

SCIENTIFIC JOURNAL

**HIGHER ECONOMIC - SOCIAL SCHOOL IN
OSTROLEKA**

2/2019(33)

<http://www.sj-economics.com/>

Łomża, 2019

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PUBLISHER
HIGHER SCHOOL OF AGRIBUSINESS IN LOMZA
18-402 Łomża, ul. Studencka 19, tel./fax. +48 86 216 94 97
www.wsa.edu.pl



Punkty Informacji Europejskiej w Ostrołęce
Europe Direct



Publikacja wydana ze wsparciem
finansowym
Komisji Europejskiej w ramach projektu
Europe Direct

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HIGHER SCHOOL OF AGRIBUSINESS IN LOMZA
Łomża, 2019
ISSN 2391 - 9167

SCIENTIFIC JOURNAL – nr 2/2019(33)

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SECURITISATION AND IT'S MARKET IN EUROPE AND THE US IN 2018

Introduction

For several months now, the term securitisation has started to appear more frequently in various types of media, not only in specialist media related to the capital market or corporate finance. The European Parliament has undoubtedly contributed to this. On 01 January 2019, Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 establishing a general framework for securitisations and establishing a specific framework for simple, transparent and standardised securitisations entered into force.

In simple terms, securitisation consists of separating a homogeneous group of assets generating financial flows and issuing securities on their basis. In Poland, this technique has no long history (the first emissions took place only in 1999) and is rather unknown. However, it is slowly gaining recognition among various financial institutions, especially banks and debt collection companies. In cooperation with investment companies, they create special securitization funds. Securitisation funds are a new, legally and capitalistically safe solution on the Polish financial market. It is currently the most common way of issuing securitization securities in Poland. (Buszko and Krupa, 2016)

The purpose of this Regulation is set out in Article 1.

This Regulation defines securitisation and lays down due diligence, risk retention and transparency requirements for securitisation counterparties, criteria for granting credit, requirements for selling securitisations to multiple retail clients, the prohibition of re-securitisations, requirements for SSPEs, and conditions and procedures for securitisation repositories. This Regulation also creates a specific framework for simple, transparent and standardised (from now on 'STS') securitisations (Regulation (EU) 2017/2402, 2017 of the European Parliament and the Council).

In doing so, the EP is seeking to increase interest in securitisation in Europe and to harmonise legal requirements for certain securitisation transactions and thus increase the flow of capital between EU countries.

The concept of securitisation

The term securitisation is a translation of the English securitisation, which comes from the word securities - securities. The first securitisation transaction is assumed to have taken place in the USA in 1970, although it has not yet been defined as such. The term "securitisation," as a name for financial engineering, was first used in the Wall Street Journal in 1977 by Ann Monroe, who edited the column "Heard on the Street." It was in this year that Salomon Brothers acted as the guarantor of the issue of share certificates based on mortgage loans. During one of the interviews given to a reporter, one of the employees of Salomon Brothers, Lewis S. Ranieri, described the transaction as a securitisation. (Kendall i Fishman, 1996).

Securitisation is defined as a carefully prepared process where loans or other receivables are merged, insured and sold in the form of securities. In practice, this means that an entity intending to raise capital (arranger, originator, creator) separates from the balance sheet a homogeneous group of current assets (receivables) together with cash flows generated by them (e.g. consumer mortgages) and transfers the rights to their ownership to a specially established entity, which on their basis (based on them) issues debt securities. Sales are usually organised in such a way that the risk related to the arranger's activity is separated from the risk related to the transferred receivables. An entity that acquires the ownership of a securitised asset is called a special purpose vehicle (SPV) or special purpose vehicle (SPV). It is a legally separate entity from the originator, established for the sole purpose of issuing securitised securities. Securitisation is a natural "child" of the development of global financial markets, where the demand for the capital of various entities is growing. They are also looking for new effective methods and ways to Finance or invest. To this end, they often move away from traditional forms of borrowing and investing money through banks to take advantage of highly expanding securities markets. Such an opportunity is offered by securitisation. It is also an excellent tool for improving financial liquidity, effective asset and liability management and diversification of financing sources.

As a new instrument for raising capital, this technique can be used by almost every economic entity. In the world, it is used by financial institutions, large companies, as well as governments and local authorities. The only basic condition for a securitisation to take place is that the entity has an adequate pool of assets backing the issue. These assets must also generate regular income and enable the forecasting of cash flows from these assets.

In the history of securitization, however, mortgage loans were the most common type of loans in the history of securitization - the first transactions in the 1970s were based on such loans. Since the mid- the 1980s, the scope of securitised assets has expanded considerably.

So far, the most frequently securitized assets were:

- various types of loans (mortgage, consumer, investment, etc.)
- borrowings
- lease receivables
- credit card receivables
- receivables from insurance contracts
- receivables under franchise agreements
- trade receivables
- health care receivables
- stocks (raw materials)
- securities (securities based on other securities are referred to as synthetic securities. "synthetic securities")
- derivatives, royalties (Kosiński, 1997).

The above list shows that the choice of assets that can be securitised is really large. This gives the potential originator a wide margin of manoeuvre in selecting the assets on which to base the securitisation. In addition, the above list is still growing, but the pace of new types of securitized receivables is not very fast and seems to be waning.

The effects of securitisation on trade wizard and investors.

The securitisation process can have a multilateral impact on the activities of the entities opting for it. The effects of this process can be both positive and negative. This rule applies as much as possible to other participants of securitization outside the arranger, first of all, investors. Of course, the advantages and benefits of securitisation must far outweigh the disadvantages and risks of securitisation. As securitisation is only one of many methods of raising capital, it must also be competitive with existing and market-tested methods of financing. It applies in particular to the sale (transfer) of assets or benefits from assets with limited marketability, asset restructuring, restructuring of sources of financing, including off-balance-sheet financing, reduction of financing costs or management of certain types of risk (credit, liquidity, operational risk), including the release of regulatory capital. (Fabozzi and Kothari, Introduction to securitization, 2008).

Fundraising outside the balance sheet structures

One of the main benefits of securitisation is the possibility of off-balance-sheet recording of the securitised assets. This is often the most important objective of securitisation, which entails other positive effects for the originator. It improves, among others, some financial ratios: asset profitability (ROA), equity profitability (ROE), capital adequacy ratio, weighted average cost of

capital. (Balcerowicz - Szkutnik, Lawędzia , Szkutnik , Wolny Dominiak i Zakrzewska Derylak, 2009).

The benefits of this type of operation are most easily illustrated by the following simplified example (Styn, 2001).

The ABC company decides to raise funds using the off-balance sheet securitisation method. During the process, the structure of its balance sheet changes.

The output structure of the balance sheet is as follows:

Table 1. The structure of the balance sheet before securitization

Tabela 1. Struktura bilansu przed sekurytyzacją

Aktywa Assets		Pasywa Liabilities		Wskaźniki finansowania Financial indicators	
Majątek trwały	100	Kapitał własny	100	Wskaźnik zadłużenia	200%
Fixed assets		Equity capital		Debt ratio	
Majątek obrotowy	200	w tym zysk	10	Rentowność aktywów	3,33%
Current assets		including profit		return on assets	
w tym należności	100	Zobowiązania	200	(ROA)	
including receivables		liabilities			
Suma /Sum	300	Suma /Sum	300		

Source: Own study on the basis: Styn I, Benefits of off-balance securitization. Rynek Terminowy 2001, nr 4

Źródło opracowanie własne na podstawie: Styn I, Korzyści z sekurytyzacji pozabilansowej. Rynek Terminowy 2001, nr 4

The company plans to raise new funds of 100. For this purpose, it chooses one of the following financing methods: borrowing or bond issue. Each of these methods in the balance sheet will result in identical changes.

The new structure of the balance sheet is as follows:

Table 2. The structure of the balance sheet after borrowing

Tabela 2. Struktura bilansu po zaciągnięciu kredytu

Aktywa Assets		Pasywa Liabilities		Wskaźniki finansowania Financial indicators	
Majątek trwały	100	Kapitał własny	100	Wskaźnik zadłużenia	300%
Fixed assets		Equity capital		Debt ratio	
Majątek obrotowy	300	w tym zysk	10	Rentowność aktywów	2,5%
Current assets		including profit		return on assets	
w tym należności	100	Zobowiązania	300	(ROA)	
including receivables		liabilities			
gotówka /cash:	100				
Suma /Sum	400	Suma/Sum	400		

Source: Own study on the basis: Styn I, Benefits of off-balance securitization. Rynek Terminowy 2001, nr 4

Źródło opracowanie własne na podstawie: Styn I, Korzyści z sekurytyzacji pozabilansowej. Rynek Terminowy 2001, nr 4

There is a clear increase in the debt ratio and a decrease in the profitability of assets.

If the company had opted for off-balance-sheet securitisation, neither the structure of the balance sheet nor the level of the ratios would have changed. Therefore, there is no effect of asset release.

There would only be an exchange of receivables for cash.

Table 3. Structure of the balance sheet after securitization

Tabela 3. Struktura bilansu po sekurytyzacji

Aktywa Assets		Pasywa Liabilities		Wskaźniki finansowania Financial indicators	
Majątek trwały	100	Kapitał własny	100	Wskaźnik zadłużenia	200%
Fixed assets		Equity capital		Debt ratio	
Majątek obrotowy	200	w tym zysk	10	Rentowność aktywów	3,33%
Current assets		including profit		return on assets	
w tym gotówka	100	Zobowiązania	200	(ROA)	
including cash		liabilities			
Suma/Sum	300	Suma/Sum	300		

Source: Own study on the basis: Styn I, Benefits of off-balance securitization. Rynek Terminowy 2001, nr 4

Źródło opracowanie własne na podstawie: Styn I, Korzyści z sekurytyzacji pozabilansowej. Rynek Terminowy 2001, nr 4

In this way, the obtained funds may be used by the ABC company for an investment or for the repayment of a part of its debt. The result of this, of course, is an improvement in indicators. The structure of the balance sheet after such an operation is as follows.

Table 4. Business balance after repaying liabilities from funds obtained from securitization

Tabela 4. Bilans przedsiębiorstwa po spłacie zobowiązań ze środków uzyskanych z sekurytyzacji

Aktywa Assets		Pasywa Liabilities		Wskaźniki finansowania Financial indicators	
Majątek trwały	100	Kapitał własny	100	Wskaźnik zadłużenia	100%
Fixed assets		Equity capital		Debt ratio	
Majątek obrotowy	100	w tym zysk	10	Rentowność aktywów	5%
Fixed assets		including profit		return on assets	
		Zobowiązania	100	(ROA)	
		liabilities			
Suma/Sum	200	Suma/Sum	200		

Source: Own study on the basis: Styn I, Benefits of off-balance securitization. Rynek Terminowy 2001, nr 4

Źródło opracowanie własne na podstawie: Styn I, Korzyści z sekurytyzacji pozabilansowej. Rynek Terminowy 2001, nr 4

The above example shows that securitisation as an off-balance sheet source of raising capital improves financial ratios and results in the "release" of costly capital. Improvement of indicators affects the condition of the company and improves its image. In this way, the company can often increase its rating and reduce the cost of raising external capital. This is particularly important for over-indebted individuals.

Another positive aspect of off-balance sheet securitisation is the ability to manage the company's receivables. This allows, among other things, to increase the amount of cash and reduce the number of frozen funds. This is a very important fact for any company. Why would I do that? The greater the scope for freezing funds in debt claims, the more likely it is that the costs of the lost benefits will be incurred, while at the same time reducing the rate of return on capital (Sierpińska i Wędzki, 1997).

Off-balance sheet securitisation is particularly beneficial for banks. The activity of banks as institutions of public trust is particularly limited by legislation. The Bank must comply with a number of prudential standards aimed at ensuring the safety of its customers. This applies in particular to the capital adequacy ratio. A bank that wants to improve its capital adequacy ratio must increase the ratio of equity to risk-weighted assets. It can only do so by increasing the size of its funds or reducing the size of its assets. The latter method is possible thanks to securitisation. If the sum of risk-weighted assets exceeds a predetermined ceiling, the bank may sell receivables with a high-risk level, thus increasing the capital adequacy ratio. (Fabozzi and Konishi, Asset and liability management: investment strategies, liquidity requirements, risk control for banks and saving, 1998) Besides, when assets are taxed as in Poland, by "taking them out" of the balance sheet, it avoids an increase in tax burdens.

Assets in securitisations

The basic condition and starting point for any securitisation process is the identification and segregation of the assets (debt claims) based on which the securities can be issued. The selection of these assets should be based on one main principle. Securitisation loans must yield stable, reliable, and statistically proven income.

The most important condition that separable assets should meet is that they can generate specific cash flows promptly. Shall also meet the following requirements:

- the claims will certainly be paid in full in the agreed amount
- the due date (ideally if the probability of repayment were more than 97-98%) the pool of receivables),
- the debtors have a high degree of credibility,
- receivables not repaid on time have a small share,
- the amounts and payment dates are easy to plan, because the proceeds from

the

- of individual entitlements shall be carried out following a pre-established timetable a schedule (e.g., according to a loan or lease agreement),
- the assets form a homogeneous group, the set of assets is sufficiently large (both in terms of value and value) (quantity) and there is diversification of assets, e.g. in terms of geographical or sectoral, the legal situation of the claims should be clear and compatible with the applicable law regulations (e.g., assets must not be encumbered with third party rights)
- assets have an average maturity longer than one year. (Curtain, 2001)

The claims on which the securitisation is based shall meet all of the above requirements, but this is not a necessary condition. Some of these criteria do not have to be met and are often not. However, if the segregated assets hold on to them, they minimize the risk associated with the securities issued. Thus, they reduce the rate of return demanded by investors. This also increases the profitability of the transaction itself.

One of the important requirements - among those mentioned - that must be fulfilled is the homogeneity (homogeneity) of the claims. Concerning securitised assets, this concept should be understood as a set of assets with similar structural characteristics, such as origin, unit value or maturity (Sinkey jr., 1998). Examples include mortgages or leasing receivables. The condition of homogeneity of separated receivables is related to the type of securities issued based on them. It is not worthwhile to carry out securitisations based on assets with different characteristics. In such a case, it is impossible to adjust the flows generated by them appropriately to the repayment of liabilities resulting from issued securities (principal and interest installments).

Another important feature of the securitized assets is that they must be of appropriate size. The pool should be sufficiently large because of the costs associated with the securitisation transaction itself. These costs are quite high and include, among other things, the maintenance of the SPV, legal analysis and rating, fees for the guarantee institutions. With pools of low value, it is difficult to ensure the cost-effectiveness of the process. Let us remember that securitisation should be a more beneficial way of raising capital than other financing techniques. Only then is there any point in doing so.

One of the basic conditions for the existence of a securitisation process, in addition to the requirements to be met by assets subject to securitisation, is the existence of appropriate legal regulations in a given country. Since securitisation is a complex technique, it often requires appropriate rules. They concern, among others, the legal form of the SPV and its links with the arranger, the problem of transferring the ownership of receivables from the initiator to the SPV, tax issues, the rules of issue and purchase of debt securities, etc. The issue of the SPV's legal form and its links with the arranger, the problem of transferring the ownership of

receivables from the initiator to the SPV, tax issues, the rules of issue and purchase of debt securities, etc.

Securitisation steps

I have already mentioned that the identification and segregation of securitised assets is both a first step and a kind of a start to the process. The further securitisation process involves the following steps:

- feasibility study,
- selection of cooperating entities,
- due diligence procedures,
- analysis of the data,
- financial modeling,
- Preparation of the documentation,
- obtaining a rating for a pool of segregated assets in an SPV,
- marketing,
- marketing of securities and possible secondary trading (Rudny, 2000).

Almost every financing technique requires a feasibility study. This also applies to securitisation. Given the complexity of this process, this seems to be a necessary step in the process. The range of issues covered by the feasibility study may vary depending on the type and complexity of the securitisation in question. The most important and most frequent aspects of this phase of securitisation include :

- legal aspects of securitisation; verification that the laws of the country concerned to allow the lawful transfer of assets to a special purpose vehicle,
- tax aspects of the securitisation for all participants in the securitisation,
- accounting aspects concerning the reflection of the transfer arranger in the book's assets, which include balance-sheet or off-balance-sheet disclosures securitised assets, scope of disclosures in the financial statements and impact on the financial result,
- adequacy of assets to protect investors' interests,
- the rating criteria used,
- identification of the group of investors to whom the issue of securities is to be addressed Asset-backed securities,
- estimated costs of the securitisation process,
- expected time of implementation.

The next step is to select the actors who will be involved in the process. I mean both entities are supporting the preparation of transactions (legal advisors, rating agencies, insurance companies) and entities supporting the distribution - issue - of securities (investment bank, brokerage house). At this stage, a decision should also be made about the administrator of the whole process. The arranger may take care of the administration of the securitisation himself or may delegate

this task to an external body. This stage is connected with the next one, i.e. due diligence procedures. They concern a comprehensive assessment of transactions and participating entities. This also applies to the initiator himself. This activity is performed based on information coming from inside and outside the given unit. Inside information may include ownership structure, credit policy, cash and receivables management, balance sheets, cash flow statement, financial and management accounting, internal audit. External information about the entity may include market position and industry position, external audit, security registers, data from business intelligence.

The next two stages, i.e., data analysis and financial modeling, are aimed at analyzing and simulating the ability of securitized assets to generate payments to investors.

The next stage, i.e., preparation of the necessary documentation, obtaining the rating, undertaking marketing and information activities to attract investors, does not require any further discussion. The introduction of securities to trading follows the same rules as for the issue of traditional debt securities.

It goes without saying that not all of these steps must occur in every securitisation. It is possible, for example, to carry out this process without a rating. However, this will certainly have an impact on the level of investors' interest in the securities. Securities without rating by credit rating agencies are riskier. They often also require a higher rate of return.

Securitization bond market in Europe and the USA

In 2018, the value of securitisation bond issues across Europe totaled EUR 268.8 billion in 2018, up 13.9% in 2017.

Since the crisis, emissions have fallen sharply and remained stagnant. The ECB's debt purchase program, including credit-based securities, did not even help boost the securitisation market.

The securitized securities market in Europe, which before the crisis was worth up to 800 billion euro (in 2008), shrank to less than 300 billion euro in 2018. Compared to the US market, these values are significantly lower (Fig. 1). Only the crisis year 2008 recorded a similar volume of issues. This was probably due to the delayed impact of the crisis in Europe compared to the USA. In the following years, the value of issues on the American market systematically increased and stabilized at the level of approximately EUR 1.8 trillion (2015-18). Securitization bonds in the United States have regained their pre-crisis popularity. Unfortunately, this cannot be said for Europe. Emissions of less than €300 billion over the last few years clearly show the weakness of this market on our continent.

Table 5. The value of bond issues in Europe and the US in 2007-2018 in bn EUR. Tabela 5.

Wartość emisji obligacji w Europie i USA w latach 2007-2018 r. w mld. euro.

Rok Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Wyemitowane w Europie Issued in Europe	594,9	818,7	423,9	378	376,8	257,8	180,8	217	216,6	239,5	236	268,8
Wyemitowane w USA Issued in US	2080,5	967,3	1447,2	1245,9	1068,9	1609	1565,1	1190,9	1744,5	1860,4	1899,3	1767

Source: www.afme.eu, Securitisation Data Snapshot Q4 2018 and 2018 Full Year, published on 30/01/2019

Źródło: www.afme.eu, Securitisation Data Snapshot Q4 2018 and 2018 Full Year, opublikowano 30.01.2019 r.

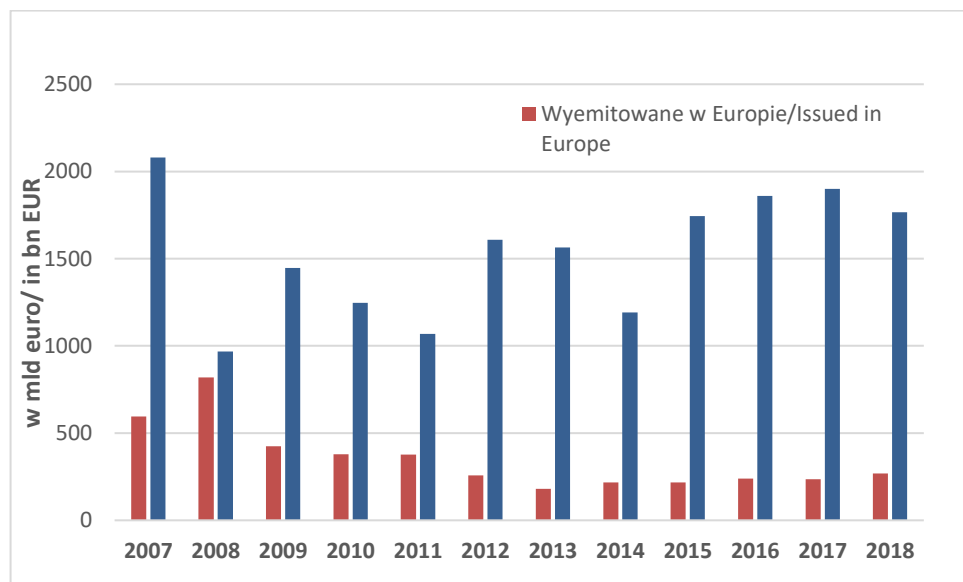


Figure 1. Issue of securitization bonds in 2007-2018 in Europe and the USA, in bn EUR.

Rysunek 1. Emisja obligacji sekurytyzacyjnych w latach 2007-2018 w Europie i USA, w mld. euro.

Source: www.afme.eu, Securitisation Data Snapshot Q4 2018 and 2018 Full Year, published on 30/01/2019

Źródło: www.afme.eu, Securitisation Data Snapshot Q4 2018 and 2018 Full Year, opublikowano 30.01.2019 r.

In Europe, the most developed market for securitisation instruments is the United Kingdom. In 2018, the value of the issue amounted to EUR 58.7 billion. High trading volume is also visible in Italy, the Netherlands and France. (Figure 2). The lower value of the issue in Germany is due to the competition from German pfandbriefe (mortgage bonds) for

securitisation vehicles. The issue of mortgage bonds is strongly rooted in the German real estate financing system. This instrument is well known and appreciated by investors. Pfandbriefs are a huge market in Germany, a value exceeding the European securitisation market. In 2017, the value of issued pfandby zones in Germany amounted to EUR 362 billion. (Melms, 20018)

A large pool of covered bonds (EUR 55 billion) is made up of pan-European securities, which cannot be attributed to a single country of origin. They are issued by international financial institutions, which secure these securities with receivables from many European countries. The value of securitization issues in Poland is so small that it was included in the group of other EU countries (EUR 1.8 billion). This does not mean that such emissions do not take place in our country. Getin Noble Bank's Getin Noble Bank is happy to use securitisation. In 2012-2017, GNB Auto Plan issued bonds worth PLN 3.5 billion through its special purpose vehicle. (Rudke, 2017)

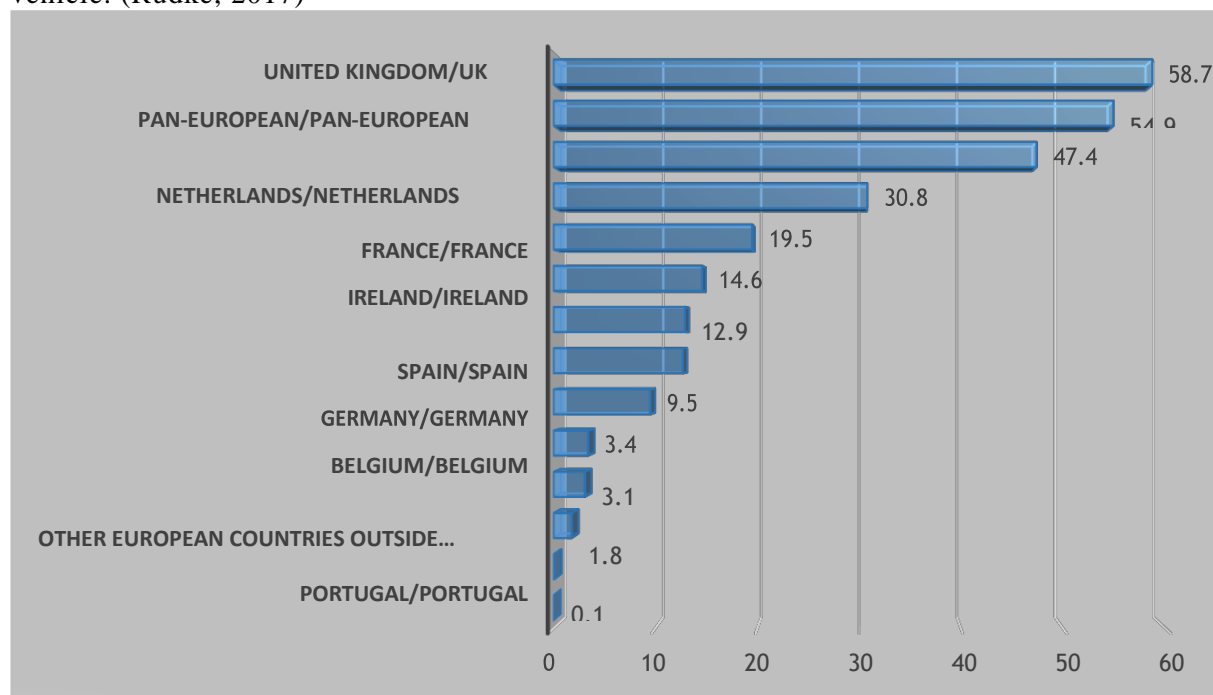


Figure 2. Bond issue by country of collateral 2018 (in bn EUR)

Rysunek 2. Emisja obligacji z uwzględnieniem kraju zabezpieczenia 2018 r. (w mld. euro)

Source: www.afme.eu, Securitisation Data Report Q4 2018, published on 18/03/2019.

Źródło: www.afme.eu, Securitisation Data Report Q4 2018, opublikowano 18.03.2019 r.

Summary

Although securitisation is a complex transaction, it can bring many benefits to companies. This is not only another way of raising capital, but also a method of managing the balance sheet and investment risk. It seems to be a perfect complement to the dynamic development of the Polish and European capital markets. And it may contribute to increasing capital flows between countries. In order to be competitive in a globalised world, European financial institutions must use the financial techniques used by their western "rivals". In the United States, the securitization securities market has already forgotten about the crisis and is developing dynamically again, approaching the value of EUR 2 trillion a year. In Europe, it has stagnated and cannot exceed EUR 300 billion a year. We should therefore welcome any action taken by the European Parliament to stimulate the securitisation market.

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SEKURYTYZACJA I JEJ RYNEK W EUROPIE I USA W 2018 R.

Summary

The aim of the paper was to present one of the techniques of capital raising - securitization. The principles of operation of this method, participants and benefits of its application were discussed. An analysis of the securitization securities market in Europe and the USA in 2018 and the years 2007-18 was also made.

The analysis shows that since the crisis in 2008, the value of the European securitization market has remained low. It also shows no signs of recovery. In contrast, the US market returned to its size before 2008.

Key words: securitization, financial market, bond market, asset management

Streszczenie

Celem artykułu było przedstawienie jednej z technik pozyskiwania kapitału-sekurytyzacji. Omówiono zasady działania tej metody, uczestników oraz korzyści z jej zastosowania. Dokonano również analizy rynku papierów sekurytyzacyjnych w Europie i USA w roku 2018 r. oraz na przestrzeni lat 2007-18.

Z przeprowadzonej analizy wynika, iż od kryzysu w 2008 r. wartość europejskiego rynku papierów sekurytyzacyjnych utrzymuje się na niskim poziomie. Nie wykazuje również oznak ożywienia. Rynek amerykański powrócił natomiast do swej wielkości z przed 2008 r.

Słowa kluczowe: sekurytyzacja, rynek finansowy, rynek obligacji, zarządzanie bilansem

JEL Classification: G100

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