International Journal of Business and Management Studies,
CD-ROM. ISSN: 2158-1479 :: 2(1):499–507 (2013)

INTERNATIONAL JOURNAL of Business and Management Studies

THE ROLE OF THE SECURITIZATION IN ECONOMIC CRISIS OF 2008: OVERVIEW ON TURKEY

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The economic crisis of 2008 first appeared in US mortgage market as of July, 2007 and turned into a global crisis affecting the financial as well as real markets in a short span of time. The crisis stemmed from the low-interest policies practiced in USA and other developed countries in 2001 and 2002. The loan applications in automotive and residential sectors mounted thanks to the low-interest policies. The securitization operations gained speed in order to respond to the increasing demand. Through securitization, the banks accumulated their residential loans in a basket and sold this basket to an investment bank or a mortgage institution after having turned the loan basket into a fund and pricing it in accordance with its internal structure. This transaction made the financial system fragile. Likewise, the slightest failure in loan repayments within this system means loss for both the creditor bank and the other financial institutions purchasing the security. This spot assumes a vital place in order for the crisis to be reviewed in detail because several other methods of obtaining funds will emerge as the financial markets develop; thus every new method shall cause a crisis once it has not been analyzed well. This study involves the detailed analysis of the role of the securitization in the crisis and an evaluation from Turkey's perspective.

Keywords: Global crisis of 2008, securitization, mortgage, Turkey.

The Role of the Securitization in Economic Crisis of 2008: Overview on Turkey

Introduction

From the late 1980s to the present day, economic globalization period not only has made the flow of good, service and production factors between the countries dependent, but also it has eased the leap of the economic crises in the big countries to other countries.

Emerging in 2007 and gaining a global quality by spreading throughout the world in 2008, Mortgage crisis in U.S.A is seen as the biggest global crisis after 1929 crisis. In general, the cause of the crisis is the wrong policies applied after 2000s and thereby overvaluation of the prices of properties in U.S.A. Tendency to orientate towards balance of the overvalued prices of properties gave rise to the crisis.

In this study, the role of securitization in the crisis was discussed. In this context, the causes of emergence of crisis and the development period of it were examined. Then, securitization and mortgage method were discussed in detail. In third part, effects of securitization method on the crisis were explained. Lastly, the study was completed by mentioning securitization applications in Turkey.

Crisis

Crisis is described as spontaneous or originated fluctuations for the repair of unsustainable structuring emerging in the basic balances of the economy. (Bayraktutan, 2000:15). If these flucutations result from finance sector in which there are establishments such as banks, insurance companies, mutual fund management companies, leasing and factoring, such crises are called financial crisis. In a structure in which the aforementioned finance sector preclude industry and real investment, the revenue provided by the change of current values seems easier and more profitable than the revenue provided by investment. Therefore, nominal production in the finance market precludes real production. This process has the characteristic of causing a global crisis (Toprak ve diğerleri, 2001:33).

So and so, the crisis starting in 2007 in the property market of U.S.A and exercising effect over the world in a short time is financial economic crisis. Although at first this crisis was seen as a local turmoil occurring only in finance markets of U.S.A, it took on a global dimension by affecting World Finance System in a short time. At the same time, during this period many finance institutions went to the wall and many of them was seized by e state. The most obvious distinguishing characteristic of this crisis is that rather than a classic banking, it is consisted of more complex and high volume derivatives and that is spread the world quickly (Bocutoğlu ve Ekinci, 2009:67).

It is wrong to show a single cause as a reason of crisis. Deficiency of national governments in U.S.A and many other countries in controlling and coordination of the finance markets and that finance sector companies in especially U.S.A undertake excessive risk by using some new financial instruments emerging after 1990 are seen as the main causes of the crisis (Kibritçioğlu, 2011:5). In addition to this, liquidity abundance and imprecise loans given for this reason, excessive securitization, lack of transparency, inability of rating agencies in activity and default in intervention of monitoring foundations are listed among the reasons of the crisis (Alantar, 2009: 1).

Erdönmez (2009:86) examined the developments in global crisis the progress by dividing into two periods. The first is the unsteady period in financial market starting on July 2007 and continuing until September 15 2008. The second is the period starting on September 2008 with the bankruptcy of banks and financial institutions, especially Lehman Brother. However, the developments before the crisis should also be taken into consideration in order to comprehend the crisis. Since 2000's, efforts have been done to keep the economy of U.S.A alive by applications of low interest and excess liquidity. In this period, when interest rates drop below the rises in the price of immovable, leveraging in immovable became profitable. Those who wanted to make use of this situation tended to immovable and increased the price of the immovable further. The increasing prices of immovable caused this area to arouse the interests of new investors. This generated mechanism pleased everyone as the prices rose. However in this period, immovable prices created a speculative bubble in this field by overvaluation (Ertuna, 2008: 26). Moreover, asymmetric information resulting from insufficient information given to borrowers about the details related to loan use and its expenditures, caused the perception of buying house as an investment instrument (house jobbing) and the unexpected problems in loan repayments (Demir vd, 200:4). As can be seen in the following parts of the study with details, mortgage papers taken from those who bought immovable with loan was sold to others by converting these mortgage papers to different financial intermediaries. The new intermediaries taken from the others were sold as highly profitable financial intermediaries to others. By this way in the period between the years 2000-2006, individuals in U.S.A tent to spend more than

their income and used more loans than normal. And one third of these loans was consisted of floating rate loans (Susam ve Bakkal, 2008:74).

In 2006, the immovable market of U.S.A reached the repletion and recession. This caused the unsold house stock to increase and the prices of houses started to decline. In addition, banks seized the houses of those who had difficulty in repaying their loan and put them up for sale by enforcement. This situation decreased the prices of the houses by increasing their number. At the same time, interest rate of mortgage loan with floating interest increased more and this burdened those who used these loans. Non-repaid loans caused liqudity shortage in banks. As a result of these situations, seizures increased and the first period of crisis started.

The second period of the crisis is consisted of the bankruptcy of the biggest investment bank Lehman Brothers in 2008 and state's takeover of Freddie Mac and Fannie Mac, institutions founded for developing secondary market of mortgage loans. In this period, U.S.A central bank and the other central banks made the biggest monetary intervention in the history by providing 2,5 trillion dollar to the markets (Erdönmez, 2009:89).

The impact of global crisis on developing countries was relatively less. Because the financial structures of these countries do not include complex structures like in the U.S.A. However, the crisis spread to many countries via negative impacts resulting from trading tolls of assets with extreme risk, loan toll, trade toll, lack of trust and uncertainty. Among the spreading tolls we mentioned, toll of assets with extreme risk is usually effective in the spread of crisis to developed countries. Loan and trade toll caused the spread of crisis to developing countries (Kibritçioğlu, 2011:7).

Securitization

Securitization is the process of creating a pool by gathering such debt instruments as receivable providing cash inflow in the future and personal loans, deriving security on the basis of these pools, selling of their credibility to third party investors by enriching and rating (Ceylan, 2003: 441).

Securitization is defined also as the process of gathering similar illiquid instruments in balance sheets of a firm with a purpose of risk sharing and making these assets merchantable. Therefore, large amounted investment instruments become more accessible to small investors, and this situation enables risk sharing between institutional investors and small investors. In other point of view, by this means, firms have a chance to procure funds with low costs directly from investors in return for future economic benefits of illiquid assets (Kaplan, 1999: 8 and Ataman Erdönmez, 2012: 62).

Securitization enables those who need fund to connect directly to maney and capital markets by eliminating conventional intermediaries. Conventional investors and thrift instutions have been replaced by equity institutions constituting receivable pool, loan enrichers, rating agencies, special-purpose institutions, investment banks, local and global investors (Ceylan, 2003: 442). At this point, it is useful to mention a typical securitization process. In the securitization process, firstly, the equity firm which needs fund sells instruments which will be securitized to a special-purpose institution in return for a sale price. The special-purpose institution take over the receivable. In this transfer process, aforesaid receivables, are transferred to active of special-purpose by subtracting it from equity firms active. In return for these receivables, asset backed securities issued. Debts arising from this issuance, take part in the passive of special-purpose institution. Asset backed securities are sold in capital markets and with the funds obtained from the sale, expenses of receivables bought from equity firm and the other issue expenses are met

(Doğru, 2007: 44). Some conditions related to extraction of receivables taken over by equity firm as a result of securitization from the balance sheet are explained in IAS 39 issued on December 2004. (http://www.iasplus.com/en/standards/standards/standard38). According to this;

- If majority of risks and yields related to receivable is transferred to special-purpose institution, it will extract the receivables from balance sheet; it will record the rights and obligations of the transfer to the balance sheets.
- If the majority of the risks and yields related to receivable continues to belong to the equity firm, the equity firm will not be able to extract receivables from the balance sheet.
- If one part of the risks and yields is transferred and the other part is not transferred, who controls the receivable will be taken into account; if the equity firm does not control, first clause will be applied; if the equity firm controls the second clause will be applied.

Main issuers of the assets securitized in the application of securitization, in other words equity firms are merchant banks, thrift banks, finance companies and special-purpose institutions. The number of issuers increases as securitized actives type expands. However, loan issuing institutions are generally banks (Ataman Erdönmez, 2006,s.76).

New debt instruments generated through securitization are called as "asset backed securities"(Ceylan, 2003: 441). The reason for this is that payments (capital and interest) related to this security were done by cash flow obtained from securitized asset. If there is a blanket bond of the securitized receivables, securities becoming safer are called as "mortgage backed securities"(Doğru, 2007: 44). In other words, mortgage backed securities are issued backed by mortgage pool created by gathering regulated mortgage loans and they have cash flows of this mortgage pool (Eroğlu, 2010: 21).

Capital Market Board of Turkey explained instruments of mortgaged capital market securities guaranteed by mortgage and mortgage backed securities and defined it as follows: they are capital market instruments other than shares issued by mortgage finance companies and are the other capital market instruments issued backed by receivables housing finance or guarentee of them. (SPK, 2010:.14). Mortgage Guarenteed Securities are debt instruments isseud by putting up mortgaged loans as collateral. Mortgage Backed Securities are debt instruments issued by putting up assets in housing finance fund portfolio as collateral. While Mortgage Guarenteed Securities are used in such European countries Netherlands, Ireland,Spain and Inited Kingdom and especially in Germany, Mortgage Backed Security system is used mostly in U.S.A (Erol, 2009: 25).

Mortgage

Application part of securitization in literature and in this regard even the only part known by society is "mortgage." This study focuses especially on the mortgage part of application of securitization. Because the most important cause of the crisis is thought to be mortgage.

Mortgage is fundamentally a mortgage backed security issue. Mortgage is banks' and similar financial institutions' presentation long dated and low interest loans for the people wanting to own real estates in order to guarantee themselves; then their offer of mortgage backed securities in secondary markets in order to convert their mortgage to cash. Therefore banks create resources for financing of the new loans (Ayçıray ve Yıldırım, 2007: 53). Therefore mortgage

system is self-sufficient in regards of funding and differs from direct housing system with this characteristic (Eroğlu, 2010: 32).

Mortgage is consisted of primary market, secondary market and capital market. Primary market is the market in which houses are handed over and buyers benefit from corporate house financing for buying housing. Primary market is not just enough for calling housing loans as mortgage loan; secondary market and capital market should also be present. Secondary market provides funding to primary market. At this stage, mortgage guaranteed securities which are secondary instruments of banks come in. Capital market is the market in which funds are provided to mortgage loans given to primary market by disposing these mortgage guaranteed securities (Özsan, 2004: 5).

There are two main secondary market systems in mortgage system, namely on balance sheet and off balance sheet (German Model- American Model). In on-balance sheet system (German Model), issued loans continues to remain in the sheet of mortgage bank. In other words, the risk of immovable loan remains on the mortgage bank. In off-balance sheet system (American Model), mortgage loaning institution sell these loans and convert them into cash in a collaboration with public enterprises by gathering these loans in a pool. Therefore, there are opportunities for presenting low interest loans, and they transferred the risks of loans because they extracted these loans from their balance sheets (Ayrıray ve Yıldırım, 2007: 57; Berberoğlu, 2009: 123).

Mortgage and Crisis

The crisis which became global in the second part of 2008 is based on the problems of mortgage market in U.S.A. Emerging as from 2000s, Low interest rates increased property prices and this situation made investment in property beyond the need attractive (Birdal, 2009: 14). Some financial institutions started to give mortgage loans also to the people whose credibility is low as from 2003 in order to meet the strong housing demands. Banks in the U.S.A, gave subprime loans[1] to the people and institutions whose solvency and credibility are low (subprime borrowers) in order to enliven the economy through construction sector (Susam ve Bakkal, 2008: 73). These subprime loans were also securitized like prime loans given to riskless customers and complex securities were created by putting both types of loans into the same package (Osmanoğlu, 2012: 86).

That interests could not keep the same low level and the falling prices of properties were disappointment for loan institutions. Expecting that they would seize the properties whose prices increase unless subprime loans could not be repaid, loan institutions made loss and could not fulfil their liabilities. That these institutions issued asset backed securities which include non-performing loans created a joint multiplier effect in the finance sector (Akgüç, 7).

Another reason for the rapid increase of the crisis is right appraisal of subprime loans. In IAS 39, which is mentioned before, it is stated that fair value approach should be used in the recognition of trading and available securities, derivative products and guaranteeing. According to this standard, there are three levels in determining of fair value. These levels are explained below (Topbaş, 2009: 57).

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[1] Subprime loan is given to customer groups believed to have difficulty in repaying the loans(the unemployed, immigrant, students, those who delay their loan repaying) with higher interest and more severe conditions because of the higher risk of them (Osmanoğlu, 2012: 69-70).

1st Level: Market operations observed for the same type financial assets. This level enables market to market.

2nd Level: Market operations observed for the same type financial assets. This level enables mark to model.

3rd Level: The values emerging from the use of valuation method created by using market data as base. They are consisted of assumptions of related institution about the prices created in the light of the most reliable information which are not undetectable under market conditions and obtained by market agents with the reasonable cost and effort they expended. There is no validation required when the used value is in accordance with the approaches of market agents.

Subprime loans were appreciated in the second level, but with the crisis they receded to third level. The information in the third level is based totally on assumption. So, the values of subprime loans did not reflect the reality and publicity disappeared. Abundance of banks determining loan prices as they want and misguided investors triggered the rapid spread of the crisis (Topbaş, 2009: 58).

Overview on Turkey

Banking system of Turkey and mortgage market which has been tried to create since 2005 was not directly affected by global financial crisis. Perhaps the most important reason for this is the lack of banks' positions in securities backed by non-performing loans which created the global crisis, because the banking system in Turkey is based on deposit banking system rather than investment banking (Erol, 2009: 17).

5528 numbered "Law on the Amendment of Various Laws Related to Housing Finance system" came into effect by being published in Official Gazette 03.06.2007 dated and 26454 numbered. The regulation mentioned does not foresee a separate and independent law which can be said as mortgage or mortgaged housing finance law. Instead of this, a model is tried to create by making additions to the laws including Execution and Bankruptcy Law, Financial Leasing Law, Law on the Protection of the Consumer, various tax laws and especially Capital Markets Law (Topaloğlu, 2011: 457). The law is criticized because of the fact that it is not a fundamental law and it includes regulations related to many laws. Moreover, it is also criticized that the base of the system is consumers, but there is not adequate regulations related to consumers (Can, 2011: 266).

The main purpose of this law is the creation of the mortgage or asset backed securities market (secondary market). Mortgage backed securities which was sold to investors by secondary market enable bank and other mortgage financing institutions to present new and lower interest rate housing loan by funding their loans in a cheaper way. With the new law, banks will be able to create cover pools including housing loans they supplied and they will be able to present two different mortgaged capital market instruments, (described in the previous sections) namely Mortgage Guaranteed Securities and Mortgage Backed Securities, backed by these pools to investors (Erol, 2009, 25).

In the developed countries, mortgage market is losing power by the crisis, but In Turkey an opposite course of development is followed. According to data of European Mortgage Federation, Turkey is ranked as first in the increase of mortgaged housing loan (Aktaş, 2012: 1).

In Turkey the efforts to create a secondary market started with 5528 numbered law but the necessary housing stock for creating secondary markets could not be provided. Because, the building to join the portfolio which will be created for secondary markets are required to be populated and 60 percent of the housing stock are not populated in Turkey. It is clear that "Urban Transformation Project"[2] will contribute much to providing increase of housing stock and opening the road to secondary markets (http://www.hurriyet.com.tr/ekonomi/21216568.asp).

Conclusion

Along with the globalization, the international markets have marked a significant improvement and the world has gone through a new financial era since the capital receded itself from the manufacturing while it made it for the finance sector which challenged today's economies (Foster, 2008:45). Throughout this process, the markets have interacted more which has caused the current crisis to gain more global dimension.

2008 global crisis accordingly turned into a more severe one that affected the whole world. Having appeared through liquidity and loan abundance, the crisis turned into a confidence one in the upcoming months and exerted negative impacts on the economy thanks to the environment of uncertainty. As a result of the crisis, the unemployment and inflation rate boosted. The residential prices went down, which lowered down the demand from the consumers while it minimized the wealth of them.

It does not seem correct to attach the 2008 global crisis to a single cause while there might be multiple reasons. The most distinctive feature of this crisis unlike others is that the complicated and high volume derivative products grew which helped the challenges related to these products spread expeditiously across the globe.

The mortgage, known as the sole securitization method in the practice, is a system employed by the banks in order to create resources to finance the new loans and it is the credit on real property as well as to supply this credit to the secondary markets as a security.

Housing that became attractive through the low-interest policies in the USA made it possible to issue housing loans to those who were assumed to have hard time refunding. The subprime loans were placed in the same basket as the prime ones and supplied to the market as security. The whole value of the basket decreased once the subprime loans were gradually not being refunded and those loans were not separated from the others in the basket.

The impact of the role that the securitization, more specifically mortgage, on the 2008 crisis could be derived from the fact that the developing countries where the securitization was not practiced literally suffered comparatively less from the crisis. Turkey is also among the countries which got affected less than others. Though Turkey ranked the first in the list of mortgage loans increase of European Mortgage Foundation as the countries under crisis

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[2]Carried out by 05.16.2012 dated and 6306 numbered "Transformation of Areas Under Disaster Risk Law" includes such actions as demolishing of building with earthquake and building the riskless ones and finding solutions to the other urban problems(contruction disrupting historic fabric of the city). Demolishing of the buildings within the scope of Urban Transformation started on 10.10.2012 in İstanbul and it will ve applied in many provinces at the same time.

approached mortgage with more caution, mortgage is still not very common in Turkey as the law put into effect in 2007 is not a basic law which only adds some amendments to several laws and a secondary market still does not exist. The structural transformation in banking sector following the financial crisis of 2001 that brought increased regulations and auditing corroborated the financial sector against 2008 global crisis and lowered the impact of the crisis

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