

Chapter 2

The Alchemy of Securitization. Evolution and Perspectives

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Abstract The term securitization is used to represent the process whereby assets are pooled together, with their cash flows, and converted into negotiable securities to be placed into the market (Tasca and Zambelli 2005) or to be used as collateral in refinancing transactions with Central Banks or with market participants. Securitization is aimed at transforming illiquid assets into securities. These securities are backed or secured by the original underlying assets and are generally defined as Asset Backed Securities (ABS). Theoretically, any financial assets producing cash flows (receivables, residential and commercial mortgages, credit card receivables, and other consumer and commercial loans) can be securitized (see, e.g., Buchanan 2016, Buchanan 2017; Kara et al. 2016; Malekan 2014; Lipson 2012). The main purpose of the chapter is to analyze the basic characteristics and the market structure of traditional securitization, especially with reference to the Italian market.

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2.1 Introduction and Literature

As an aftermath of the global financial crisis, securitization has been often accused of involving high level of asymmetric information and moral hazard, lack of proper monitoring and insufficient disclosure, as well excessive risk transferred to retail investors without proper regulation (see, e.g., Beltran et al. 2017).¹ Securitization has also been connected to an increase in insider trading activity (Ryan et al. 2016). After the 2007–2009 crisis, securitization has been accused of being one of the causes that contributed to exacerbating the global financial instability (see, e.g., Neuhauser 2015). Therefore, a number of stringent laws and regulatory proposals have been introduced worldwide to regulate securitization more heavily, in the hope of guaranteeing a higher financial stability and a greater investor protection (see, e.g., Beltran et al. 2017; Fligstein and Roehrkasse 2016; Kravitt et al. 2015; Albertazzi et al. 2015; Neuhauser 2015; Cherasi and Rochet 2014; Acharya and Richardson 2009; Beck 2014; Lützenkirchen et al. 2013; Juhas 2013; Solomon 2012).²

Unlike US banks, Italian banks showed a lower exposure to toxic assets and a higher involvement in a less risky form of securitization, called traditional securitization. An empirical study on the securitization activity of Italian banks confirmed the positive effects of traditional securitization (Albertazzi et al. 2011) compared with the riskier synthetic securitization, which was more often adopted in the US (Egly et al. 2015).

The main purpose of this chapter is to analyze the basic characteristics and the market structure of traditional securitization, especially with reference to the Italian market. In particular, this chapter intends to answer the following questions:

1. What are the characteristics of traditional securitization?
2. How is the traditional transaction structured?
3. What is the role of financial intermediaries within the securitization process, especially in Italy?
4. What are the main characteristics of the Italian securitization activity?

To answer the above questions, we will first explain the basic components of a securitization transaction, describing the typical structure and the main players involved. Secondly, we will analyze the Italian securitization market, emphasizing its peculiarities through an international comparative analysis.

Generally speaking, the purpose of securitization is to transform illiquid assets into securities. For the purpose of this chapter, the term securitization is used to represent the process whereby assets are pooled together, with their cash flows, and converted into negotiable securities to be placed into the market (Tasca and

¹For the lack of regulation, the securitization activity has also been labeled as shadow banking (see, e.g., Gennaioli et al. 2013).

²For current updates about rules and regulations on securitization in Italy see, e.g., the following website: <http://www.securitisation-services.com/it/normative/index.php>.

Zambelli 2005) or to be used as collateral in refinancing transactions with Central Banks or with market participants. These securities are backed or secured by the original underlying assets and are generally defined as Asset Backed Securities (ABS).³ Theoretically, any financial assets producing cash flows (receivables, residential and commercial mortgages, credit card receivables, and other consumer and commercial loans) can be securitized (see, e.g., Buchanan 2016, 2017; Kara et al. 2016; Malekan 2014; Lipson 2012).⁴

This chapter is organized as follows. Section 2.2 describes the basic structure of the typical securitization transaction (traditional securitization). Section 2.3 discusses the securitization process. Section 2.4 emphasizes the particular role of financial intermediaries within this process, and Sect. 2.5 discusses regulatory issues on securitization. Section 2.6 highlights the role of financial intermediaries within the securitization process. Section 2.7 presents current and future trends of the securitization market, from an international perspective. The last section provides concluding remarks.⁵

2.2 The Traditional Securitization: Definition and Deal Process

Securitization is a financial tool aimed at transforming a pool of assets into marketable securities, which are secured by the cash flow stream related to the underlying assets (Asset Backed Securities—ABS).

It is realized through a transfer of assets by a company (Originator) to a separate entity (Special Purpose Vehicle—SPV), which then issues securities, in the form of

³An ABS represents a security backed by specific assets. This means that principal and interest repayment rely directly on the capability of the underlying assets to generate the expected cash flows. In the US it is common to distinguish between:

- Asset backed securities (ABS), which represent securities backed by specific assets (auto loans, credit card receivables, student loans, equipment leases). This definition does not include mortgages loans or corporate bond loans;
- Mortgage backed security (MBS), which are securities backed by specific mortgage loans.

Outside the US, the definition of ABS may include deals backed by mortgages loans. For the purpose of this chapter, we will use the term of ABS to indicate all classes of securitized instruments. See: Bhattacharya and Fabozzi (1997), Saunders and Cornett (2004), Burton et al. (2003), Spotorno (2003).

⁴For a recent overview of the literature on securitization and its real effects see, e.g., Berg et al. (2015), Buchanan (2016, 2017), Lu et al. (2013), Albertazzi et al. (2011). See also: Battacharya and Fabozzi (1997), Fabozzi (1999), Colagrande et al. (1999), Bontempi and Scagliarini (1999), Artale et al. (2000), Damilano (2000), De Angeli and Oriani (2000), Rumi et al. (2001), Porzio et al. (2001), Galletti and Guerrieri (2002), Ferro Luzzi (2000), Gualtieri (2000), La Torre (2000), (Caneva 2001), Navone et al. (2002).

⁵Sections 2.2, 2.3, 2.4, 2.6 represent a revised version of Tasca and Zambelli (2005).

debt instruments, to be placed into the market through a private or public offering (see, e.g., Kara et al. 2016) or to be used as collateral in refinancing transactions.

The concept of asset securitization was introduced in the US financial system in the 1970s, when the Government National Mortgage Association issued securities backed by a pool of loans, represented by residential mortgages.⁶

Two main types of securitization transactions exist:

1. **Cash flow based (CFB) securitization.** The transaction is structured as a sale of assets by a company (Originator) to a special entity (Special Purpose Vehicle, SPV), which then issues securities backed by the underlying assets. The CFB securitization is also defined as *Funded Securitization*, because the Originator can raise money through the asset sale, diversifying its financing sources (for details see, e.g., Lipson 2012).⁷
2. **Synthetic securitization.** It is a transaction through which the credit risk or a right to access to stream of future cash flows, associated with a reference pool of assets, is transferred to a separate entity (SPV). It is not a sale of assets, so the Originator does not receive any cash flow. The SPV in this case is not the owner of a pool of assets, but only the entity that carries the associated credit risk. It is realized through the use of derivatives (total return swaps and credit derivatives, or CDO; for more details see, e.g., Berg et al. 2015).

For the purpose of this chapter, we will focus on the first type of transaction, which has been subject to a higher level of regulation and has showed a much lower level of risk.⁸ For an overview of synthetic securitization transaction, see: Caputo et al. (2001). In order to analyze the basic structure of a securitization transaction, let us consider the following example. The Originator is a bank, willing to raise money by liquidating a specific pool of loans through securitization.

As Fig. 2.1 shows, we can identify two key elements of the securitization transaction:

1. Asset sale⁹;
2. Issuance of Asset Backed Securities.

⁶See: Saunders and Cornett (2004), Burton et al. (2003), Spotorno (2003).

⁷Recently, another form of securitization became important: the whole business securitization in relation to leveraged buyout acquisitions (SBO deals). For more details on SBO deals, see Buszko et al. (2013). For more details on Leveraged Buyout deals and their legal structure, see, e.g., Zambelli (2008, 2010).

⁸For a recent overview of the literature on securitization and its real effects see, e.g., Berg et al. (2015), Buchanan (2016, 2017), Lu et al. (2013), Albertazzi et al. (2011). For a recent overview of the risks connected to securitization see, e.g., Chen et al. (2017), Le et al. (2016), Laurent et al. (2016), Cifuentes and Pagnoncelli (2014), Wu et al. (2011).

⁹The example represented in Fig. 2.1 considers a transfer of credits and receivables between the Originator and the SPV.

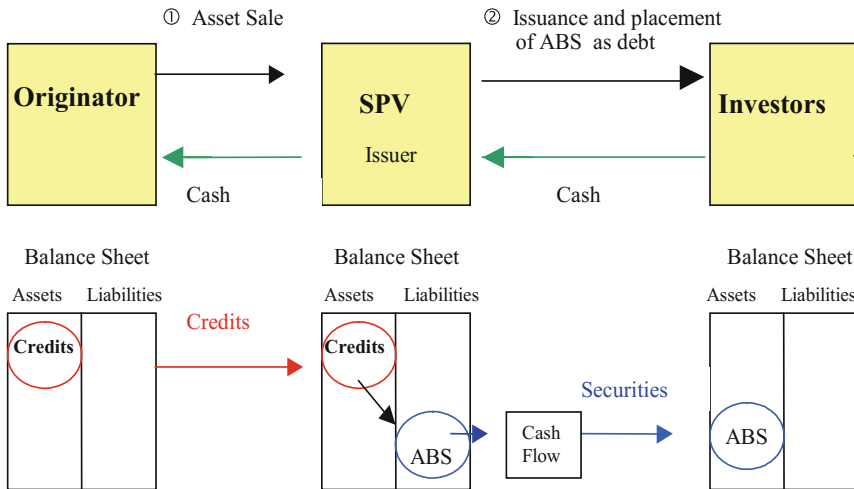


Fig. 2.1 Transactions involved and relative funds flow. *Source* Tasca and Zambelli (2005, p. 8)

- **Asset Sale.** The first element is represented by a true sale of assets between two parties:
 - (a) One party is the seller of the pool of assets and is known as the “Originator”. In our example it is represented by a bank;
 - (b) The other party is an independent entity, established for the purpose of buying the assets and transforming them into negotiable securities to be placed into the capital market. This entity serves only as securitization vehicle and so it is often defined as “Special Purpose Vehicle” (SPV) or “Special Purpose Company” (SPC). It may take the organizational form of corporation or limited partnership.
- **Issuance of Asset Backed Securities.** In order to finance the asset purchase, the SPV issues securities (usually debt obligation instruments), which are backed by the acquired assets (Asset Backed Securities—ABS). The cash flows originated by the acquired pool of assets are then used to pay the principal and interest on the securities sold to the final investors (holders of ASB securities).¹⁰

As a result of the securitization:

1. The Originator can use its illiquid assets to raise funding to use immediately for its business activity, without waiting for the maturities of each credits;
2. The underlying securities, issued by the SPV, are backed by a portfolio of assets, which allows a better segregation of risks and the optimization of asset-liability matching risk exposure;

¹⁰The payments collection related to the securitized portfolio is managed by a third party, the Servicer, which usually is represented by the Originator itself.

3. The issuance of Asset Backed Securities contributes to satisfy different investors' risk appetites and to develop primary financial markets, allowing a transfer of certain performance risks to the final investors.

The risks carried by the investors depend mainly on the quality of the performance of the underlying assets, rather than the creditworthiness of the issuer or the Originator. A careful evaluation of the assets' characteristics and track record is then essential before performing any securitization transaction. The quality of the assets in fact will affect:

1. The creditworthiness of the related ABS, which is usually represented by a rating assigned by specialized agencies¹¹;
2. The type and the amount of credit enhancement tools, which might be necessary to lower some of risks associated with the asset pool expected performances and improve their rating.

A securitization differs from a traditional equity or debt financing for at least two reasons. First, it is not a loan. It implies an asset segregation from the Originator to the SPV. Second, the buyers of Asset Backed Securities rely primarily on the cash flows generated by the underlying pool of assets, rather than the cash flows generated by the business activity of the issuer.¹²

2.2.1 The Role of the True Sale of Assets to the Special Purpose Vehicle (SPV)¹³

Securitization is realized through a true sale of assets by the Originator to a separate company (SPV), which issues securities backed by those assets. The true sale mechanism allows a company to isolate a group of financial assets, separating the risk of the firm as a whole from the risk associated with the securitized assets.¹⁴ Second, the SPV represents a critical actor within the securitization process: it serves as a vehicle to accomplish a securitization transaction.

In order to understand the crucial role played by the SPV, let us consider the following scenario. Imagine that the Originator could directly issue securities

¹¹For a critical overview on the real efficacy of rating agency to actually forecast the default probability of a issuer, see, e.g. Lützenkirchen et al. (2013), Peicuti (2013).

¹²In a traditional financing, instead, the return to investors depends mainly by the capacity of the company to generate sufficient cash flows to repay its debt obligation.

¹³This Section is based on Tasca and Zambelli (2005).

¹⁴The expected return to investors depends mainly on the risk associated with the cash flows guaranteed by the securitized assets, rather than the default risk of the Originator.

backed by a pool of assets, without selling it to an intermediate vehicle. In this scenario, the investors interested in buying the Asset Backed Securities would carry both the default risk connected to the entire business activity of the Originator and the risk related to the securities. In reality, in a securitization transaction investors are willing to assume only the risk related to the performance of the pool of assets they are investing in. In order to protect final investors against the bankruptcy risk of the Originator, it is crucial to isolate the securitized assets from its business activity and its creditors. To guarantee this asset isolation, it is necessary to structure the transaction as a “true sale” of assets between the Originator and a third independent entity, the SPV, a purpose company which is established exclusively for the accomplishment of the financing.

The SPV involvement provides an investor with greater protection against the default risk of the Originator.

The SPV is a separate company which is intended to generate a perfect legal segregation of the assets from the originator. In principle, once a pool of assets is transferred to a special independent vehicle, it is no longer available to the Originator or to its creditors. The assets “isolated” from the Originator and the cash flows arising from them can only be used by the SPV to make payments to the holders of the Asset Backed Securities. The vehicle can only hold specific assets and issue in turn securities backed by these assets. The SPV is not allowed to begin other business activities and to assume new obligations. This is why the vehicle is also called a “bankruptcy remote entity”.¹⁵

With reference to the asset isolation effect, it is important to highlight a crucial difference between the Italian and the US regulation system.

In the US the assets sold by a borrower before falling into bankruptcy do not become part of the bankruptcy procedure. Consequently, the Originator is not allowed to reclaim the transferred assets and so, in case of default, its creditors cannot call on them to satisfy their claims.¹⁶

By contrast, according to the Italian Securitization Law, the risk of reclaiming the sold assets is eliminated only if the sale occurred more than one year before the bankruptcy event (Fig. 2.2). Secondly, it is necessary to demonstrate that the assets have been sold to a fair price. If the above conditions are not satisfied, it is legally possible for the Originator (or its creditors) to reclaim the assets transferred to the SPV.¹⁷

¹⁵JCR-VIS Credit Rating Company Limited (2003), Bond Market Association (2002).

¹⁶In the US there is no bankruptcy code provision regulating the legal status of securitized assets. Securitized assets are then considered as legally sold and are excluded from the eventual bankruptcy procedure of the Originator. For more information see: Nomura Fixed Income and Research (2002).

¹⁷In case of bankruptcy of the SPV, the period in which it is possible to reclaim the sold assets is six months. See: Spotorno (2003).

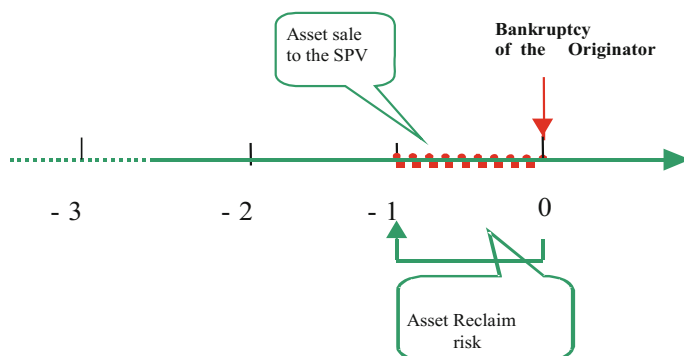


Fig. 2.2 Asset Reclaim Risk, according to the Italian Securitization Law (L. 130/99). *Source* Tasca and Zambelli (2005, p. 11)

2.3 The Alchemy of Securitization: The Process from Assets to Securities

In order to understand how it is possible to transform illiquid assets into marketable securities, let us describe the main steps that are required for accomplishing a typical securitization transaction.¹⁸ As Fig. 2.3 shows, a securitization process involves the following phases.

- **Selection of a pool of assets.** In the first place, the Originator has to identify a pool of assets with similar characteristics. Theoretically, any asset producing cash flows (receivables, residential and commercial mortgages, credit card receivables, and other consumer and commercial loans) can be securitized, including non-performing loans, as we will emphasize in the course of the analysis of the Italian securitization market.
- **Asset sale/True sale transaction.** In the second place, it is necessary to guarantee the isolation of the pool of assets from the Originator. As noticed, this is achieved by structuring a true sale of the pool of assets by the Originator to an external entity (SPV), which has no business other than acquiring assets and issuing securities backed by these assets.
- **Definition of the capital and the legal structure of the transaction.** Arrangers and advisors (legal and agents) define the capital structure of the transaction, define the flow of funds (waterfall) and draft the set of legal contracts to govern them.
- **Issuance of asset backed securities.** To finance the acquisition of the assets, the SPV issues securities to be sold in the marketplace to investors. These debt

¹⁸See, e.g., Saunders and Cornett (2004), Burton et al. (2003), Spotorno (2003), Leixner (<http://pages.stern.nyu.edu>), JCR-VIS Credit Rating Company Limited (2003), Nomura Fixed Income and Research (2002), Bond Market Association (2002).

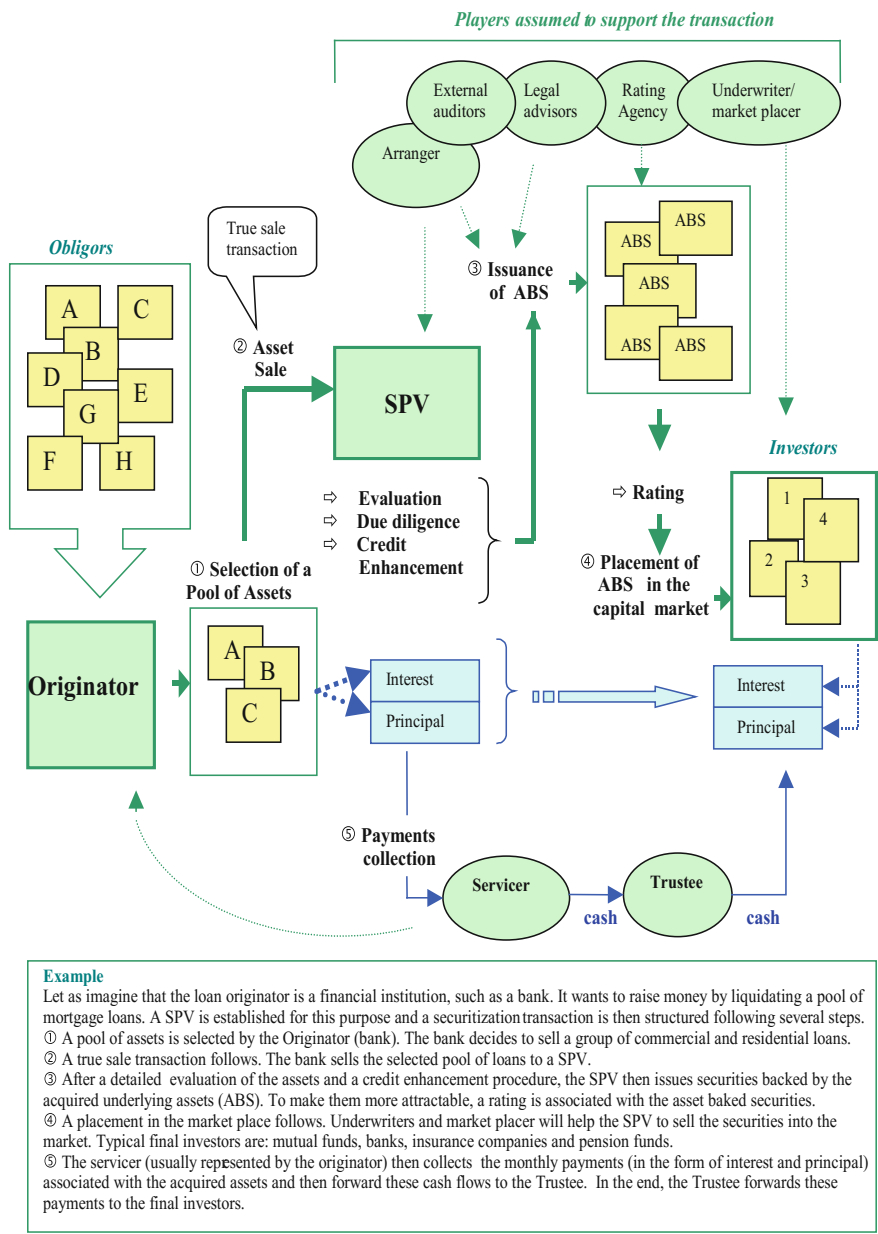
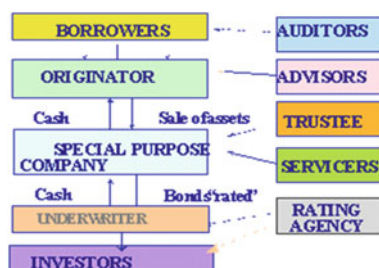


Fig. 2.3 Basic securitization process. *Source* Tasca and Zambelli (2005, p. 13)

Fig. 2.4 Players involved in the securitization process.

Source Tasca and Zambelli (2005, p. 17)



securities are secured by the underlying assets acquired by the vehicle (Asset Backed Securities—ABS).

- **Market placement.** The SPV sells these securities on the capital market, through a private placement or public offering, with the help of underwriters. Usually, the ABSs are purchased by banks, insurance companies, pension funds and other institutional investors.
- **Payment of the asset purchase.** In the end, the funds raised by the SPV from the market placement are used to pay the pool of assets originally acquired by the vehicle.

As a result of the securitization process, funds will flow from the investors to the issuer (SPV) and from the issuer to the Originator.¹⁹

The securitization process is simplified in Fig. 2.3 and the actors involved are summarized in Fig. 2.4. The process summarized in Fig. 2.3 is quite basic. In reality, it actually involves more steps and additional players, especially financial intermediaries and legal firms, to support the accomplishments of the entire operation.

For example, in order to ensure marketability to the ABSs and to make them more appealing, a credit rating from specialized agencies can be a requirement for the issued securities. The rating identifies the creditworthiness, in term of the default risk, of the issuance and could affect the cost of the entire operation, paid by the Originator.²⁰

Some credit enhancement strategies can be useful to improve the credit rating of the marketable securities and to limit some of the risks that are transferred to investors. These procedures aim at creating specific mechanisms to mitigate potential losses.

Credit enhancement can be either internally determined within the transaction structure (internal enhancement) or externally provided by a third party (external enhancement).

¹⁹Saunders and Cornett (2004), Burton et al. (2003), Spotorno (2003), Leixner (<http://pages.stern.nyu.edu>), JCR-VIS Credit Rating Company Limited (2003), Bond Market Association (2002).

²⁰For more information: JCR-VIS Credit Rating Company Limited (2003), Nomura Fixed Income and Research (2002).

Typical examples of internal credit enhancement provisions are the following:

1. Overcollateralization. In this case, the fair value of the underlying assets acquired by the SPV is greater than the total face value of the issued securities. Excess cash flows will then be used to cover potential losses or to cash flows temporary shortfalls;
2. Spread accounts. The spread is represented by the positive difference between: the yield generated by the underlying assets and the yield associated to the related securities, issued by the SPV. This spread is retained by the SPV in order to absorb potential losses;
3. Reserve Funds. A cash reserve fund might be created in order to cover potential cash flows shortfalls;
4. Senior/subordinated debt structure. With this provision, the SPV sells different types of securities (senior, subordinated) with different risk/return/maturity characteristics. In particular, the securities have different payment priority. Senior securities are characterized by a lower risk, higher rating and lower return. Conversely, junior securities are more risky. As a consequence, they are associated with: lower rating and higher expected return. In the worst-case scenario, senior securities give the holder the right to receive the related payments before the subordinated securities ones. Consequently, cash flows will be used to pay the senior securities and eventually, only if sufficient capital is left, to satisfy the subordinated securities.

External credit enhancement examples are the following:

1. Letter of credits by a bank or insurance company, to guarantee the security issuance;
2. Insurance contracts;
3. Special guarantees from a third party.

As Fig. 2.3 shows, among the parties that are involved into the securitization process there are: the Servicer and the Trustee.

The Servicer is responsible for the management of the portfolio and the collection of receivables and other payments on the assets acquired by the SPV. Often the management of the portfolio is delegated the Servicer to a Special Servicer, an entity whose capabilities and track record are specifically focused on the management of a particular asset type.

The Trustee is an independent third party (usually a bank) assumed to monitor the entire collection process and to make payments to the security-holders. Its aim is to protect the investors' interests, monitoring the regular payment-reports prepared by the Servicer.

Often the Originator acts as a Servicer. This occurs when the Originator is represented by a financial institution. In this situation, the obligors continue to make payments to the Originator, which will forward the cash flows to the Trustee. Then, the Trustee will forward the cash flows collected by the Servicer to the final investors.

2.4 The Main Players Involved in a Securitization Transaction

The securitization process requires that:

1. The asset seller (Originator) shall be a company satisfying the requisites provided by law;
2. The sums paid by the assigned debtors shall be exclusively dedicated to the satisfaction of the debt service and principal payment of the securities issued by the special purpose vehicle and to the payment of the transaction-costs.

Credit derivatives, wholesale securitization and synthetic securitization transactions are not included into the above legal definition.²¹

As it is shown in Fig. 2.4, the securitization process involves many players, with different roles: borrowers, loan Originator, special purpose company, rating agency, credit enhancer, underwriter and investors. In particular, the main actors of securitization can be summarized as follows:

1. The **Asset Seller** (Originator);
2. The **Special Purpose Vehicle** ("SPV"): the SPV is the entity specifically established to undertake particular securitization transactions, which would hold the legal rights over the assets transferred by the Originator. It can take the form of limited liability company (s.r.l.). A disposition of the Central Bank Governor also requires the SPV to be recorded into a special register (according to the provisions of the Legislative Decree 58/98 art. 107) and to satisfy minimum capital levels, depending on the volume of transactions managed²²;
3. The **Arranger**: the financial institution (bank or other) which agrees to structure a securitization transaction. The Arranger is responsible, alone or through a syndicate structure, for the placement of the ABS;
4. The **Servicer**: entity which is responsible for the day-to-day collection. In many case the Originator also performs the role of the Servicer, based on a servicing agreement;
5. The **Trustee**: institution (bank or other) which administers the securitization transaction, manages the inflow and outflow of moneys and does all acts needed for protecting the investors' rights.
6. **Other actors**: collection account bank, deposit account bank, cash manager and paying agent, representative of the noteholders, liquidity facility provider, corporate services and administrative provider, hedging counterparts. These actors play an important role in order to implement the collection, deposit, management and hedging of the cash-flows and risks related to the securitization process.

²¹See Caputo et al. (2001).

²²By law, the SPV needs be exclusively involved with one or more securitization processes.

Moreover, other agents may be involved into a securitization process:

- **Rating agencies:** institutions which assign credit rating to debt obligations after analyzing the issuer and the transaction characteristics;
- **Legal consultants** for the deal structuring;
- **Auditors:** institutions dedicated to the due diligence of the credit portfolio.

Other financial institutions might be involved in the securitization process, in order to guarantee collateral services, such as the hedging against the interest rate risk.

2.5 Key Regulatory Issues on Securitization

The issuance of a dedicated Regulation is essential when establishing a framework for securitization in any jurisdiction. In every jurisdiction the key elements of securitization are regulated within specific set of regulatory standards: asset and cash flows segregation from the originator default risk, limited recourse rights towards SPV assets against any third party claim, limited enforcement rights against the sale of the securitized portfolio, asset sale de-recognition in the originator's books.

But regulation plays a relevant role in enhancing the development of the securitization market also at multi-jurisdiction level in leveling the playing field for originators and investors.

As a response to the global financial crisis, policy makers and Regulators around the world started introducing a more and more stringent framework for securitization in order to contribute to make the financial industry more resilient and to facilitate the sustainability of the development of the securitization market. The regulatory effort is still in progress but the key elements are related to the evidence that securitizations can be structured in many different ways and in different jurisdictions but the capital treatment of the exposures toward risks embedded in a securitization must be considered on the basis of its economic substance than its legal form. The stress on economic substance versus legal form is one of the milestones now achieved.

Another pillar stone of the regulatory effort is to enhance the level of transparency and disclosure, both on the securitized underlying portfolio level and on the securitization legal and capital structure level. Simple, transparent and comparable (STC) securitization criteria has become a mantra for regulators.

Simplicity refers to the homogeneity of the underlying asset pool and the capital structure of the transaction.

Transparency aims to providing a sufficient level of disclosure on the portfolio, the structure of the transaction, the parties involved in it and in promoting the understanding of the risks embedded in the structure at closing and during the life of the transaction.

Comparability intends to facilitate asset class analysis and performance valuation within different jurisdictions.

STC criteria are intended to facilitate any party involved in a securitization transaction (originators, investors, agents, accountants and regulators), in the assessment of the risks and the returns involved in a particular transaction and to enable them to make more easy comparisons across different deals within an asset class and across portfolios originated in different jurisdictions.

STC criteria help investors in accessing to a greater and reliable set of information about the underlying asset characteristics and performance and the legal and capital structure of the transaction. STC criteria compliance will be rewarded with a preferential regulatory capital requirements standards.

2.6 The Role of Financial Intermediaries Within the Securitization Process

Financial intermediaries play a crucial role within the securitization process, which includes different steps.

The first step includes the identification of homogeneous financial assets, which can be securitized, according to the provisions specified by the art. 1 of Law 130/99 and the rating criteria used by specialized agencies. Informally, the Originator and the Arranger might contact rating agencies in order to receive general advices on the feasibility of the operation and on the entity of credit enhancements. The aim of credit enhancement is to enhance the security or the rating of the securitized instruments. Credit enhancement can be internal (subordination, over-collateralization, yield spread, excess spread, reserve funds), or external (third party guarantee, letter of credit, cash collateral account, collateral invested account).

The second step of the securitization process refers to the asset-evaluation implemented by rating agencies, on the basis of investigation and analysis of the transaction and the issuer's characteristics. In particular, rating agencies tend to evaluate:

- Assets characteristics;
- Credit tracking;
- Payment methods and timing;
- Diversification of the asset portfolio;
- Default rate;
- Recovery Timing.

According to the above assets characteristics, the chosen credit rating agency defines together with the Arranger the particular financial structure of the securities that will be issued into the market and backed by the assets. Credit rating agencies usually identify: collateral guarantees, "priority of payments", and those credit events that will imply an anticipated reimbursement (trigger events).

If the analysis implemented by credit rating agencies is positive, a pre-sale report is then written. In the same time, external auditors implement a due diligence of the asset portfolio.

Once the pre-sale report has been completed, legal firms implement the deal structuring.

The basis set of legal contracts that are governing a securitization transaction can be divided into two main blocks: the asset transfer block and the issuance block. In the transfer block there are the following contracts:

- Transfer Agreement
- Corporate and Administrative Services Agreement
- Servicing and Sub-Servicing Agreement.

In the issuance block there are the following contracts:

- Term and Conditions of the Notes;
- Intercreditor Agreement;
- Master Definition Agreement;
- Cash Management Agreement e del Collateral Management Agreement;
- Trust deed;
- Deed of Pledge;
- Subscription Agreement;
- Prospectus.

After the deal structuring phase, it follows the marketing activity, including a road show aimed at presenting the transaction characteristics to institutional investors (usually assumed as target investors).

The fifth phase implies the issuance and the placement of the asset backed securities into the primary market. If the securities are sold to professional investors, it is important to design an Offering Circular, according to the provision of art. 2, Law 130/99. If the securities are sold to private investors, it is necessary to elaborate a particular information prospect, according to the Legislative Decree 58/98.²³ The underwriter works together with SPV and credit enhancer entity in order to arrange the placement of the securities into the primary market, usually offering to the Originator a service of acquiring those securities that remain unsold.

The next step of the securitization process is the acquisition of the securities by investors, represented exclusively by institutional investors. Once the placement of the securities into the primary market has been completed, the resulting net inflow is transferred by the SPV to the Originator. In this way, the debt obligation related to the asset sale initiated by the Originator is honored.

After the market placement, it is important to monitor and manage the cash flows payments that are related to the asset backed securities (servicing activity). Usually the Originator is responsible for the management of the portfolio and the collection

²³So far, the issuances of ABS in Italy have been directed to qualified investors and consequently no information prospects have been elaborated.

of the cash flows arising from the portfolio. Sometimes, a separate Special Servicer might be employed for the management of the entire portfolio and collection process.

The Servicer must ensure that the SPV keeps the cash flows derived by the asset backed securities separated from the other SPV's assets. This "management and accountant isolation" represents a condition required by Law.

In order to better protect investor's interests, a Servicer must be enrolled into a special register held by the Regulation Authorities and also must have a sufficient own equity capital and has the duty to inform the monitoring Authority whenever irregularities in the payments-process occur.

2.6.1 Strategic Business Areas of Activities

As anticipated, financial intermediaries play a crucial role within the securitization process and can be distinguished according to the different areas of activity:

1. asset selling and underwriting (primary market);
 2. cash flow collection and asset management (secondary market);
 3. market making (secondary market).
1. The Arranger is the institution responsible for the asset placement into the primary market. The success and the costs of the whole transaction depend mainly on the placement skills of the Arranger. The choice of the Arranger is then very important and usually takes into account different elements: international experience; track record; business contacts (with investors and rating agencies); reputation; placement and underwriting capacity. There is a trade-off between reputation and cost of the deal of the Arranger: the greater is the reputation of the Arranger and the higher is the commission requested by him.
 2. The Servicer is the institution responsible for the cash-flows collection. If it is a financial institution, the Originator act as Servicer. The Servicer activity is usually played by the financial institutions which originated the securitization process, or by a subsidiary (captive organizational structure). Independent Servicer institutions play a marginal role (but increasing) within the Italian securitization market. Regarding the securitization process initiated by big-size corporate, the Servicer activity is usually done by a separate financial institution, who takes care of the all collection activity. Small-medium size firms, on the other hands, usually sign a contract of sub-service with a financial institution, acting as a primary Servicer.²⁴
 3. The marketing maker activity is currently limited to the transactions among qualified investors, especially institutional investors (gross market).

²⁴In the US market, the servicer activity is usually played by auditing companies and not by financial institutions.

2.7 The Securitization Industry: Current and Future Trends

The purpose of this section is to provide a picture of the recent trends in the international securitization industry and its level of vitality in term of issuance and outstanding volumes and in term of underlying pools diversification. The analysis of these elements are fundamental when assessing the maturity achieved any domestic jurisdiction, its peculiarities, its growth potential and its sustainability in the medium time horizon.

During the financial crisis Central banks support to the securitization primary and secondary market has played a fundamental role in maintaining the market alive and in providing an adequate level of support and confidence for a new start. Investor confidence suddenly faded away when Lehman collapsed, but the US Federal Reserve stepped in granting the market a huge ABS purchase support program that prevented the collapse of the US and International securitization industry.

ECB followed the same path during the Eurozone confidence crisis arising from the default of Greece. ECB first move was starting accepting ABS as collateral in its repo financing transaction, allowing European banks to regain access to interbank financing. The second move ECB has set in place is the ABS secondary market purchase program.

The first ECB measure was intended to prevent European ABS collapse while the second is intended to facilitate the restart of the market and to restore investor confidence.

The relevance of the Central banks interventions in the securitization industry testify how relevant is the ABS market regular functioning for the international banking industry in order to provide economies with an adequate level of financing to sustain growth.

The figures in Table 2.1 evidence the recovery of the US ABS market vis a vis of the European market, volumes in the US primary market show a good level of recovery, while European resilience in the level of issuance is supported by ECB.

In term of market diversification Europe is much more developed than its peers (see Table 2.2) but the differences can be explained by the different features of the financial industry for SME and Corporate financing in Europe and in the US and Australia.

In terms of ABS volumes outstanding, see Table 2.3 for European consolidated data, the figures show that some asset type are more resilient than others during the period, CLO/CDO and CMBS outstanding volumes shrank dramatically while RMBS decline path is subsequent the economic crisis that hit most part of the European domestic economies.

In Table 2.4 UK, Italy and the Nederland are the most relevant market in Europe in term of ABS issuance (in the figures Covered Bonds are not considered).

Table 2.1 Securitisation historical issuance (€ Billions)

	EU	US	AU
2007	594.9	2080.5	34.3
2008	818.7	934.9	6.6
2009	423.9	1385.3	9.7
2010	378.0	1203.7	15.5
2011	376.8	1056.6	20.4
2012	257.8	1579.2	14.8
2013	180.8	1515.1	22.4
2014	217.0	1131.5	22.1
2015	216.4	1620.7	19.9
2016	237.6	1792.9	9.6

Source Bloomberg, Bank of America-Merrill Lynch, Citigroup, Dealogic, Deutsche, JP Morgan, Macquarie, RBS, Thomson Reuters, Unicredit, AFME & SIFMA

Table 2.2 Issuance by Collateral (€ Billions)

	EU		US		AU	
	2016	2015	2016	2015	2016	2015
ABS	70.6	66.4	162.0	176.5	2.2	4.2
CDO/CLO	21.2	14.2	25.4	72.9		
CMBS	3.7	6.0	1529.5	1297.0	0.3	0.2
RMBS	119.4	102.0	76.0	89.0	7.1	15.5
SME	19.8	27.1				
WBS/PFI	2.9	0.8				
Total	237.6	216.4	1792.9	1635.4	9.6	19.9

Source Bloomberg, Bank of America-Merrill Lynch, Citigroup, Dealogic, Deutsche, JP Morgan, Macquarie, RBS, Thomson Reuters, Unicredit, AFME & SIFMA

Table 2.3 Outstandings by Collateral in Europe (€ Billions)

	2016	2015	2014	2013	2012	2011	2010
ABS	209.4	201.0	199.9	208.3	205.9	204.4	201.4
CDO/CLO	125.7	105.0	118.7	145.5	187.5	212.5	255.5
CMBS	67.6	79.3	86.0	100.7	117.5	134.0	154.5
RMBS	712.9	752.4	855.8	883.8	1008.7	1228.9	1325.4
SME	89.6	94.6	106.9	121.4	154.9	174.8	162.0
WBS/PFI	68.7	69.6	73.9	72.8	70.0	67.6	70.5
Total	1274.0	1,301.9	1,441.1	1532.7	1744.5	2022.2	2169.2

Sources Bloomberg (US & Europe), Fannie Mae (US), Federal Reserve (US), Freddie Mac (US), Ginnie Mae (US), Macquarie, Thomson Reuters (US), AFME & SIFMA

Table 2.4 Issuance by Country of Collateral (€ Billions)

	2016	2015	2014	2013	2012	2011	2010	2009
Belgium	3.6	1.2	4.1	2.0	15.4	19.0	14.1	27.4
Denmark			0.0	0.8			1.5	
France	20.3	17.0	50.6	9.9	14.9	16.4	9.2	6.9
Germany	17.5	45.1	18.3	21.9	10.2	12.9	13.4	17.5
Greece	1.3		0.2		2.0	6.4	1.0	22.5
Ireland	4.6	0.7	2.1	1.0	1.2		6.6	25.1
Italy	41.3	33.7	19.7	27.0	62.8	51.3	16.4	69.3
Netherlands	33.4	21.4	25.2	39.6	48.7	85.6	137.6	44.2
Portugal	1.3	4.9	2.9	3.3	1.4	10.6	16.9	10.5
Spain	34.0	26.3	27.2	27.5	18.6	61.7	55.4	64.9
UK	55.1	45.9	49.1	33.5	78.6	100.4	101.0	88.7
Other EU	1.4		0.8	1.6	1.3	0.6	0.1	
Other Europe	2.0	2.7	1.1	3.1	1.7	2.8	1.5	1.8
PanEurope	21.7	15.0	15.4	9.2	0.4	3.1	2.6	21.4
Multinational		1.2	0.2	0.4	0.5	6.0	0.8	23.7
European Total	237.6	216.4	217.0	180.8	257.8	376.8	378.0	423.9

Source Bloomberg, Bank of America-Merrill Lynch, Citigroup, Dealogic, Deutsche, JP Morgan, Macquarie, RBS, Thomson Reuters, Unicredit, AFME & SIFMA

2.8 Summary and Conclusions

In this chapter we analyzed the securitization process. The securitization is a process through which illiquid assets are transformed into negotiable securities to be placed in the market.

The Originator pools together a set of assets with homogeneous characteristics, in order to sell them to a particular special purpose company (SPV), which buys the rights to receive the related future expected payments. Thanks to the asset sale to a SPV, the transaction becomes unaffected by the bankruptcy of the Originator. To finance the purchase of the assets, the SPV then issues asset backed securities (ABS), with the help of investment underwriters.

Many steps are necessary to accomplish securitization transactions. The credits are first transferred by the Originator to a SPV, and then transformed into marketable securities to be sold to final investors. The payments on the receivables are then collected by a servicing institution (Servicer), usually represented by the Originator. The funds are forwarded to a third party (Trustee) which forwards them to the security holders.

As a response to the global financial crisis, policy makers and Regulators around the world started introducing a more and more stringent framework for securitization in order to contribute to make the financial industry more resilient and to facilitate the sustainability of the development of the securitization market. The regulatory effort is still in progress.

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