Box 1

THE IMPACT OF MFI LOAN SECURITISATION ON MONETARY ANALYSIS IN THE EURO AREA

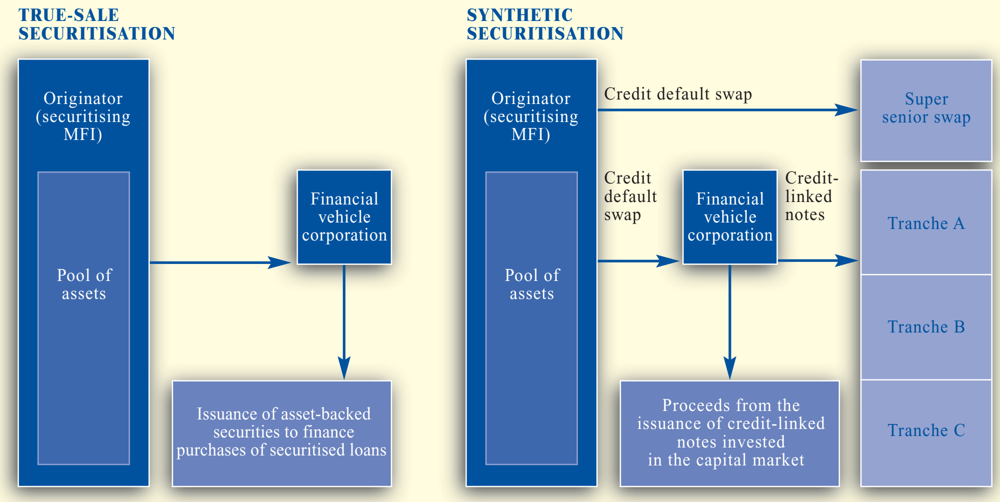
Recent years have witnessed a strong expansion of loan securitisation by MFIs.[1] To the extent that securitisation implies a transfer of loans off the MFI balance sheet, they drive a wedge between the actual growth rate of total loans to the private sector and that derived from the MFI balance sheet. In general, MFI loan securitisation involves the use of separate legal entities that are classified as financial vehicle corporations (FVCs) and belong to the other financial intermediaries (OFIs) sector. Latest available estimates suggest that, by the end of 2003, FVCs represented about 7% of total OFI assets, and are a fast growing component of that sector. Against this background, this box reviews the main conceptual issues related to the process of MFI loan securitisation and discusses the impact of this process on monetary analysis.

Conceptual issues

The term "loan securitisation" denotes a process whereby non-tradable assets such as mortgage loans and corporate loans are pooled and repackaged as marketable securities that can be sold to investors. There are two main types of loan securitisation: true-sale securitisation and synthetic securitisation. While true-sale securitisation involves the actual transfer of loans off the MFI balance sheet, synthetic securitisation only transfers the associated credit risk, with the loans remaining on the originator's balance sheet.

1 A comprehensive description of the instruments and risk management practices of MFIs can be found in the publication entitled "Credit risk transfer by EU banks: activities, risks and risk management", ECB, May 2004. In addition, the box entitled "Securitisation and the activity of special finance vehicles" in the October 2003 issue of the Monthly Bulletin provides further information on the activity of the financial vehicles involved in the process of loan securitisation.

Chart A Basic structure of a true-sale securitisation and a synthetic securitisation



Sources: Deutsche Bundesbank and ECB.
Notes: **True-sale securitisation:** the securitising MFI sells the securitised loans to a financial vehicle corporation (FVC). The latter issues asset-backed securities to finance the purchase.
Synthetic securitisation: with the aid of credit derivatives, the securitising MFI transfers the credit risks to an FVC. The latter issues credit-linked notes in individual tranches (A, B, C), which are purchased by investors, who then assumes the credit risks. The tranches are rated according to their loss participation. The FVC invests the proceeds in the capital markets. If the nominal value of the underlying portfolio of the MFI exceeds the par value of the credit-linked notes, then the MFI can transfer the residual risk to other market participants without involving the FVC. Such a credit default swap is often called a super senior swap, as it usually has the lowest risk of loss participation.
For more information, see the article entitled "Credit risk transfer instruments: their use by German banks and aspects of financial stability" in the April 2004 Monthly Report of the Deutsche Bundesbank.

MFI loan securitisation typically involves the use of an FVC as counterpart for the transaction. In the case of true-sale securitisation, the FVC finances the purchase of securitised loans by issuing asset-backed securities, the interest payments and repayment of which are financed by the cash flows generated by the securitised loans. Owing to diversification of the underlying risk, these securities generally represent a lower level of risk than the original securitised loans. Synthetic securitisation, by contrast, has a more complex basic structure. It involves the use of credit derivatives which transfer the risk to the FVC and, ultimately, to market investors through the issuance of credit-linked notes, while leaving the loans themselves on the MFI balance sheet (see Chart A for an illustration of the process).

In view of these characteristics, loan securitisation is likely to change the dominant role of MFIs in the euro area in providing loans to non-financial corporations and households. On the one hand, loan securitisation introduces new players to credit markets (as do other forms of financial innovation) and may thus broaden the financing possibilities for firms and households. On the other hand, it may become more difficult to assess the ultimate owners of credit risk in the financial system.[2]

The impact of securitisation on monetary analysis

Loan securitisation can affect monetary analysis in various ways. First, true-sale securitisation reduces the amount of MFI loans (in terms of both stocks and flows) while at the same time

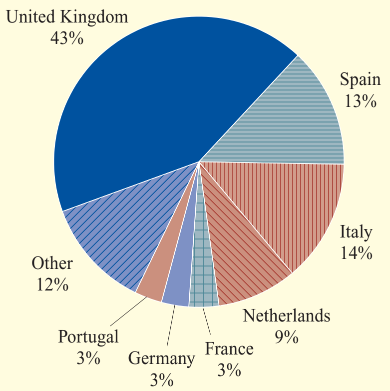
2 For a discussion of the possible effects of loan securitisation on financial stability, see the special feature entitled "Has the European collateralised debt obligations market matured?" in the June 2005 issue of the ECB's Financial Stability Review.

increasing that of FVC loans (and, therefore, that of OFI loans). As a result, loans as calculated from the MFI balance sheet will imply an underestimation of total loans to the private sector, thus possibly distorting the analysis of credit dynamics. Second, as a result of synthetic loan securitisation, OFIs are likely to become increasingly important as a money-holding sector if the funds raised by selling the credit-linked notes are – at least temporarily – stored in short-term deposits. This may have consequences for the analysis of the components of M3, as the structure of OFIs' demand for money across monetary instruments may differ from that of non-financial corporations and households. In addition, the volatility of OFIs' deposit holdings may increase and thereby blur signal extraction in the monthly monetary analysis. Third, as securitisations are often settled through offshore centres, they also have an impact on the external assets and liabilities of MFIs. Finally, loan securitisation (both synthetic and true-sale) is likely to have a positive impact on both the demand and the supply of credit to the private sector by increasing the population of potential lenders to the private sector and reducing the costs of borrowing.[3]

In recent years, true-sale loan securitisation has become more important in the euro area, partly in response to the prevailing low level of interest rates and the strong growth of loans to the private sector: anecdotal evidence suggests that the volume of such transactions has approximately doubled over the past three years, reaching €25 billion in 2004.[4] The importance of loan securitisation can also be seen from the statistics regarding the issuance of debt securities by non-monetary financial corporations, which consists almost exclusively of debt securities issued by OFIs. In May 2005 the amount outstanding of debt securities issued by non-monetary financial corporations accounted for around 8% of the total outstanding debt securities and 15% of the debt securities issued by the private sector. These shares are larger than the corresponding shares of debt-securities issued by non-financial corporations. With regard to the situation at the national level, several countries – for instance, Spain, Italy and the Netherlands – witnessed a considerable volume of true-sale securitisation in 2004 (see Chart B).[5] However, the level of loan securitisation in the euro area remains relatively low by comparison with the United Kingdom, which continues to be the leading country in terms of securitisation volumes, accounting for almost half of the securitisations in Europe.

Chart B Country share of total securitisations in Europe

(2004; percentages by country of collateral)



Sources: Dealogic Bondware, Thomson Financial Securities Data (ESF Securitisation Data Report, Winter 2005).
Note: "Other" includes Austria, Belgium, the Czech Republic, Greece, Ireland, Latvia, Luxembourg, Poland, Russia, Sweden, Switzerland, Turkey, Ukraine and "multinational" (i.e. cases where collateral is outstanding in several countries).

3 There may be several cost benefits for MFIs to securitise parts of their loan portfolio; for example, they could sell securitised loans to improve solvency. Some MFIs use loan securitisation to obtain collateral that can be used in the weekly refinancing operations of the ESCB. For a comprehensive overview of the motives behind loan securitisation and the different types of securitisation, see the article entitled "Growing importance of securitisation and special purpose vehicles" in the December 2003 Statistical Bulletin of De Nederlandsche Bank.

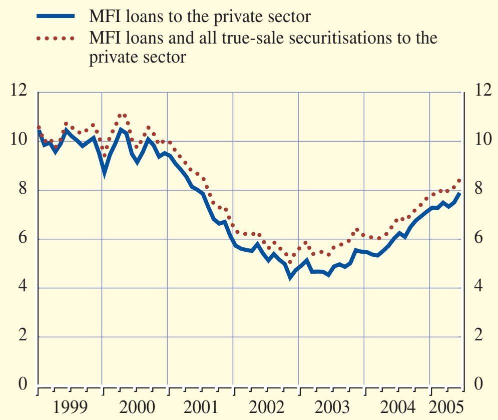
4 For information on the expansion of the issuance activity of FVCs, see the box cited in footnote 1 and the box entitled "Credit derivatives markets continue to grow rapidly" in the December 2004 issue of the ECB's Financial Stability Review.

5 For recent developments at the country level, see, for example, the articles "Special Purpose Vehicles: einde aan de groei?" in the June 2005 Statistical Bulletin of De Nederlandsche Bank and "Credit risk transfer instruments: their use by German banks and aspects of financial stability" in the April 2004 Monthly Report of the Deutsche Bundesbank.

Rough estimates suggest that the annual growth rate of MFI loans to the private sector understates the total annual growth rate of loans to the private sector (originated by MFIs) by approximately ½ percentage point in the euro area (see Chart C). This is in line with the analysis of the financing of the household sector, as reported in Sub-section 2.7 of the "Monetary and financial developments" section of this issue of the Monthly Bulletin. It should be noted, however, that the currently available estimates of true-sale securitisation are surrounded by considerable uncertainty and should, therefore, only be seen as indicative.

Chart C Impact of true-sale securitisations on the annual growth rate of loans to the private sector

(annual percentage changes)



Source: ECB and ECB estimates.

In summary, loan securitisation by MFIs, although still relatively low, appears to be gaining in importance and will increasingly affect monetary analysis based on MFI data. In this respect, the various aspects of securitisation will need to be monitored closely. This would also entail the need for statistical improvements with respect to data on securitisation in the euro area, both from the MFIs' and from the FVCs' side.