The development of securitisation statistics in Ireland

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1. Introduction

The recent crisis has highlighted a number of areas where the information which is available to policy makers has failed to keep pace with financial innovation. One such gap relates to credit risk transfer – an area which has increased greatly in its use and complexity in recent decades. Within the euro area, this is being tackled on two fronts: the collection of loan sales and transfers by resident monetary financial institutions (MFIs), and the collection of data from resident financial vehicle corporations (FVCs) which are engaged in securitisations.

Statistics on securitisation in Ireland developed in tandem with their use by domestic credit institutions, in order to complete data on lending to the private sector. However, in recent years, Ireland has become a prominent location for FVCs which are engaged in securitising loans of *non*-resident credit institutions and in a wide range of related activities, such as the repackaging of asset-backed securities into new securities. This sector has grown to just under 15% of the total financial sector in terms of assets. Ireland has the largest population of FVCs within the euro area by number and assets. These vehicles have been subject to reporting requirements since December 2009 under the ECB Regulation on Financial Vehicle Corporations[2].

The size and nature of the FVC population has posed numerous challenges in terms of identification and data collection, some of which are still in the process of being resolved. The purpose of this paper is to provide an overview of the collection of securitisation statistics in Ireland in terms of its early and more recent development, and a synopsis of future developments and improvements which could be made within the existing framework.

2. Background

As in other common law jurisdictions, securitisation uses a vehicle (FVC), which is typically set up as a bankrupt remote company with the beneficial shareholding held on trust by share trustees. Directors of the FVC are often provided by its "corporate services provider", which also supplies a registered address for the vehicle and other administrative functions.

Certain tax provisions for securitisation companies located in the International Financial Services Centre (IFSC) were first introduced in 1991 and allowed them to be structured as broadly tax-neutral. These provisions could be utilised by companies holding "qualifying assets", and were extended to transactions outside the IFSC in Section 110 of the Taxes Consolidation Act 1997 (effective in 1999). The range of qualifying assets was widened considerably in an amendment of Section 110, in Section 48 of the Finance Act 2003. Section 110 companies may hold equities, bonds, receivables, leases and derivatives as assets. Property is not a qualifying asset, but the vehicle may invest in another company

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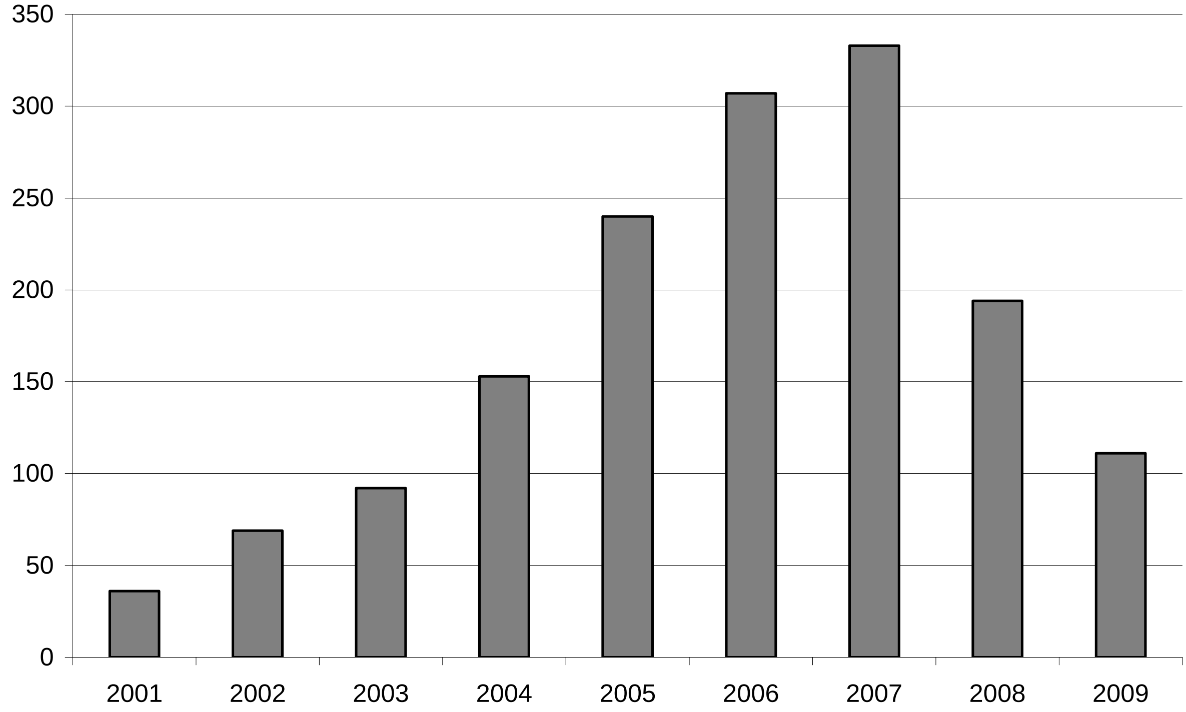
[1] Statistics Department, Central Bank of Ireland.

[2] Regulation ECB/2008/30 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions.

which holds property. Qualifying assets were further extended in subsequent years, to include investments in money market funds in 2006, and greenhouse gas emissions and insurance/reinsurance contracts in 2008.

Annual registrations of Section 110 companies with the Revenue Commissioners – the national tax authority – grew rapidly from 2001 (Chart 1) to over 300 companies per annum in 2006 and 2007, before falling sharply following the crisis. Although some of the registered companies may not have in actual fact taken up activities, or may be outside the scope of the FVC definition, this indicates the rapid growth in the number of companies using the provisions allowed by the above legislation in the period before the FVC Regulation came into effect.

Chart 1: Registrations of Section 110 companies with the tax authority



Source: Revenue Commissioners.

There are around 750 active vehicles which are reporting data to the Central Bank. As this paper will show, only a relatively small proportion of these (by number and by assets) are related to the securitisation activities of domestic credit institutions. The following section will look at the use of securitisation by domestic banks, before coming to the wider population of vehicles.

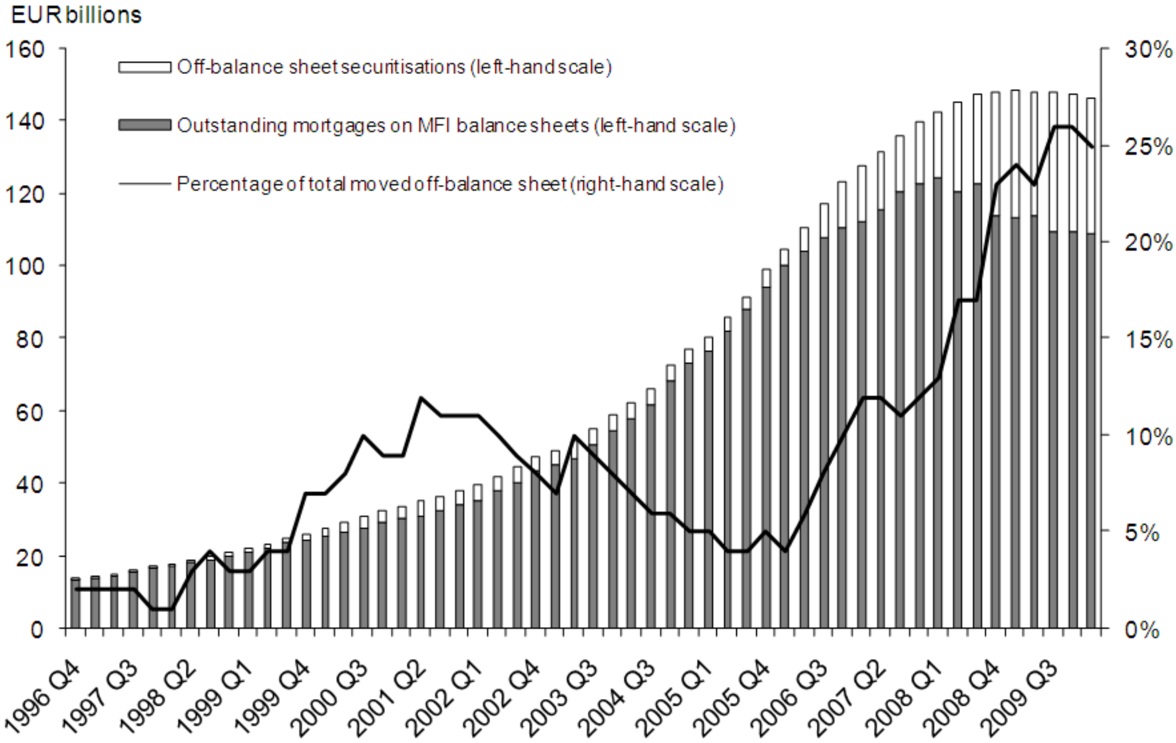
3. Capturing securitisation data from domestic credit institutions

3.1 Securitisations by domestic credit institutions

Statistics on securitisation initially responded to the need to correct outstanding lending stocks for off-balance sheet lending, and hence were first focussed on domestic credit institutions. The first securitisation of Irish mortgages was of IR£200 million in 1996, and off-balance sheet household mortgages have since grown to around €37 billion (Chart 2). As of

1996, banks were required to provide the outstanding stock of off-balance-sheet mortgages which had been securitised on a monthly basis. As is usual in such cases, the credit institution continued to act as servicer to the loans. Although outstanding mortgage balances were requested on a vehicle-by-vehicle basis from the banks, no information was requested from the FVCs themselves. These volumes were then incorporated into the statistics on lending to the household sector and credit growth rates.

Chart 2: On- and off-balance sheet mortgages of Irish MFIs



Source: Central Bank of Ireland.

The use of securitisation was initially restricted to specialist mortgage lenders, but became more widespread from 2005 to 2007 as the larger credit institutions began to rely on securitisation to fill funding gaps in a period of strong credit growth and house price increases[3]. Issuance of covered bonds also increased during this period, as some credit institutions set up “mortgage banks” in order to issue asset-covered securities[4]. However, unlike securitisations, loans transferred to mortgage banks remained within the MFI sector, and therefore were covered by banks’ statistical requirements.

Despite the freezing of securitisation markets during the financial crisis, the proportion of loans that had been moved off-balance sheet reached a peak of 26% of outstanding volumes in mid-2009. The motivation for these “internal” securitisations was to create eligible assets to be used in central bank refinancing operations – a trend that was seen across many other euro area countries.

3 See: Doyle (2009) and Addison-Smyth *et al* (2007).

4 The issuance of covered bonds was enabled by legislation in 2001 and first carried out in 2004.

In addition, there have been securitisations carried out by domestic credit institutions which were not captured in the securitisation statistics of the Central Bank, either because the assets were not mortgages or NFC loans, or because they were not derecognised from the balance sheet of the MFI. These will be captured, however, by new statistical requirements on securitisations and loan sales.

3.2 New ECB requirements for MFI securitisation statistics

The information previously supplied by credit institutions on off-balance sheet securitisations, which was limited to the amount of loans transferred, has been superseded by the more detailed requirements of a new ECB Regulation on money and banking data[5]. The new ECB Regulation allows the collection of consistent statistics on securitisation across the euro area, as opposed to the unharmonised approach carried out before.

MFIs are requested to provide sectoral, geographic and maturity breakdowns of loans securitised – and volumes which continue to be recognised on the banks' balance sheets, or which have been derecognised. This is wider than the previous statistical collection which only captured loans moved off-balance sheet.

In addition to the monthly reporting on securitised lending required from banks, there is also a quarterly requirement for a geographic breakdown by country of residence of FVC. Where MFIs are acting as servicer to loans they have originated, a derogation may be offered by the National Central Bank (NCB) to the FVC. In such cases, the missing breakdowns will be provided by the servicing MFI and combined with the FVC data (see section 5.2).

The first data collection under these new statistical requirements took place in July 2010, with reference to the three quarters Q4 2009 to Q2 2010. This will provide data on credit risk transfer from banks through loan sales and securitisations, whether this is through transfer to another euro area resident or not. If the transfer is to a euro area FVC, information will be available through the FVC reporting framework, which is discussed in the following two sections.

4. Securitisation activities of financial vehicle corporations

4.1 Definition and register of FVCs

The FVC Regulation has a very broad definition of securitisation which encompasses the transfer of assets or a pool of assets to a securitising entity, or the transfer of credit risk through the use of credit derivatives (synthetic securitisations). The activities of the FVC which may qualify as "issuance" include issuing of debt securities publicly or through private placement, and also, potentially, funding through the use of derivatives or loans. Vehicles which do not come within the scope of the Regulation are those which solely grant loans to parties on its own account as part of an investment strategy – i.e., the entity is the "first" or "original" lender of the loans and, therefore, the loans have not been transferred to the entity from another lender. In addition, if there is a synthetic transfer of a non-credit risk (e.g. insurance risk) to an entity without any transfer of assets themselves, then that entity is not an FVC.

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[5] Regulation ECB/2008/32 concerning the balance sheet of the monetary financial institutions sector.

The first challenge for the Central Bank arising from the FVC Regulation was to identify securitisation vehicles. The FVC Regulation requires that NCBs maintain a list of resident FVCs as of March 2009. This list, updated quarterly, is published on the website of the ECB to simplify the identification of FVCs by statistical reporting agents. There was no register of FVCs for statistical or regulatory purposes at the Central Bank or Financial Regulator prior to the ECB Regulation. The necessary legislation which would have allowed the Section 110 list maintained by the Revenue Commissioners to be shared with the Central Bank was not in place, but even if it had been available, it would have been deficient in a number of respects. The greatest deficiency is the matter of definition, as the companies which are allowed to utilise Section 110 do not necessarily coincide with the FVC definition. Also, there is no means by which a company can "deregister" from this list, and so it is likely to contain a large number of dormant, matured or liquidated vehicles.

Under the FVC Regulation, the onus is on FVCs to identify themselves to the NCB – initially by end-March 2009, or within one week of taking up business if established after end-March 2009. The Central Bank engaged with industry members at an early stage – beginning with bilateral meetings with corporate service providers in 2007. The Central Bank also held discussions with the local industry body, the Irish Securitisation Forum, on which a number of corporate service providers and law firms are represented. The Regulation was further publicised through an article in an industry magazine.

There were difficulties in some instances as directors and legal advisors of vehicles tried to determine if certain vehicles fell within the definition contained in the FVC Regulation. Due to the complexities of some structures and the broad nature of the definition, there were a number of cases on the borderline of the Regulation, often concerning whether or not the funding of the vehicle qualifies as issuance. Forthcoming guidance at a euro-area level will help in this regard. However, due to the breadth of structures, legal environments and innovation in the sector there are likely to remain cases for which it is difficult to determine whether some vehicles are inside or outside the scope of the Regulation, and these will have to be dealt with on a case-by-case basis.

4.2 What activities are carried out by resident FVCs?

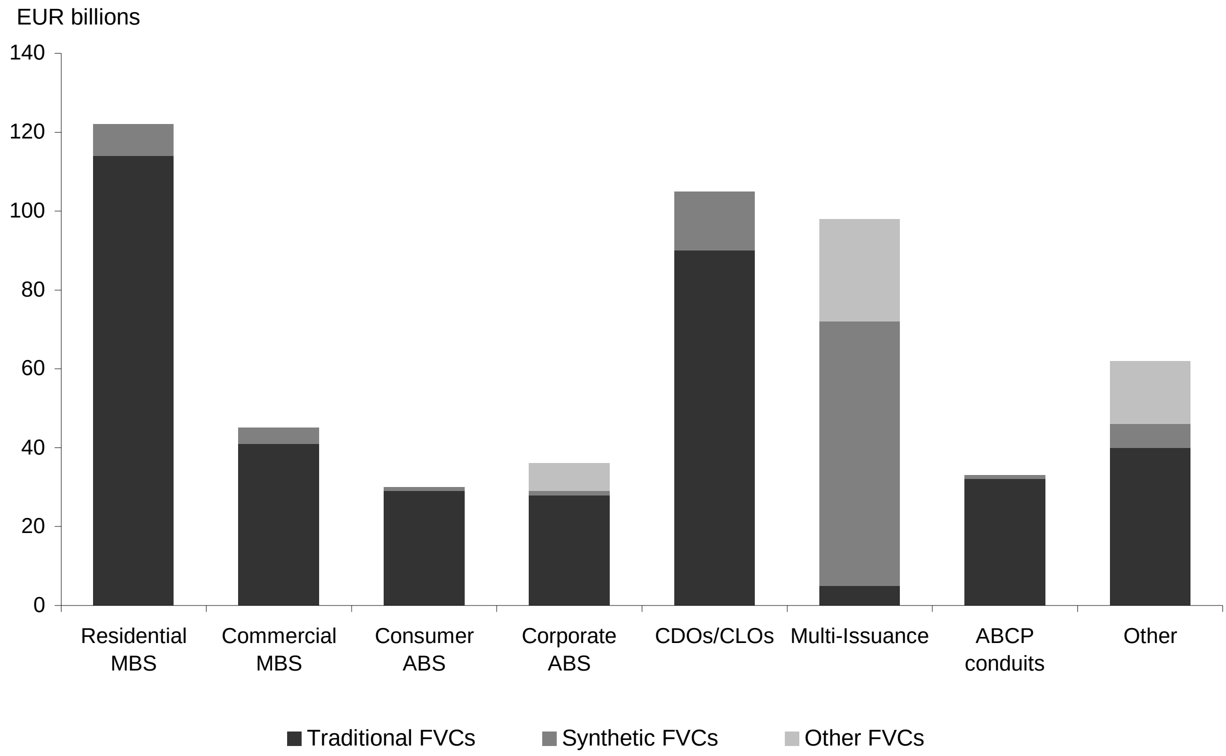
The resident population of FVCs is a very heterogenous group with a wide range of underlying assets, including residential and commercial mortgages, financial and operational leases, trade receivables, and also resecuritisations of asset backed securities. Under the FVC Regulation, three balance sheets must be aggregated on the basis of the nature of securitisation: traditional securitisations, synthetic securitisations and "other" FVCs. Traditional FVCs make up 72% of the population by total assets. The volume of synthetic securitisation is significant in Ireland relative to many other jurisdictions, at 19%. Currently, 9% of resident FVC total assets are in the "other" nature of securitisation category. "Other" primarily includes hybrid FVCs which are carrying out both traditional and synthetic securitisations, and it has not been possible yet to allocate to either traditional or synthetic (for example on the basis of the majority of activity). Once such issues are resolved, it is likely that the relative size of the "other" nature of securitisation category will be significantly reduced.

As well as the nature of securitisation, registering FVCs were also asked for their type of activity. The list of activities included: Residential MBS, Commercial MBS, Consumer ABS, Corporate ABS, Cash (i.e. true-sale) CDO, Synthetic CDO, and a residual Other category. A brief description was requested in the case of Other types of vehicles, and two common classifications were added by the Central Bank as categories: ABCP conduits and Multi-Issuance Vehicles (MIVs). If these classifications (based on commonly-used industry descriptions) were missing or unclear, alternative sources were used to determine their main activity such as prospectuses, audited annual accounts and stock exchange or rating agency categorisations.

Residential MBS is the largest group by assets, including both traditional and synthetic volumes (Chart 4). The next largest category is cash and synthetic CDOs, followed by MIVs. An MIV is a single entity which issues multiple (perhaps dozens) series of notes in which specific assets are contractually ring-fenced to a specific issuance, and are hence bankrupt-remote from each other[6]. There can be a mix of both traditional and synthetic series within one vehicle, so many have not been allocated to either of these types of securitisation. However, it may be possible to use other sources of information on the series in order to determine which is the dominant type of securitisation for the MIV.

This high-level qualitiative information greatly enhances the usefulness of quantitative data when the population is as varied as it is in Ireland. The differing profiles of these types of FVCs are apparent in examining the aggregated balance sheets by type (Chart 4). It is expected that the synthetic vehicles – e.g. synthetic CDOs – would have a larger part of their balance sheets made up of deposits, while the ABCP and MIV conduits should have a large proportion of their assets in debt securities. Cash CDOs' assets (which includes CLOs and CBOs) are split between loans and debt securities, although there is the flexibility to seperately identify CLOs and CBOs based on individual balance sheets if desired.

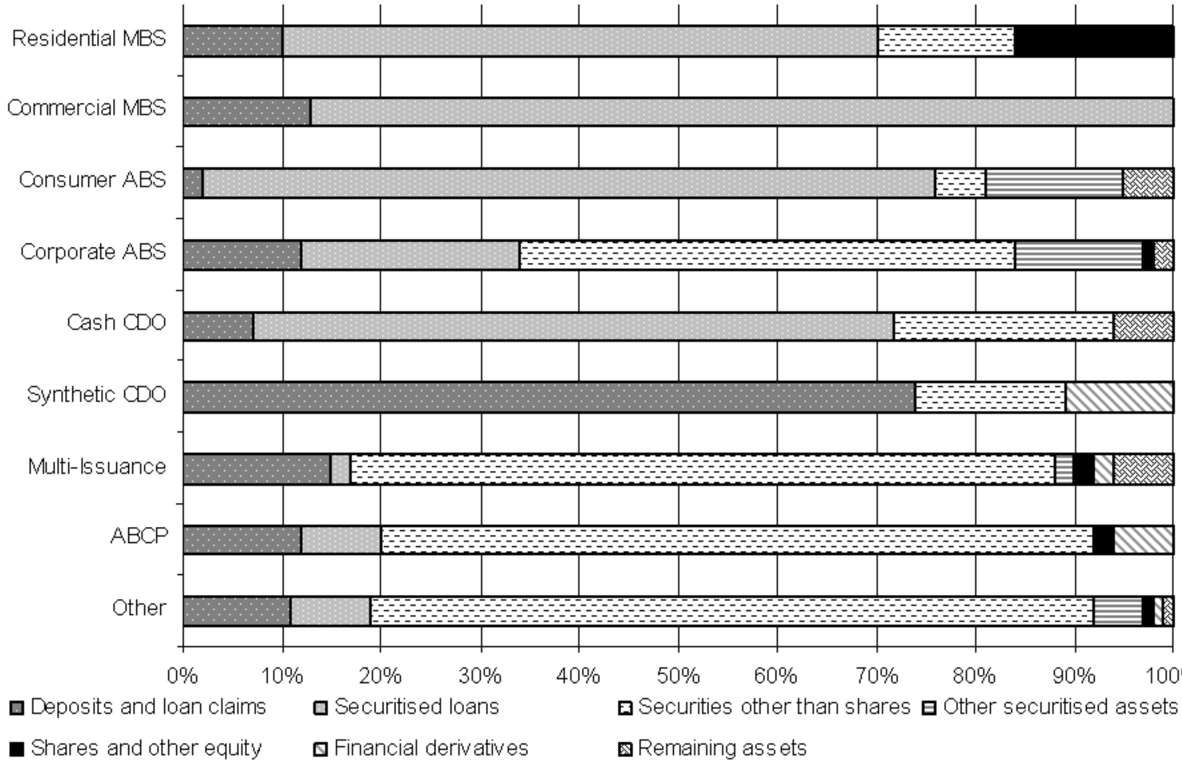
Chart 3: Activities of FVCs



Source: Central Bank of Ireland. Preliminary data for Q4 2009.

[6] This is similar to structures in some other jurisdictions which use "compartments".

Chart 4: Aggregated assets of FVCs by activity



Source: Central Bank of Ireland. Preliminary data for Q4 2009.

With such a large population (for which publicly available information is often scarce) it would be difficult to monitor the collateral underlying each transcation in order to ensure that it is being reported appropriately. However, classifications by activity have already proved helpful in determining what types of collateral are typically used by specific categories of vehicles. This in turn, allows the Central Bank to query those vehicles who hold non-standard types of collateral to verify the accuracy of the information reported.

5. Capturing securitisation data from financial vehicle corporations

5.1 Reporting requirements

The reporting requirements of the Central Bank for FVCs are based on Annex I of the FVC Regulation. The return has three elements:

- End-quarter balance sheet data, including on the assets side: deposits/loan claims, securitised loans, debt securities, financial derivatives; and on the liabilities side: deposits/loans received, debt securities issued and financial derivatives. Securitised loans are broken down by originator (euro-area MFI, euro-area non-MFIs and rest of world originators). For most items only total amounts are requested. For loans which were originated by euro area MFIs, the requirements are the same as they would be if the loans were still on the balance sheet of the MFI – i.e. with breakdowns by:
  - sector - Households, Non-Financial Corporations, Other Financial Intermediaries, Insurance Corporation and Pension Funds;
  - geography - Domestic, Other Monetary Union Member State, Rest of World;
  - and maturity - for loans to Non-Financial Corporations only

- Quarterly financial transactions for the same balance sheet items as above
- Write-offs and write-downs of securitised loans during the month

Debt securities held are collected on the basis of ISIN code, if an ISIN has been assigned to the security. This information is combined with the ESCB's Centralised Statistical Database (CSDB) in order to compile the necessary breakdowns by geography and maturity. This level of information is also useful in enhancing the information available on non-resident flows and positions for balance of payments and international investment position purposes. It also provides other valuable information including the type of securities held, and the sectors issuing these securities.

The FVC is the reporting agent under the Regulation, but due to their "brass plate" nature they must nominate another company to provide the statistical data on their behalf. There are no restrictions regarding whom is nominated, and there is a wide variety of companies acting in this role on behalf of FVCs. In around 90% of cases, the corporate services provider provides the quarterly reporting requirements, although usually the necessary information must be collated from other counterparties, such as the loan servicer, collateral manager, investment manager, etc. Domestic MFIs usually provide returns on behalf of transactions for which they continue to act as loan servicer. The FVC may also nominate a non-resident counterparty to meet its reporting obligations, where this counterparty is best placed to provide the information required.

There are a number of features of the FVC Regulation which seek to minimise the impact of the reporting burden. Although reporting is with regard to the end-quarter reference date, statistical data may be compiled from an investor report (or equivalent) which has a reference date *within* the quarter, as long as any significant differences between the investor report reference date and the end-quarter are taken into account. This has a number of advantages for reporting agents:

- It utilises data that are already being compiled for the FVC which should enhance its accuracy and reduce the burden. However, additional information is often required from some counterparties, especially if the transaction pre-dates the Regulation and the documentation is not sufficient for all requirements.
- Usually the investor and distribution reports are timed to coincide with the payments to noteholders, and so accruals are minimised. Accruing interest between this date and the end-quarter is not necessary.
- As the reference date of the investor report is in often in advance of the end-quarter, it allows additional time for compiling the returns for many vehicles so that the burden on the reporters can be spread over a wider period[7].

Another concern for reporting agents was the difficulty in getting timely information on market prices where it is required under national accounting practices. As many of the assets are illiquid, the process of marking-to-model is particularly difficult (and costly). However, the Regulation allows the valuations used in the investor (or similar) reports to be used for the purposes of statistical reporting, in cases where the national accounting practice would imply marked-to market prices should be reported.

5.2 Combining data on securitised loans from MFIs and FVCs

In many loan securitisations, the originating bank will continue to act as servicer and will be best placed to provide information on the breakdowns of borrowers by sector, residency, etc.

[7] The deadline for FVC returns in Ireland is 19 working days after the end of the quarter.

In order to avoid duplication of reporting requirements, the NCB may allow the breakdowns to be supplied by MFIs in their regular quarterly reporting requirements, rather than from the FVCs themselves.

This is facilitated by a cross-border exchange of data via the ECB. MFIs report the breakdowns for loans which have been securitised using an FVC resident in the euro area on a country-by-country basis. This information is aggregated by country by the NCBs and transmitted to all other euro area NCBs (via the ECB). If the NCB has decided to allow this derogation for resident FVCs, this data exchange will be used to complete the missing data on the breakdowns of securitised loans.

For applicable cases, Irish FVCs should only report total securitised loans which they have on their balance sheets[8] (and total transactions), and no breakdowns of sector, geography or maturity for loans which are serviced by an MFI are requested. These breakdowns should be collected in the data provided by domestic and other euro-area MFIs to their respective central banks.

As it is likely, particularly in the early stages, that the breakdowns provided by MFIs will not match the totals provided by the FVCs exactly, procedures have been put in place to gross up or down the breakdowns in order to match the control totals reported by FVCs. While banks provide balance sheet information for FVC loans that they service, they are not required to provide similar information on transactions. It was determined that it would be counterproductive to request transactions breakdowns on loans from FVCs when they have a derogation on outstanding amounts. The financial transactions are therefore computed from the cross-border exchange of MFI information – i.e. from the quarter-on-quarter movement of stocks, the reclassifications and write-offs/write-downs of loans securitised by banks which they continue to service.

Difficulties are likely to arise from either double-counting of securitised loans volumes (i.e. the FVC reports breakdowns which are also reported by MFIs and both are incorporated) or from cases where neither an FVC nor an MFI reports the necessary breakdowns. This can be reduced by monitoring both the data exchanged and the FVCs utilising the derogation on securitised loans breakdowns. Over fifty of the reporting FVCs are using this derogation on their securitised loans breakdowns in Ireland, but the accuracy of the data can only be assessed when it comes to be combined with the MFI data. Although this is quite straightforward for domestic FVCs and MFIs, it is more difficult for other euro area resident MFIs as the data received is on an aggregate basis. For FVCs using this derogation, the Central Bank has asked for the name and residency of the servicing MFI to help ensure the quality of the data exchanged across borders.

5.3 Reduced reporting for smaller FVCs

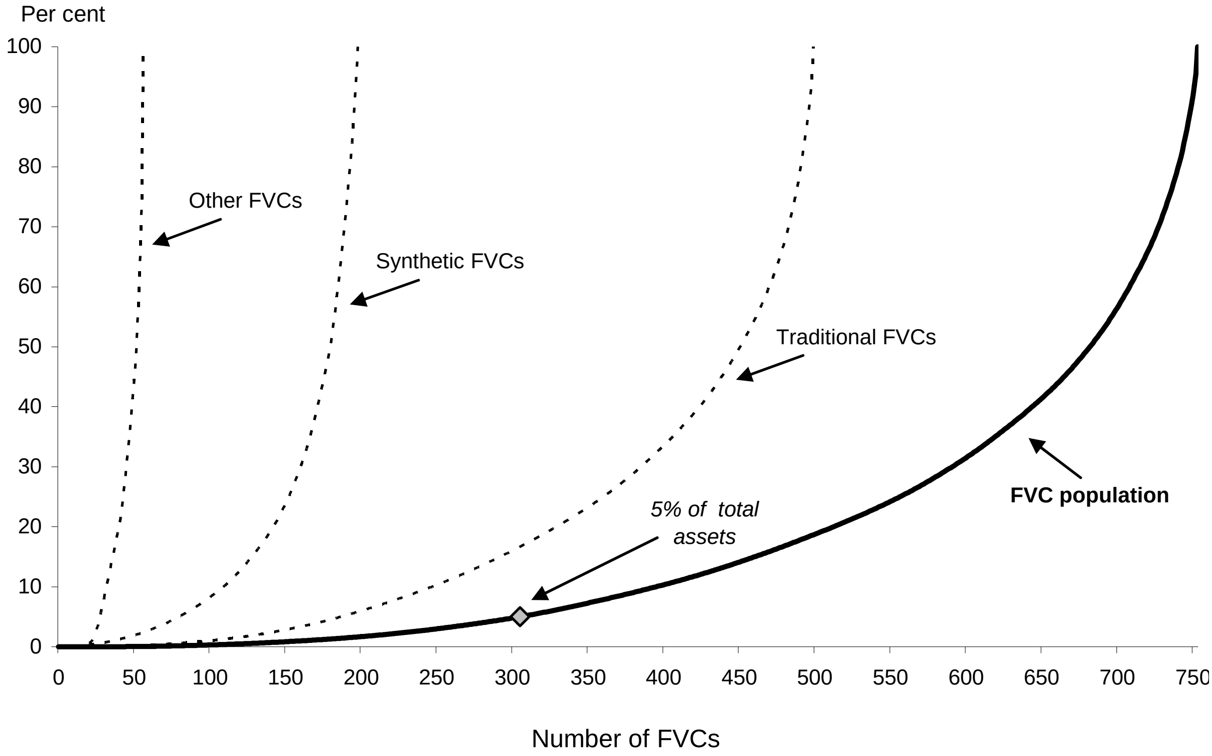
FVCs which have total assets of less than €180 million are subject to a reduced reporting requirement. Rather than the full balance sheet and financial transactions requirements, they provide only total assets on a quarterly basis. Under Article 5.1(b) of the FVC Regulation, this may be granted by an NCB as long as the total assets of all FVCs subject to the derogation is less than 5% of the total assets of the national FVC population as a whole. The threshold is subject to annual review to ensure it is within the limit set in the FVC Regulation.

Due to the profile of FVCs resident in Ireland, this 5% threshold covers a large proportion of vehicles (Chart 5). The current of threshold of €180 million allows some flexibility so that coverage may still meet the 5% criterion, even if there are changes in the profile of the

[8] Although the derogation in the FVC Regulation could apply to *all* outstanding securitised loan data, totals are still requested from resident FVCs because it is necessary for the vehicle's balance sheet to balance.

reporting population. It was determined that this threshold would maximise the number of FVCs which may use the derogation, while ensuring continuity in terms of reporting requirements for the FVCs. Although the 5% threshold of the Regulation must apply to the population as a whole, a further determining factor was its impact for traditional, synthetic and other FVCs to ensure adequate coverage in the three aggregated balance sheets which must be compiled for the ECB.

Chart 5: Cumulative total assets and derogation on full reporting requirements



Source: Central Bank of Ireland.

The derogation on reporting requirements was allowed for FVCs with assets of €180 million or less at end-Q4 2009 with two exceptions: FVCs that had not yet fully taken up business (e.g. were in a ramping-up or warehousing stage) and would exceed this amount at a future date; and FVCs that were using the derogation described in section 5.2 on securitised loans, so that their balance sheet information could be combined with MFI data. Due to difficulties which may arise with FVCs moving in or out of the derogation group from quarter to quarter (not least, administratively) it was decided that FVCs whose assets were above the threshold at Q4 2009 but subsequently fell below €180 million must continue to provide the full reporting requirement until they mature or until the threshold is reviewed.

There are a number of advantages arising from the derogation for both the reporting agents and the NCB. Firstly, it considerably reduces the costs of reporting across the population. As the cost of reporting the FVC return may be thought of as broadly fixed in terms of vehicle size – i.e. the costs of reporting depend largely on the complexity of the vehicle, rather than total assets – it is appropriate that the reduction in burden should be provided particularly for smaller FVCs. Secondly, the derogation allows a greater focus on the accuracy of information provided by reporting agents on behalf of larger FVCs. In this way, although an element of estimation needs to be introduced to account for smaller FVCs with a derogation, there may in fact be a benefit in terms of quality due to the focus on larger and more complex FVCs.

5.4 Consolidating the sector

In many cases, a securitisation transaction may involve a number of vehicles, possibly in more than one jurisdiction. Loans between euro area FVCs involved in a structure are captured through "of which FVCs" positions, as are shareholdings in FVCs and holdings of notes issued by FVCs. This allows a consolidated picture of the sector and avoids double counting transactions involving more than one vehicle. This requires careful monitoring to ensure consistent treatment on both sides of such transactions and is particularly challenging when the vehicles are based in multiple jurisdictions. The register of FVCs currently does not include a facility to identify links between vehicles.

Another important factor in examining credit risk transfer and the ultimate holders of such risk is the level of resecuritisations (where asset backed securities are themselves securitised). This is common in Ireland – as evidenced by the large number of CDOs, MIVs and ABCP conduits – and a high proportion of the non-MFI debt securities held by FVCs were originally issued by euro-area FVCs. Security-by security information on holdings is useful in analysing resecuritisations, especially for securities issued in the rest of the world for which no information on the issuer is requested.

6. Conclusion

The recent advances in the collection of securitisation statistics provides a greater understanding of credit risk transfer and the role of FVCs in financial intermediation. Most importantly, data from FVCs provide an overview of a sector for which little information was previously available. This is particularly useful in Ireland, where in the past few years the sector has come to make up a relatively large proportion of the financial sector, and this data will enhance statistics on balance of payments flows and positions and securities issues statistics. Given the cross-border focus of most FVC activity in Ireland, the development of these statistics can help address some of the statistical gaps identified in terms of cross-border exposures.

There are a number of developments in the short to medium term which can further enhance the benefit of these statistics within the current framework. Firstly, the collection of security-by-security information from banks, investment funds and FVCs themselves can be used to help determine the holders of FVC securities. Secondly, the benefit of even high-level qualitative information is significant, and could be improved with further information on the links between FVCs and between sponsoring banks and FVCs.

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