item covered by the securitization.

A synthetic review of post-crisis regulatory solutions provides a basis for an attempt to assess the impact of the new legal order on the development of the securitization market. It can be stated with full conviction that the new regulatory environment increases the security of securitization transactions and at the same time gives this part of the financial market its transparency features. Nevertheless, will the new prudential approach be sufficient to revitalize the securitization market?

4. European securitization market

In the European financial market, the first transactions of asset securitization appeared at the beginning of the 1990s. This nearly thirty-year history of the European securitization market is divided by the global financial crisis of the years 2007+ into two periods – dynamic growth (1987–2009) and successive decline (from 2010) (fig. 1). The asset securitization market in Europe recorded its highest value in 2009 when the debt on securitization financial instruments was more than 35 sectors higher than in 1998 and represented twice as much value as in 2017.

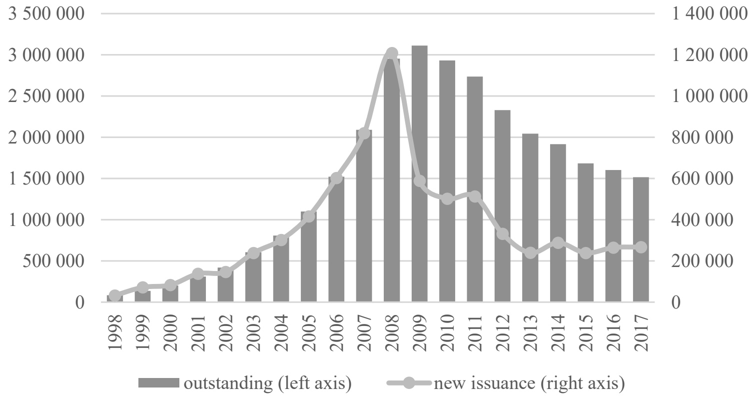

Figure 1.Value of the European securitization market in 1998–2017 (in USD millions)

Source: own work based on Securities Industry and Financial Markets Association (2018).

However, this broadly formulated statement, supported by data on the value of debt on securitization financial instruments issued, requires a certain degree of complementarity. It turns out that broadening the analysis by the issue of emission activity slightly changes the face of the assessed market. The time horizon set by the financial crisis 2007+ continues to determine the moment of the collapse of the securitization market in Europe (2009), but the downward trend in new securitization transactions remains only until 2015. The growth rates estimated for the issuing activity in the area of securitization of financial instruments for subsequent years (2016 and 2017) indicate a slight increase in interest in the use of securitization and stabilization of the market (111 and 101%, respectively).

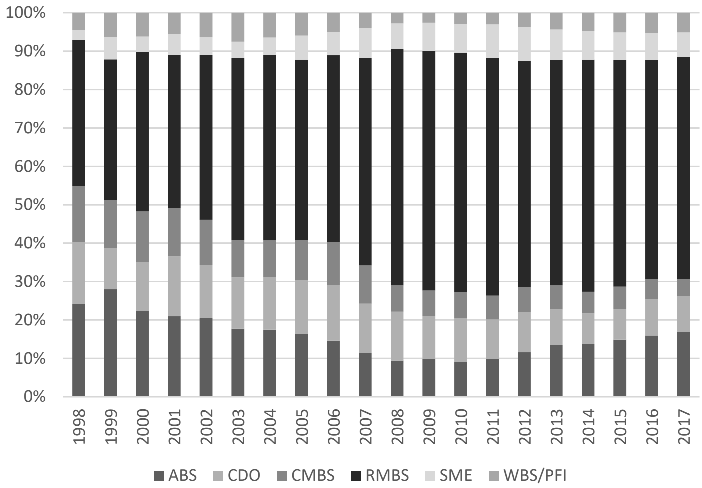

Figure 2. The structure of European securitization market in 1998–2017 – outstanding (%)

Source: own work based on Securities Industry and Financial Markets Association (2018).

The structure of the European asset securitization market is relatively stable. In principle, since 2006, the securitization process has been used in the context of financing mortgage loan portfolios granted to individuals (fig. 2). In the years 2006-2017 RMBS securities represent more than 50% of the value of securitization financial instruments. The second significant group is ABS papers, whose share in the same period (2006–2017) in the structure of the analyzed market falls within the range of 10–16%. The remaining part of the market is distributed proportionally among the remaining classes of securities.

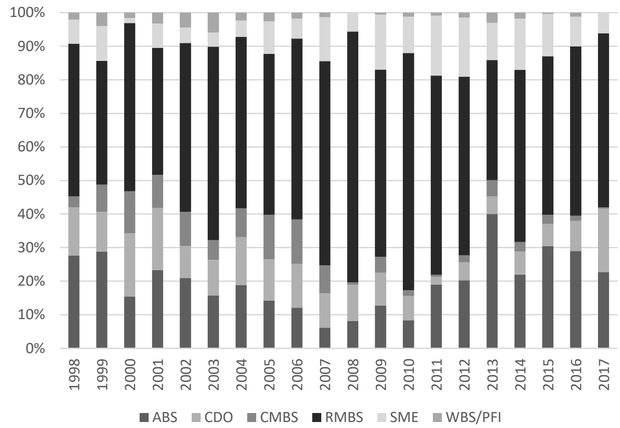

Fig. 3.The structure of European securitization market in 1998–2017 – issuance (%)

Source: own work based on Securities Industry and Financial Markets Association (2018).

The analysis of new issues of securitization financial instruments only confirms the thesis of the dominance of RMBS in the structure of the European securitization market (fig. 3). In 1998–2017, securitization transactions served primarily to refinance portfolios of mortgage loans granted to natural persons – new issues of securities based on this asset class represented from 36% (2013) to 75% (2008) of the value of all transactions.

However, the fact that out of all the classes of securities distinguished, only two types of securities show an upward trend between 2015 and 2017, forming the basis for a reversal of the downward trend in new securitization transactions, needs to be clearly underlined. These are, of course, RMBS securities, where the growth rate of new issues is positive at 120% and 105% (2016 and 2017, respectively). The second type are CDOs with an upward trend of 150% (2016) and 213% (2017), with a small share in the total debt structure due to securitization transactions.

Conclusions

The need for a revival of the securitization mechanism is indisputable. For over 40 years, this mechanism has functioned in the structure of the global financial system, supporting the activity of its participants and gaining more and more importance, measured by the successive increase in the value of this market segment. The securitization process, although rooted in public awareness as a premise of the global financial crisis, did not in itself pose a threat to the stability of the global financial system. The origins of the crisis include the regulatory and prudential failures of securitization processes described earlier and the globalization and liberalization of capital flows, which opened up the possibility of free movement of financial innovation and, as it later turned out, risk between markets.

The presented figures do not provide a solid basis to prejudge the title recovery of the securitization market in Europe. The dynamics of new issues on the European securitization market in 2008–2017 is variable, while the upward trend is observed only in the last three years of this time interval. The extension of the mentioned analysis to the structure of new issues indicates a silent comeback of securitization in selected segments – RMBS and CDO. Thus, in the case of other asset classes underlying the securitization process, a gradual decline in issuance activity is observed.

Certainly, market regulators emphasize the important role that securitization performs in the activities of financial institutions and, consequently, in the financing of economic processes. They express this in the form of prudential regulations and mechanisms used to popularize the use of securitization. Nevertheless, the post-crisis role of securitization in the European financial market is concentrated on financing housing market (refinancing long term mortgages), while in other securitization market segments a decline in new transactions and outstanding is observed.

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RYNEK SEKURYTYZACJI PO GLOBALNYM KRYZYSIE FINANSOWYM: PRZYPADEK EUROPY

Słowa kluczowe: sekurytyzacja, papiery wartościowe, kryzys finansowy, rynek finansowy

Streszczenie. Celem artykułu jest ocena europejskiego rynku sekurytyzacji aktywów po globalnym kryzysie finansowym XXI wieku. Przedstawione rozważania koncentrują się na dwóch podstawowych aspektach: (1) identyfikacji zmian w otoczeniu regulacyjnym sekurytyzacji w europejskim systemie finansowym oraz (2) analizie zmian w wielkości i strukturze europejskiego rynku sekurytyzacyjnych instrumentów finansowych w latach 1998–2017. Prowadzone rozważania stanowią próbę odpowiedzi na pytania: czy europejski rynek sekurytyzacji aktywów odradza się?

Citation

Pawłowski, M. (2018). The Revival of the Securitization Market after the Global Financial Crisis: A Case of Europe. *Ekonomiczne Problemy Usług*, *4* (133/2), 29–37. DOI: 10.18276/epu.2018.133/2-03.