

# ***Letter from the Editors***

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## **Mortgage Backed Securities: Liquidation of the Mortgage Book**

### **I. MORE THAN ONE EUROPEAN PATH TO THE SECONDARY MORTGAGE MARKET**

#### **A. MBS in the U.S.**

In the U.S. mortgage backed securities created by securitizing mortgages are the core of the secondary mortgage market. Securitization integrates the bank market with the securities markets. Originators sell mortgages to the Government Sponsored Enterprises, the GSEs (the Federal Home Loan Mortgage Corporation, Freddie Mac and The Federal National Mortgage Association, FNMA) for cash or in exchange for MBS or to the private conduits for cash. The GSEs and private conduits finance purchases of mortgage pools via real estate investment mortgage conduits (REMICS) which issue multiple tranches of securities (collateralized mortgage obligations) the design of which depends on the demand for various elements of the mortgage pool. Proceeds from the issues of collateralized mortgage obligations are used to finance the purchase of the mortgage pool from the conduit.

“GE Capital Mortgage Services, Inc. (“GECMSI”), a wholly-owned affiliate of GE Capital Mortgage Corporation, is engaged primarily in the business of originating, purchasing, selling and servicing residential mortgage loans collateralized by one-to-four-family homes located throughout the United States. GECMSI obtains servicing through the origination and purchase of mortgage loans and servicing rights, and primarily packages the loans it originates and purchases into mortgage-backed securities which it sells to investors. GECMSI also originates and services home equity loans.”<sup>1</sup> (10-K, 2000).

Bank of America Funding Corporation recently securitized \$1.8 billion of mortgages it purchased from Fleet Financial Corporation via a REMIC BAFC 2000-1. The pool of mortgages was financed with 28 different classes of securities. Fleet Financial continues to service the mortgages.<sup>2</sup>

Mortgage backed securities received in exchange for pools of mortgages are either retained by the originator or refinanced through REMICS. There is also an active forward market for mortgage loans in the U.S. Originators sell their production forward to conduits that warehouse the loans until the pool is large enough to be securitized. Conduits and originators hedge their exposures in the MBS and treasury markets.

In the U.S. the MBS market was kick started and has been sustained by the activities of GNMA, FNMA, and Freddie Mac. The first GNMA guaranteed MBS was issued in 1970. FNMA securitized its first pool in 1981 and Freddie Mac issued the first CMO, backed by 30 year fixed rate mortgages in 1983. The pool was refinanced with the issue of three classes of securities that matured sequentially.

National mortgage conduits such as FNMA and Freddie Mac do not exist in Europe. Without depth and liquidity of MBS/ABS markets, securitization is not as valuable and cannot be as popular especially when banks have alternative techniques of refinancing their mortgage portfolios. In the U.K. which is the largest market in Europe for both mortgage and asset backed securities, only 6% of U.K. mortgages are securitized while in the U.S. it is 60% (Council of Mortgage Lenders).<sup>3</sup>

#### **B. MBS in the U.K.**

Woolwich, a U.K. bank, originates mortgages in France and Italy through its banking subsidiaries. For now Woolwich funds these mortgages on balance sheet through its Euro MTN, CD, CP programs, its U.S. CP program, and its deposit base. Woolwich has a long term unsecured rating of A1 by Moody’s and a short term rating of P-1.

In 1999 Woolwich established a “fee based mortgage services” joint venture with Countrywide Credit Industries, a U.S. finance company that specializes in the origination and servicing of mortgage assets. Country-

wide relies heavily on the use of securitization to liquidate its mortgage assets net of servicing. It appears that Woolwich and Countrywide are going to apply Countrywide's model in the U.K. and across Europe. "Our proposed joint venture with Countrywide Credit Industries Inc. is expected to streamline mortgage services to securitisation standards and increase our efficiency. Scale economies are available and the size of the Woolwich portfolio will allow the partnership to achieve such economies"<sup>4</sup>

Abbey National the largest U.K. mortgage lender with about a 10% share of the net mortgage lending securitized its first pool of mortgages in 1998 and then followed in 1999 with two transactions. Abbey National securitizes its mortgages through its Holmes securitization program. Currently Abbey National funds 80% of its U.K. mortgage book with retail savings. It has also established an U.S. asset backed commercial paper program.

"In February 1998, we launched a pilot securitisation followed by another in February this year. This has enabled us to test our systems capability in what could become an increasingly important capital management tool in the UK. We are actively exploring the possibility of adopting more effective capital structures, including tax efficient tier 1 capital. In December 1998, ANTS sponsored a US\$ 5 billion asset-backed commercial paper programme which invests in a wide range of asset-backed securities. This adds flexibility to the ANTS balance sheet and represents an attractive capital management instrument for the future".<sup>5</sup>

Abbey National Treasury Services (ANTS) is sponsoring an ABCP program to earn fees and spread income via an off balance sheet vehicle. The vehicle is set up as a so called "arbitrage driven" program. In this type of program the conduit purchases rated liquid asset backed securities and funds them in the CP market. Sounds a bit like traditional financial intermediation with the difference that the assets that can be funded are restricted to liquid asset backed securities and the intermediary is not a bank.

In the U.K. the mortgage market has been characterized by on balance sheet funding and has been dominated by building societies and banks with centralized mortgage lenders such as Paragon (Formerly National Home loans) filling gaps left by the traditional lenders. Most of the centralized lenders are now owned by the banks. Paragon remains independent.

The first foray into securitization in the U.K. was by centralized mortgage lenders (finance companies) in the late 1980 and early 1990s. Without access to a deposit base they relied on continuous access to the wholesale financial markets. Centralized lenders intended to originate mortgages, warehouse the mortgages until the

pool was large enough, and then securitize the mortgages. Fees were earned from servicing and originating the loans, and interest earned on the subordinate loans they made to the securitization vehicles.

This excerpt from National Home Loans 1996 annual report offers a summary of what centralized lenders expect from securitization and how a typical U.K. securitization of mortgage works.<sup>6</sup>

"NHL is a market leader in the securitisation of mortgage and other financial assets. Since 1987, the Group has issued approximately £5 billion of asset backed securities, including some £813 million in the past twelve months alone.

Securitisation remains the Group's primary source of funding and, as such, represents a fundamental part of our strategy for the future. It provides limited recourse finance from the capital markets which is attractive to us for a number of reasons:

1. Investors in the capital markets will accept maturities anywhere between one month and forty years. This enables us to structure the maturity of our funding to match the profile of the assets being funded. There is no obligation to repay these bonds until the underlying assets have repaid.

2. Such investors are a diverse group, including banks, building societies, managed funds, corporations, insurance companies and other financial institutions, both UK based and from Continental Europe, Asia and the Middle East. This diversity provides depth to the markets, helping to minimise the effect of political, economic or commercial events in any one area, which might otherwise restrict the availability of funds.

3. Capital markets funding structures require less capital than conventional lending arrangements. This more efficient use of capital can improve the return on shareholders' funds. At the same time, the amount of capital employed in a securitisation limits our exposure to the risks attaching to the assets being funded.

Whilst the objective behind securitisation is straightforward, the structure of transactions is rather more complex. In order to be attractive to investors, the funding must be both liquid and highly rated by the relevant agencies, typically Moody's, Standard and Poor's, Duff and Phelps, or Fitch Investors Services. Therefore, the structure of any securitisation is moderated, if not prescribed, by these agencies.

In order to achieve the necessary structure, once a pool of suitable assets has been identified, either for financing or refinancing, a special purpose vehicle company, or SPV, is created. The rating agency then conducts a detailed examination of the assets in order to determine the amount of credit enhancement it requires to be

provided to protect investors against possible losses. Such enhancements may be achieved in one of three ways; through the use of any excess margin generated by the assets; via a cash reserve fund provided by the Group; or by creating a subordinate tranche of notes which carry a lower rating.

Where a cash fund is established, the Group receives quarterly payments of any excess margin generated by the assets, in the form of an interest payment on the loan made to establish the fund. Investors receive interest on the bonds they have purchased, but are only repaid as the underlying mortgages, or other loans, are repaid.

Working together with our investment bankers and the rating agencies, we have made significant advances in recent years which have made securitisation an even more useful funding tool for the Group. For example, we have securitised pools comprised entirely of loans in arrears, formed mixed pools of performing and non-performing loans, and placed more of the credit enhancement required with investors through more deeply subordinated tranches of notes than was possible previously. In addition, we are now able to fund assets at origination via a unique, revolving securitisation facility. A key advantage of this arrangement is that the Group is aware of the credit enhancement required before advancing any loan. Thus, an informed decision can be made as to the capital efficiency of an asset, it is already rated for further securitisation, and there is no funding mismatch.”

Originating mortgages with the intent of liquidating them through whole loan sales or securitizations net of servicing is characteristic of the U.S. mortgage market. It is a model that has become ingrained in the housing finance system and is supported by the large mortgage conduits such as GMAC, GE, FNMA, Freddie MAC, and Countrywide among others. It is a model that relies on a deep and liquid secondary mortgage market.

A number of events came together in 1990/1991 that stifled the growth of the nascent U.K. market for MBS foremost of which was the sustained depression in the housing market that resulted in historically high levels of defaults and arrears. As default rates on the securitized portfolios began to increase, rating agencies put a number of issues on credit watch and eventually downgraded them. In addition a number of issues were enhanced by mortgage pool insurance policies underwritten by companies that had their claims paying ability downgraded as a result of large losses in the commercial real estate market. The MBS that were supported by these insurance policies had to be downgraded since the general premise of rating agencies is not to rate an issue higher than the rating of the third party credit enhancer. Bank of Credit Commerce International (BCCI) collapsed causing a liquidity crisis that hit National Home Loans,

the largest of the U.K. centralized mortgage lenders, particularly hard. NHL through its banking subsidiary, The National Mortgage Bank, had relied on deposits from local authorities which also had exposure to BCCI. When BCCI collapsed, the local authorities withdrew their deposits from The Mortgage Bank. High arrears and defaults on securitized mortgage portfolio eroded the equity of the centralized lender as their subordinate loans to SPVs and their servicing portfolios lost value. Uncertainty regarding the accounting treatment of securitization in the U.K. and risk weights the Bank of England would assign to mortgage backed securities, contributed to the paralysis in the market. Both issues were resolved. Mortgage backed securities enjoy a 50% risk weight as they do through out Europe and U.S. unless they carry a guarantee of FNMA, or Freddie Mac in which case they are weighted at 20%. GNMA MBS receive a 0% risk weighting.

As a result of this confluence of events in the U.K. investors lost confidence in the market for mortgage backed securities sponsored by the centralized mortgage lenders. The building societies and banks did not face capital constraints and were able to finance their mortgage portfolios on balance sheet. In the U.S. during the S&L crisis of the 1980s and early 1990s the flow of mortgage credit was not disturbed even though a large percentage of the primary originators of mortgages were becoming insolvent. In this case it was the liquidity of the secondary market which made up for the loss of the S&L balance sheets.

Northern Rock is a United Kingdom Bank that converted from a building society in 1997. Its primary business is the provision of housing finance and other consumer financial services. In 1999 it began to securitize its mortgage portfolio to offset the stresses imposed by the increasing costs of deposits. Northern Rock has broadened its wholesale funding capacity to stabilize and diversify its funding sources.

“We were not prepared to sacrifice profit for uneconomic growth and in the first half of the year we offset a planned outflow of retail funds by increasing our proportion of wholesale funding. The very high cost of growth via retail funding was a threat to our strategy but we met this problem by securitisation which provided a welcome new source of funding. As competition eased a little in the second half we were able to fund retail again and we more than offset the earlier outflow...”

Our Treasury operations did particularly well to manage cash flow in the first half. Over the year as a whole we were aiming to reduce balance sheet risk by further diversification of funding by type and duration. We had successful road shows throughout Europe and the United States and our reward was the successful issuance of a US

medium Term Note Programme and a Euro Issue totaling £7775 million. Northern Rock is recognised as a first class name in the universal market place. We work very hard to convince credit raters that our low risk operation allied to successful growth demands an improved rating... In October 1999 we successfully launched our inaugural securitisation issue raising £600 million of mortgage backed securities. Our second issue, for a further £750 million, will complete on 1 March 2000. We anticipate securitising approximately £1.5 billion in 2000, with securitisation becoming a significant source of funds enabling incremental volume growth and capital efficiency... We have established three strong sources of funding; securitisation, non retail funding and our retail franchise. These, together with improvements in distribution and processing systems, will support strong growth in lending volumes in the current year".<sup>7</sup>

Again we see that securitization is a funding option that companies are being compelled to develop. More important than the actual volume of securitization transactions taking place in Europe which is increasing at a steady pace is the development of the capacity to securitize so that when balance sheet funding becomes less efficient or when banks offer better terms to their corporate clients for funding through a bank sponsored asset backed commercial paper conduit or medium term note program the corporate is in a position to take advantage of securitization. Securitization capacity requires good historical data on receivable performance and reliable systems for monitoring and servicing receivables.

Financial Reporting Standards 5, "Reporting the Substance of Transactions" (FRS 5) was issued in the U.K. in April of 1994. In relation to securitization transactions, FRS 5 allows a transferor of assets to derecognize the assets when a) all significant rights or other access to benefits relating to that asset and b) all significant exposure to the risks inherent in these benefits have been transferred. In securitization transactions the originator will typically retain some limited exposure to the transferred assets such as a subordinate loan to the securitization vehicle. When the originator retains rights and benefits deriving from the securitized pool, but its exposure is limited to a fixed monetary amount, FRS 5 calls for a linked presentation of the securitization. A linked presentation requires that the securitized assets net of the amount transferred to the SPV is consolidated in the accounts of the transferor while the gross amounts are shown on the face of the balance sheet.

"Debts subject to financing arrangements relate to securitised installment credit and mortgage receivables as described below. In accordance with Financial Reporting Standard 5, the agreements have been shown on the

balance sheet under the linked presentation method. The amounts shown on the balance sheet represent the gross asset values securitised less the remaining amount of the Floating Rate Notes which were issued to finance the acquisition of the securitised receivable..." Neither Standard Chartered PLC nor any of its subsidiaries or associates are obliged to support any losses which might arise from any asset securitised under the arrangements described above, nor does it or any other Group company intend to do so. The note holders have agreed in writing, in the financing documentation, that they will seek repayment of the Notes, as to both the principal and interest, only to the extent that sufficient funds are generated by the assets securitised and that they will not seek recourse in other form. The Group has no interest in the share capital of any of the purchasers of the securitised assets or of the trustee companies responsible for the collection of the related receivables".<sup>8</sup>

Standard Chartered description of its securitization arrangements confirms the premise upon which investors and originators have built the market for mortgage and asset backed securities. Securitization offers financial institutions a way of refinancing assets in the capital markets at terms directly related to the quality of the asset pool and independent of the evolution of value of the originator's balance sheet.

Standard Chartered has securitized motor vehicle installment credit contracts through a number of special purpose vehicles, Cardiff Automobile Receivables 3 and Cardiff Automobile Receivables 4. A subsidiary of Standard Chartered, Standard Chartered Bank securitized HK1 billion of Hong Kong Residential mortgages via the special purpose finance company Mortgage Asset Receivables Securitisation 1 (MARS 1) which funded the notes by issuing mortgage backed securities, notes secured on the mortgage pool. Standard Chartered retained a residual interest in the securitized assets which flows back to it once the obligations of the securitization vehicle have been redeemed in full.

### **C. MBS in France**

In France financial institutions have three alternate methods of funding their mortgage portfolios on a secured basis in the capital markets in a way that isolates the credit risk of the bank from the credit risk of the mortgage collateral. Each method offers the opportunity of funding a pool of mortgages at rates superior to what they could attain if they issued secured debt.

Caisse de Refinancement de L'Habitat (CRH) is a mutual credit institution with the sole function of refinancing mortgage portfolios owned by its shareholders, the major French banking institutions. Banks which

own shares in CRH issue secured mortgage notes to CRH. Notes are secured by qualifying mortgages that must exceed the note principal by 25%. As the mortgage portfolio amortizes banks must substitute in new collateral to maintain the security at 25% of the note balance. CRH issues fungible bonds on the capital markets to finance the portfolio of secured mortgage notes. Coupons and terms of the debt issued by CRH are structured to match its loan portfolio. All proceeds from the bonds issues are loaned to its shareholders. In 1998 CRH issued six bonds for an amount of FRF 14.06 billion (7 billion was an exchange of outstanding bonds for a new issue). Four of the bonds were issued at a spreads of 28 bp over the benchmark treasury issue, one at a spread of 29 bp and one at a spread of 43 basis points.<sup>9</sup> CRH is rated AAA by FitchIBCA and AAA by Moody's. For banks the cost of tapping CRH is the yield on CRH borrowings plus the cost of the capital they must tie up in CRH equity subordinate loans they are required to make to CRH, and the overcollateralization of their mortgage notes. This cost must be compared to the cost of alternative methods of financing the mortgage portfolio all of which require equity financing. Securitization via a French Fond Commun de Créance (FCC) would require equity in the form of credit enhancement. The credit enhancement could take the form of subordinate securities issued by the FCC, overcollateralization, a third party guarantee or a combination of the three forms. Deciding on the level of credit enhancement depends on the credit spreads at the time of the issue. If the originator is willing to refinance the bulk of the asset pool at AA rather than AAA, less credit enhancement is necessary. Rather than being determined by an institution or regulatory constraint the level of credit enhancement is determined by the credit rating agencies and the market place.

In France, Securitization is governed by the law 88-1201 of December 23 1988 and its subsequent revisions. In a French securitization transaction a financial institution or corporate transfers financial assets to a FCC the entity that the law created to act as the SPV. An FCC has no corporate status, the units it issues to finance itself represent undivided ownership interest in its assets. An FCC must be jointly established by a management company and a custodian. Assets sold to the FCC are removed from the balance sheet of the originator. The FCC is bankruptcy remote from the transferor of the assets and investors have no recourse back to the transferor. The FCC is tax neutral, it can buy receivables from financial institutions and corporates, and can buy non-performing loans and it can purchase loans originated outside of France. An FCC can borrow funds and enter into derivative contracts to enhance liquidity. The FCC can issue multiple series of securities secured by

a single pool of assets or it can be compartmentalized and issue multiple series each one secured against a different pool of assets. The asset pool can revolve so that the maturity of the assets is disconnected from the maturity of the securities issued by the FCC and the FCC can purchase additional receivables after its creation. We emphasize what the FCC can do because the original 1988 law constrained the FCC to making a onetime purchase of performing assets that had maturities greater than two years from banks or the Caisse des Depot et Consignations and to financing the purchase with a single series of securities. The FCC was unable to borrow for liquidity purposes.

Master Domos, the securitization program Paribas uses to securitize mortgages originated by its subsidiary, Union de Credit pour le Batiment (UCB), is a Fond Commun de Créance able to issue multiple series of mortgage backed securities to finance a revolving pool of mortgages.<sup>10</sup> Credit enhancement is considerably less than the 25% overcollateralization required by CRH. Master Domos is capitalized with two levels of credit enhancement. The senior notes are supported by a subordinate note equal to 5% of the mortgage pool balance and by a reserve fund set at 1.5% of the pool balance. Subordinate notes are enhanced by the reserve fund. Master Domos finances a broader array of mortgage contracts than banks are able to refinance through CRH. Master Domos purchases both fixed and floating rate loans as well as loans that give the mortgagor the option to convert from a floating rate loan to a fixed rate loan, and mortgages that have payment schedules linked to the inflation rate. In addition to mortgages Master Domos buys guaranteed housing loans "prêts immobiliers cautionnés". Principal and unpaid interest are guaranteed by an insurance company. A program like Master Domos is more flexible than CRH but not necessarily a substitute for CRH. CRH still enjoys funding advantages over those of FCCs, which it passes along to its owners in the form of lower yields, however, it is unclear whether the reduced yield is offset by the additional capital CRH requires over securitization. CRH placed Euro 975 million 10 year bonds in January of 2000 at a spread of 47 bp over the 10 year Euro Bund index. Master Domos issued a series of sequential notes (Domos 1999-1) to fund a purchase of fixed rate and floating rate mortgages. Tranche A4 rated AAA was issued with an expected maturity of 10 years at 70 basis points over the 10 year Euro Bund.<sup>11</sup>

From January 5, 1999 through April 28, 2000 the spread between the yield on the 10 year Euro Bund and the ten year Jumbo Pfandbrief index has averaged 34 basis points.<sup>12</sup> German mortgage banks have a funding advantage over both securitization vehicles and CRH. In

recognition of the funding advantage that German mortgage banks enjoy via the Pfandbrief market the French Government has passed legislation that creates a new special purpose financing institution modeled on the German mortgage bank.

The institutions "Sociétés de Crédit Foncières" (SCF) were created by the French law 99-532 of June, 1999. SCF are regulated as credit institutions but can not take deposits. As credit institutions they are subject to capital adequacy and solvency regulations. The unique purpose of SCF is to acquire or grant first mortgages in the EEA secured by residential property, guaranteed housing loans, senior classes of asset and mortgage backed securities issued under laws governing EEA members and loans to public authorities within the EEA. Investments in asset and mortgage-backed securities are limited to 10% of the SCF's assets. SCFs can not own any equity. Like German mortgage banks the composition of the SCF's assets and its capital structure is regulated by law. SCFs may issue two classes of bonds to fund their assets, a privileged class known as obligations foncières and a non-privileged class. Obligations Foncières (OF) have preferential claim on the assets of the SCF even ahead of employees and the French state. Even in the event of the SCF's parent bankruptcy, OFs can not be accelerated. The ratio of weighted eligible assets to OFs must be kept at a minimum of 1. Assets other than first lien mortgage with LTVs less than or equal to 60% and loans to public entities receive a 100% weight while guaranteed loans receive a weight of 100% if the guarantor's ratings is AA- or better.<sup>13</sup>

Two SCFs have issued OFs since the 1999 law came into effect. CIE Financement Foncier, a subsidiary of Credit Foncier de France, issued OFs backed by mortgage loans and Dexia Municipal Agency issued Euro 150 million callable OFs. CIE Financement Foncier issued EUR 1.25 billion of OFs with a maturity of 15 years at a spread of 41.65 bp over the benchmark French Treasury and 65 bp over the 15 year Euro Bund.<sup>14</sup> Both issues are rated AAA by Fitch/IBCA and Moody's. If successful, the market for OFs will capture some value from the German mortgage banks as investors move some funds into the higher yielding OF. Securitization, refinancing via CRH, and the use of OF will likely co-exist. Securitization offers the advantage of off balance sheet funding and more structuring flexibility, while CRH and the SCF currently offer a yield advantage before accounting for the equity that is needed to support each funding method.

#### **D. MBS in Germany**

German Mortgage Banks issue mortgage bonds known as Pfandbrief to finance their mortgage portfolios. Pfandbrief are collateralized by either loans to the public

sector or first mortgages. Mortgages that are eligible to serve as cover for Pfandbrief are governed by the German Mortgage Act as is the asset composition and capital structures of mortgage banks. Covers for mortgage Pfandbrief are first ranking mortgages. Pfandbrief can only be issued to finance mortgages that are less than or equal to 60% of the appraised value of mortgaged property. Mortgage balances in excess of the 60% LTV must be funded with unsecured bonds and can not exceed 20% of the bank's mortgage assets. The average maturity of a bank's outstanding Pfandbrief must equal the average maturity of the mortgage collateral. German mortgage banks can originate mortgages in the EU, EEA and Switzerland and on a limited scale in Poland, Hungary and the Czech Republic. Aside from government bond markets the Pfandbrief is the largest market component of the European bond market.<sup>15</sup> Given the depth and liquidity of the German Pfandbrief market it is not surprising that the only issues of MBS backed by German mortgages have been sponsored by institutions that did not have the right to issue Pfandbrief or have been backed by mortgages that did not qualify as Pfandbrief cover. Deutsche Bank has originated two MBS transactions through its Haus program. The securitized mortgages had an average LTV in excess of 60% and Deutsche Bank can not issue Pfandbrief.<sup>16</sup>

#### **E. Internet Banking and Securitization**

Pan European mortgage banking is a trend that will be boosted by information technologies that allow borrowers to apply and secure a mortgage via the internet. In the U.S. E-Loan acts as both an internet mortgage broker and banker. Besides originating the loan on behalf of other lenders, E-Loan gives prospective mortgagors the ability to search an extensive data base of loan products offered by seventy different lenders. E-Loan monitors refinancing opportunities for mortgagors, a service that has the potential of altering prepayment behavior.

Currently, E-Loan has an agreement with FNMA which gives it the right to use FNMA's automated underwriting services and allows it to sell qualified mortgages to FNMA. E-Loan will underwrite and fund first mortgages, as well as home equity and second mortgage liens of credit. E-Loan offers prospective mortgagees reduced search costs and lower origination fees than traditional mortgage brokers and banks. E-Loan is expanding its market to the European Union through a series of joint ventures.

"Under E-Loan's alliance with Stater BV, E-Loan and Stater BV will cooperate to support E-Loans online mortgage origination subsidiary in establishing and

operating a service that offers residential mortgage loans through the Internet directly to consumers in the European Union, other than the United Kingdom. The initial term of the alliance is five years. E-Loan expects to begin launching European services in the third quarter of 1999.”<sup>17</sup>

Europeloan, a Brussels based mortgage bank took the internet route into the mortgage market. Europeloan extended mortgage credit to households in Sweden, Belgium, the Netherlands and Finland. Europeloan planned to originate mortgages throughout the European Economic Community and use securitization as a primary funding source. Europeloan founded in 1999 went out of business in January of 2003.

Internet mortgage banking relies on offering borrowers lower fees, better information, and more efficient services than traditional banks. Traditional banking institutions are adding internet banking to their list of services making it more difficult for independent internet banks to attack their margins. To compete against a low cost deposit base and the relatively deep capital bases of well established banking institutions and well established banking networks, internet banks must originate large volumes of loans in a short time frame. They must meet the standards demanded by the bankers who finance the mortgage pipeline and investors who buy securities backed by the mortgages. Rapid inventory accumulation and turnover its the key to success.

Internet banking in general and internet mortgage banking in particular lends itself well to the expanded European market place. Although a number of independent cyber banks are being set up, the barriers to entry are quite low, and financial institutions with deeper balance sheets, more diversified operations and an established customer base, with extensive branch networks and diversified wholesale and retail operations, can easily enter and compete with internet-only banks. Internet banking and securitization are a good fit because the high volumes of loans can be originated on a small base of capital.

To date there has not been a transaction where residential mortgages originated in different European countries were securitized through a single SPV. It is more likely that a Pan-European mortgage originator that is relying on capital market funding would refinance pools segregated by country in order to make this issues more transparent with respect to consumer laws and borrower behavior. It would be possible to take advantage of

economies of scale on the funding side by structuring an SPV with multiple compartments like Ford’s Globaldrive, or the multi-compartment FCC, Securifact, established in 1999. For example a French FCC could be structured with multiple compartments, each one isolated from the others to securitize mortgages originated in various European countries. Each compartment would own mortgages from a single jurisdiction and issue securities to fund that pool. German mortgage banks that fund their mortgage portfolios with Pfandbrief are collateralizing their Pfandbrief issues with mortgages on properties across the European Economic Community. “Societes de Credit Foncieres” the special purpose mortgage banks established by French Law No. 99-532 (June 25, 1999) in France will also be able to use mortgages from multiple jurisdiction to collateralize their mortgage backed bonds, “Obligations foncieres”.

## END NOTES

<sup>1</sup>GE Capital Mortgage Services Inc., 10-K, March 31, 2000.

<sup>2</sup>NationsBanc Montgomery Funding Corp. Prospectus Supplement April 25, 2000 to Prospectus dated February 7, 2000. Registration Statement No. 333-62301

<sup>3</sup>Council of Mortgage Lenders. ([www.cml.org.uk](http://www.cml.org.uk))

<sup>4</sup>Woolwich PLC, 1998 Annual Report and Accounts

<sup>5</sup>Abbey National PLC Registration NO: 02294747, 1998 Annual Report and Accounts

<sup>6</sup>National Home Loans Holdings PLC Registration No. 02336032, 1996 Annual Report and Accounts

<sup>7</sup>Northern Rock PLC. Registration No. 03273685, 1999 Annual Report and Accounts

<sup>8</sup>Standard Chartered PLC, Registration No. 00966425, 1998 Annual Report and Accounts

<sup>9</sup>Caisse de Refinancement Hypothecaire, 1998 Annual Report. The institutions name has been cahnged fromCaisse de Refinancement Hypothecaire to Caisse de Refinancement de L’Habitat.

<sup>10</sup>MasterDomos Series 99-1, European Structured Finance New Issue, FitchIBCA, February 8, 2000

<sup>11</sup>Bloomberg L.P.

<sup>12</sup>Bloomberg L.P.

<sup>13</sup>Obligations Foncières: Fitch IBCA’s Approach, October 8, 1999

<sup>14</sup>Bloomberg L.P.

<sup>15</sup>The German Pfandbrief: A Benchmark for Europe. (Facts and Figures, 1998), Association of German Mortgage Banks. [www.pfandbrief.org](http://www.pfandbrief.org)

<sup>16</sup>Bloomberg L.P.

<sup>17</sup>E-Loan, Prospectus filed June 29, 1999

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