

Boston University School of Law

Scholarly Commons at Boston University School of Law

Faculty Scholarship

1999

Securitization: The Conflict Between Personal and Market Law (Contract and Property)

Tamar Frankel

Boston University School of Law

Follow this and additional works at: https://scholarship.law.bu.edu/faculty_scholarship



Part of the [Banking and Finance Law Commons](#), and the [Comparative and Foreign Law Commons](#)

Recommended Citation

Tamar Frankel, *Securitization: The Conflict Between Personal and Market Law (Contract and Property)*, 18 Annual Review of Banking Law (now Review of Banking & Financial Law) 197 (1999).

Available at: https://scholarship.law.bu.edu/faculty_scholarship/1008

This Article is brought to you for free and open access by Scholarly Commons at Boston University School of Law. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Scholarly Commons at Boston University School of Law. For more information, please contact lawlessa@bu.edu.



SECURITIZATION: THE CONFLICT BETWEEN PERSONAL AND MARKET LAW (CONTRACT AND PROPERTY)*

TAMAR FRANKEL**

I. INTRODUCTION

A. The Source of Problems

The road to securitization – transforming debt and loans into securities – is littered with obstacles. These obstacles seem unrelated. Yet, upon reflection, many legal and business problems arising in the securitization process can be traced to one source: the inherent conflict between contract law governing personal relations among creditors and debtors, and property law governing the same relations converted into “commodities” issued or traded in the market among investors. Identical terms can be characterized as contract loans in personal context, and as personal property (securities or bonds) in market context.

There are a number of relevant fundamental differences between contract and property laws. First, contract law historically prohibited a party to unilaterally transfer its rights and obligations without the consent of the other party.¹ Today this strict prohibition has been relaxed,² but the starting point has remained. Even when a unilateral transfer of loan contract obligations and rights is no longer prohibited,³ the cost of such transfers are higher than the cost of transferring property in the form of securities.⁴ This

* This article represents an expanded version of a speech given by the author at an OPEC Conference in Malaysia devoted to the issues of securitization, in Kuala Lumpur on December 4, 1997.

** Tamar Frankel is a Professor at Boston University School of Law, Boston, Massachusetts.

¹ See 4 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 856, at 403 (1963).

² See JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS § 18.10, at 680 (4th ed. 1998) (discussing assignment of rights); see *id.* § 18.28, at 700-03 (discussing delegation of duties).

³ See Tamar Frankel, *The Legal Infrastructure of Markets: The Role of Contract and Property Law*, 73 B.U. L. REV. 389, 401-02 & n.49 (1993) (noting development of transfers of contract rights).

⁴ Compare U.C.C. Art. 9 (1995) (contract-based) with U.C.C. Art. 8 (1995) (property-based).

default rule is based on an assumption that in a personal contract the parties put a high value on maintaining their relationship.

The default rule in property law is precisely the reverse. With few exceptions, property law prohibits a party from limiting the transferability of its rights and obligations.⁵ Thus, investors, and sometimes issuers, may transfer their rights and obligations to others without the consent of the other parties.⁶ More importantly, courts generally will not recognize unconditional limits on transferability of such obligations.⁷ This default rule is based on an assumption that parties whose obligations are commodified as financial assets put a high value on the ability to exchange "partners" in the markets rather than on the identity of the initial parties to the relations. Therefore, the issuer does not care to which investor he or she owes the obligations under the relationship. Under certain circumstances the investor does not care whether the obligations of the issuer are owed by another issuer (e.g., upon a merger). It is more important to each party that their relationship is transferable.

Second, contract parties may choose any lawful terms to govern their relations.⁸ In contrast, market law does not recognize the parties' agreements that change the fundamental models of property relations. Property relations are standardized because too many forms of property may be confusing, leading to misunderstandings among trading parties, and imposing on them high information costs. Thus, contract relationships can be unique and custom-made.⁹

Third, while both contract and market laws prohibit fraud, contract law protects the parties from fraud to a lesser degree than market law does.¹⁰ That is because personal face-to-face relationships are presumed to enable the parties to protect themselves better and cheaper than impersonal relationships that are usually established and conducted through market intermediaries.¹¹

⁵ See ROGER A. CUNNINGHAM ET AL., *THE LAW OF PROPERTY* § 2.2, at 35 (Student ed. 1984); *id.* § 3.24, at 155.

⁶ See WILLIAM L. CARY & MELVIN A. EISENBERG, *CASES AND MATERIALS ON CORPORATIONS* 421 (6th ed. 1988) (discussing restrictions on transferability of shares).

⁷ See RALPH E. BOYER ET AL., *THE LAW OF PROPERTY* § 6.1, at 117 (4th ed. 1991).

⁸ See Frankel, *supra* note 3, at 399.

⁹ See *id.*

¹⁰ See *id.* at 403 n.58.

¹¹ See *id.*

Fourth, contract law legislation protects small borrowers against large lenders;¹² property law legislation protects small lenders (investors) against large borrowers (issuers).¹³ Thus, legislation does not offer protection according to the parties' position in the transaction – whether they are borrowers or lenders – but according to their relative bargaining powers. When lawmakers deem contract law inadequate to allow small borrowers to fend for themselves, lawmakers protect these borrowers (e.g., against bank lenders).¹⁴ When lawmakers deem property law inadequate to allow small lenders-investors to fend for themselves, lawmakers protect these small lenders (e.g., against large borrowers-issuers).¹⁵

In sum, legislation interfering in both contract and property law is designed to protect the “small guys” against the “big guys.” In contract relations, the small guys are borrowers and the big guys are lenders. In property market relations the small guys are lenders and the big guys are borrowers. When these protective systems are combined, as they are in

¹² See U.C.C. Art. 9 (1995).

¹³ See U.C.C. Art. 8.

¹⁴ In fact, lawmakers treat small investors in the markets the same way, but small investors-lenders are protected against large issuers-borrowers in the markets.

¹⁵ The author notes that protections both in markets and in personal relations are based not on whether parties are debtors or creditors, but on the perceived bargaining power that these parties have vis-a-vis each other. In decisions involving the definition of notes as securities under the securities acts, the courts have distinguished between notes made in commercial transactions and notes made for investment. See *Reves v. Ernst & Young*, 494 U.S. 56 (1990); 2 TAMAR FRANKEL, SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSETS POOLS, AND ASSET-BACKED SECURITIES § 18.3.3, at 223-25 (1991 & Supp. 1998). The difficulty in classifying mortgage notes that are then distributed to the public is that they are commercial (personal) transactions between the lender and the borrower and usually would not provide the lender (bank) with protection. The bank is in a strong bargaining position vis-a-vis the borrower; the bank is in the business of making loans, and therefore is an expert in acquiring information from the borrower and making an investment decision. In addition, the bank is an expert in monitoring the borrower and in protecting its interests under the loan agreement. In contract, when such notes are of small denominations and are distributed to the public, they are held to be securities because here the borrower needs no protection and the lenders-investors do. The investors are by definition passive and are not experts in making loans or in monitoring the borrowers. Public policy encourages such “lending investors” to put their money at risk, and therefore provides them with information and other protections at reduced costs.

securitization,¹⁶ protections for the “small guys” borrowers raise the risks and costs for “small guys” investors in securities.

Problems in securitization also arise from the need to use a Special Purpose Vehicle (“SPV”) as a means of converting loans into securities. The first step in the process is loan transfers to the SPV. These transfers are governed by personal contract law. The second step is issuance of securities by the SPV. This issuance is governed by market property law and securities laws.¹⁷ The use of SPVs distinguished securitization from the usual securities issuances, which are issued directly to investors.¹⁸ The combined contract relations and market property relations are the source of many legal and business problems that securitization raises.

The issues raised here are not unique to the United States environment. In fact, they exist in both law and business environments of securitization all over the world.¹⁹ That is because the models of contract – representing personal relations – and property – representing market relations – are near universal and because without these two models, no securitization can occur in the first place. Thus, the discussion here applies wherever

¹⁶ Securitization combines personal relations with market relations by starting with personal transactions: making loans and transferring them to a Special Purpose Vehicle (“SPV”). The process ends with market transactions: the SPV’s issuance of tradable securities and the creation of secondary markets in the securities. In the United States, as in many other countries, personal and market relationships are governed by different kinds of laws. The combination of these laws in one process poses difficulties because, in some respects, these two types of laws are based on different premises.

¹⁷ See 2 FRANKEL, *supra* note 15, § 18.3.3 at 224.

¹⁸ In traditional market property transactions securities are issued to investors directly, mostly by large issuers, who can issue a substantial number of securities in appropriate denominations. Small borrowers are not viewed as issuers, although technically they are. These borrowers’ obligations are not traded in the markets because the number of the obligations is insufficient for market trading and investors’ cost of information about such small borrowers is too high. See Frankel, *supra* note 3, at 389-92 (describing features necessary for markets).

¹⁹ See Claire A. Hill, *How Investors React to Political Risk*, 8 DUKE J. COMP. & INT’L L. (forthcoming Spring 1998) (page proof at 292, on file with author) (noting that in future flows securitization transactions investors’ political risk includes risk that legal factors may prevent firm from meeting obligations); *Securitization: An International Perspective*, 61 FIN. MARKET TRENDS, June 1995 (noting that some countries’ legal infrastructures are inadequate for securitization, such as Italy and Japan).

securitization is effected, and even though the following example is derived from a United States case, it would be applicable elsewhere as well.

B. Example

The difficulties of determining the applicable law at any stage of the securitization process is illustrated by a recent United States case.²⁰ The case concerned the applicability of Rule 10b-5,²¹ an antifraud provision under the Securities Exchange Act of 1934.²² The facts were as follows: a construction company planned to take advantage of lower interest rates and refinance its mortgage loans, covering about sixty pieces of real estate.²³ The company had various options, including issuing mortgage bonds or securitizing its own mortgage loans by transferring the loans to an SPV and distributing securities of the SPVs to the public.²⁴ The company consulted an investment banking firm that recommended the second option: a structured financing plus an interim loan.²⁵ The deal soured. The interim loan was allegedly never made.²⁶ It took a long time to obtain the necessary rating. The parties disagreed on many details,²⁷ and the final contract was not executed.²⁸

The company sued the investment banker for fraud under Rule 10b-5, arguing that the agreement between the parties concerned securities.²⁹ The investment banker argued that the agreement was a two-step transaction, and that the proposed transfer to the SPV did not concern securities and was subject to contract law only.³⁰

Had the investment banker or another banking institution made the construction company a loan and then turned around and securitized the loan, the contract between the parties would clearly have been a loan contract and not a contract involving a security. Had the company prepared for the distribution of the securities and the investment banker only undertaken to distribute the securities, there is no question that the contract would have

²⁰ See *Realtek Indus., Inc. v. Nomura Sec.*, 939 F. Supp. 572 (N.D. Ohio 1996).

²¹ 17 C.F.R. § 240.10b-5 (1998).

²² 15 U.S.C. §§ 78a-78lll (1994).

²³ See *Realtek*, 939 F. Supp. at 575.

²⁴ See *id.* at 574-75.

²⁵ See *id.* at 574.

²⁶ See *id.* at 578.

²⁷ See *id.* at 577-78.

²⁸ See *id.* at 574.

²⁹ See *id.*

³⁰ See *id.* at 579.

been an underwriting contract involving securities, subject to the securities acts.

In this case, the company alleged that it was involved in all aspects of the securitization process, and undertook the risks of credit agency evaluations involved in securitization, but the parties anticipated execution of the securitization process by the investment banker. The court, noting the company's alleged obligation to rate and issue securities and the integrated nature of the transaction, held that, for the purposes of the motion to dismiss, the contract was an underwriting contract for the sale and distribution of the securities.³¹ Hence, the antifraud provision of the securities acts applied.

In sum, many of the problems involved in the stages of securitization seem to be rooted in the conversion of personal into market transactions and the application of combined personal and market laws to the process.

II. THE SEVEN STAGES OF SECURITIZATION

Securitization consists of a number of stages or steps that can be executed separately.

1. Making loans;
2. Selling the loans to sponsors or to SPVs;
3. Establishing SPVs by lenders or sponsors;
4. Providing investors with credit enhancements, usually by third parties;
5. Distributing the securities of the SPVs, usually by underwriters, who may be the sponsors;
6. Servicing the portfolio of the SPVs, usually by the original lenders; and
7. Providing custody services for the assets of the SPVs, usually by third-party banks.

Some of these steps, such as making loans, need not end in securitization. But if securitization is the desired end, all these steps must be taken.³²

³¹ See *id.* at 580-81.

³² These seven steps can be performed by one institution or by many institutions, and executed in personal transactions and in the markets.

III. MAKING LOANS³³

A. Consumer Protection

A number of problems for investors arose in connection with consumer loans slated for securitization. In contrast to large issuers that can offer their securities to the markets directly, consumer loans that reach the markets indirectly in a securitized form could be subject to borrowers' legal protections. These protections created for investors risks and uncertainty, which, in turn, formed barriers to securitization or increased the cost of capital for borrowers-issuers. In many cases the source of the difficulties was the conflict between consumer protection and investor protection. The following examples demonstrate the point.

1. Usury Laws

When securitization emerged, state laws limited the interest rates that lenders could charge consumers and mortgagors.³⁴ That posed problems for investors in such loans, especially during inflation periods, and presented uncertainty as to which laws applied: state laws where the loans were made or state laws where the loans were sold.³⁵

Congress resolved this problem by preempting most usury laws.³⁶ Small borrowers were protected by market competition. Arguably, securitization played a major role in increasing such competition by offering non-bank lenders other sources of financing and allowing them to compete with banks. Market law prevailed.

2. Prepayment Rights

A second consumer protection law allowed mortgage borrowers to prepay their mortgages without penalty.³⁷ Large issuers-borrowers usually

³³ Making loans also includes acquiring debts; that is, becoming a creditor or investor.

³⁴ See 1 FRANKEL, *supra* note 15, § 7.18.2.4, at 253 & n.22.

³⁵ See *id.* § 7.18.2.3 at 249-53.

³⁶ See Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1735f-7a(a) (1994).

³⁷ Courts may disallow prepayment penalties under the rule that unreasonably large liquidated damages are unenforceable as a penalty. See *In re A.J. Lane & Co. Inc.*, 113 B.R. 821, 828-30 (Bankr. D. Mass. 1990) (applying RESTATEMENT (SECOND) of CONTRACTS § 356(1), 356(1) cmt. b (1981)).

Some states prohibit or limit prepayment penalties in home mortgages. See, e.g., MO. ANN. STAT. § 408.036 (West 1998); N.J. STAT. ANN. § 46:10B-2 (West

have the right to "call" (prepay) 20% of the bonds they publicly issue. Prepayment is especially important for both parties in long-term loans. Borrowers will prepay their loans when interest rates fall, and that is precisely the time when investors would not welcome their money back.

This problem was not solved by laws abrogating mortgagors' rights to prepay (and in most cases to refinance) without penalty. This inaction was based on a policy to encourage people to borrow and save by investing in their homes.³⁸ Risks to investors from prepayments were covered by designing SPVs so that the risks of prepayments were shifted and allocated differently among classes of the securities issued by SPVs. That increased somewhat the cost of capital, because investors in the riskier trenches of the SPV demanded compensation for their risks. Further, tax laws were amended to provide a pass-through treatment to SPVs that are organized as grantor trusts yet allow substitution and reinvestment of the prepaid cash without loss of the pass-through tax treatment.³⁹ That amendment reduced the severity of the problem for investors. Finally, investors' market risks from falling interest rates could also be covered by derivatives, such as swaps. On this score, personal law prevailed.

3. Borrowers' Defenses to Payment

A third consumer protection law that increased investors' risks involved the borrowers' right to raise their defenses to payment that they

1989); N.M. STAT. ANN. § 56-8-30 (Michie Supp. 1996); 41 PA. CONS. STAT. ANN. § 405 (West 1992); VA. CODE ANN. § 6.1-330.83 (Michie 1993). The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association do not enforce prepayment penalties. See GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 6.4, at 497, n.18 (3d ed. 1993) (citing FNMA CONVENTIONAL HOME MORTGAGE SELLING CONTRACT SUPPLEMENT § 301.05; FHLMC SERVICERS' GUIDE § 4.113). The Federal Housing Administration also prohibits prepayment penalties. See 24 C.F.R. § 203.22(b) (1998).

³⁸ It is unlikely, in light of the strong support for home ownership, that these rules will be changed soon. However, the markets reduced the lenders' losses but imposed alternative costs. See e.g., *Legal Differences without Economic Distinction: Points, Penalties, and the Market for Mortgages*, 77 B.U.L.REV. 405 (1997).

³⁹ See Rev. Rul. 70-544, 1970-2 C.B. 6, *modified*, Rev. Rul. 74-169, 1974-1 C.B. 148; Rev. Rul. 70-545, 1970-2 C.B. 8, *modified*, Rev. Rul. 74-169, 1974-1 C.B. 147; see also Tax Reform Act of 1986, 26 U.S.C. §§ 860A-860G (1994 & Supp. IV 1998) (outlining tax treatment of real estate mortgage investment conduits ("REMIC")); Small Business Job Protection Act of 1996, 26 U.S.C. §§ 860H-860L (1994 & Supp. IV 1998) (outlining treatment of financial asset securitization of investment trust ("FASIT")).

may have against the original lenders.⁴⁰ These defenses could be raised against the assignees of the loans, and that created uncertainty for investors and reduced their ability to price the asset backed securities accurately.

For some instruments, such as notes, a partial solution to this problem was devised many years ago by protecting the purchasers of notes for value and without notice of the borrowers' defenses.⁴¹ Public policy of encouraging transferability of the notes prevailed against the public policy of protecting borrowers. However, in order to become holders, note buyers must have possession and endorsement of the notes, unless the notes are made payable to the bearer.⁴² In securitization, the endorsement requirement raises a serious practical problem when the number of notes involved (e.g., in the sale of mortgage loans) is enormous, and endorsement is very costly. In addition, the borrowers may default, and notes should be in the name of the servicer or collector to facilitate court proceedings against the borrowers.

Usually the servicer of the SPV's portfolio is the loan's originator and the payee under the notes. Therefore, in practice, notes are not endorsed, and the originator remains the holder of the notes. This practice raised a question of whether the creditors of an insolvent originator could claim the notes. As to notes that accompany mortgages, bankruptcy law was amended to make it clear that the mere fact that the notes are held by a third-party servicer does not entitle the servicer's creditors to the notes.⁴³ Market law, protecting investors, had the upper hand.⁴⁴

⁴⁰ See U.C.C. § 3-305(a) (1998) (providing that obligor's obligation to pay instrument is generally subject to obligor's defenses against assignee); E. ALLAN FARNSWORTH, *CONTRACTS* § 11.8, at 809-10 (2d ed. 1990) (discussing vulnerability of assignee to obligor's defenses at common law).

⁴¹ See U.C.C. § 3-305(b) (1998) (providing that right of holder in due course to enforce obligation to pay instrument is subject to "real defenses" and not common law defenses); *id.* § 3-302(a)(2) (defining "holder in due course" in part as a holder who purchased an instrument for value and without notice of the obligor's defenses).

⁴² See *id.* § 3-201(a) (providing that a person other than the issuer becomes a holder through negotiation); *id.* § 3-201(b) (providing generally that negotiation requires endorsement).

⁴³ See 11 U.S.C. § 541(d) (1994).

⁴⁴ Arguably, this rule would benefit borrowers. The rule would reduce the return that lenders, who plan to sell the loans, would charge the borrowers. That is because the investors would charge lower rates for the loans and increase the sellers' returns, which it would hopefully share with the borrowers. The parties that would be left at higher risk would be the lender's creditors. If the lender did not notify these creditors, its cost of capital may indeed increase. However, the lender may find ways to give notice to its creditors.

For debts that do not involve notes, the debtors' rights prevail. To reduce investors' costs, however, originators were willing to buy back debts to which debtors contest, such as disputed credit card charges. In the past, this solution raised questions about the status of the transaction as a sale of the financial assets. Originators were interested in classifying the transfers as sales rather than as borrowing, to improve their balance sheet. Yet, if the originators transferred the rights to debts, but retained the credit risks, the transactions were not likely to be classified as sales of the debts. This issue has been resolved by an act of Congress, which allowed some transfers of debts with recourse to be deemed sales, notwithstanding the recourse obligations.⁴⁵ On this score as well, market law had the upper hand.

4. Notice of Assignment

The magic of securitization is that it allows many small borrowers to draw on the resources of many small savers, a source available before only to large borrowers and issuers. However, the existence of numerous borrowers imposes costs.⁴⁶ Under assignment law, before the assignment becomes binding on them, borrowers whose loans were sold must be notified of the sale and the new payee.⁴⁷ Upon receipt of notice, borrowers must pay the assignee, and if they continue to pay the assignor, their loan will not be discharged. This rule continues to be in effect. Even though such notification to thousands of borrowers could be costly, it must be given. It is patently unfair to require borrowers without notice to discover whether and to whom their loans were assigned. This cost is usually reduced by retaining the originator to continue servicing the loans. If, however, the servicers change, a notice must be given. This solution meets the requirements of both personal and market laws.

B. Business Issues

Making loans raises a number of business issues. Standards for mass production are far more important in markets than they are in personal

⁴⁵ See Riegle Community Development and Regulatory Improvement Act of 1994, 12 U.S.C. § 1835 (1994).

⁴⁶ When one issuer distributes securities to the public no such problem arises because the one issuer can be notified if the trustee has changed. The trustee, however, keeps track of the investors to ensure payments. In securitization of many small loans the sale of the loans to a new owner creates a substantial cost. If securitization involves structured financing of one obligor, no problem arises.

⁴⁷ See 3 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS, 206-07, 217 (3d ed. 1960 & Supp. 1989).

transactions. Loans that are candidates for securitization should be made under standard underwriting principles and terms to reduce the cost of evaluating and pricing pools of such loans. Thus, the movement of making loans for securitization has reduced the custom-made features of the loan making.

For example, when numerous small loans are securitized, the traditional (personal relations) way of evaluating the credit-worthiness of each borrower imposes substantial cost, as compared to evaluating the creditworthiness of one large issuer. In fact, that is the way life insurance operated many years ago. A person who sought a life insurance policy had to obtain a physician's certificate on the level of his or her health.⁴⁸

The insurance industry reduced this cost decades ago by evaluating people according to a profile based on a very large database.⁴⁹ A similar approach to loan evaluation was developed first by large banks that had data on which they could base their predictions as to small business borrowers with a particular profile.⁵⁰ The effects of market demands on the personal relationship is demonstrated in the following two instances.

1. Automated Borrower Evaluation

Recently software companies collected information and created a database on small business borrowers for use by small banks that did not have a database on which they could ground their credit policies.⁵¹ This database offers an automated system which predicts the credit behavior of borrowers with particular profiles.

The result of this technique was to reduce the time for a bank to make a loan decision from 12.5 hours to 15-20 minutes. With the quick decisions, the time for making loans decreased and volume of loans increased.⁵² Some banks have also "outsourced" the function of evaluating borrowers. For \$5-10 per loan application, or a minimum annual \$5,000 scoring, firms offer banks the service of scoring applicants for loans. This

⁴⁸ See, e.g., *Saltzman v. Fairbank Realty Corp.*, 144 Misc. 243, 243-44, 257(N.Y. City Ct. 1932), *rev'd* 145 Misc. 478 (N.Y. Sup. Ct. 1932).

⁴⁹ See 1 TAMAR FRANKEL, *supra* note 15, § 2.7, at 59-60 (suggesting that lenders use the same technique, relying on statistical data to evaluate the credit worthiness of small borrowers including small businesses).

⁵⁰ See David S. Neill & John P. Danforth, *Bank Merger Impact On Small Business Services Is Changing*, BANKING POL'Y REP., Apr. 15, 1996, at 1.

⁵¹ See *id.*

⁵² See *id.*

automation resulted in a large additional credit capacity and in a more efficient way of securitizing individual loans and small business loans.⁵³

2. Standard Loan Documents

Securitization requires standard loan documents to establish a predictable cash flow so that investors can price the securities backed by a pool of such loans. The use of statistics gives an impetus for developing standard loan documents for small businesses that could not be securitized before.⁵⁴ Thus, the solution to the lack of standard loans was provided mainly by the markets. Loans have been standardized by sponsors who purchased substantial numbers of loans and dictated the terms on which the loans will be made,⁵⁵ and by automated evaluation of borrowers, as described above.

3. Conclusion

Overall, the problems discussed stem from the substitution of markets for personal relationships. Loan documents and underwriting processes must be standardized. Information costs must be reduced. Personal custom-made relationships must be converted into impersonal, mass produced relationships.

Not every small bank needs to automate its prospective borrowers' evaluations, especially when these banks have personal, long-term

⁵³ See *id.*

⁵⁴ See *id.* The other types of loans already have this standardization. See also Meredith S. Jackson, *Leap of Faith: Asset-Based Lending to Asset-Backed Securitization*, 2 STAN. J.L. BUS. & FIN. 193, 196 (1995) (noting that as securitization market grew, most transactions securitized common assets available in significant volume, with predictable default rates and uniform documentation and describing asset-based lender's use of software to provide information about small business receivables).

⁵⁵ See Neill & Danforth, *supra* note 50, at 1; John P. Uehlinger & John F. Bartlett, *Increased Momentum for Securitizing Commercial Mortgages*, CONN. L. TRIB., at S-24, (Apr. 15, 1996) (noting that the absence of standard loan documentation has been an impediment to the growth of the commercial mortgage market, in contrast with residential loans with standard documents).

In 1997, two financial services firms created a company to securitize small business loans for community banks. The company planned to use automated analysis to standardize processes and documents, write the loans to uniform pricing and underwriting guidelines, and buy the loans from the banks. See *CFI ProServices Inc. and TIS Financial Services Inc. Announce Creation of Company to Securitize Business Loans for Community Banks*, PR NEWswire, Mar. 20, 1997, at 1.

relationships with their borrowers. However, as borrowers follow market trends and shop for the best deals, their long-term relationships with the banks become shorter. The sentiment goes both ways, as banks sell the loans they make. Lenders, including banks that wish to offer personalized services, could do so to the smaller number of customers interested in such services. But these customers are likely to pay more for the services. The trend has been towards mass production at lower costs and loss of personal relationship. Custom-made goods and services will be available, but will cost more. The market model has become stronger.

IV. SELLING LOANS

One of the main conditions to securitization is a clear law allowing efficient assignment of financial assets. Both loan assignments and securities trading are governed by the Uniform Commercial Code ("U.C.C."). However, the two are treated differently. The Code has facilitated assignment and trading in securities. In addition, markets have facilitated securities transfers by efficient settlement processes and book entries.⁵⁶ In contrast, assignments of non-securities assets are governed by personal relations law,⁵⁷ which presents far more obstacles to speedy and inexpensive transfer of the assets.

A. Sale or Secured Lending?

The U.C.C. does not link assignments of financial assets that are not securities to markets; that poses uncertainties for investors. For example, it is unclear whether Article 9 of the U.C.C. classifies the assignment of accounts receivable as a sale or only as secured lending. That is so even though banks have assumed that sale of accounts receivable is possible. The result is that rating agencies require sales of credit card receivables to comply with the requirements of the Code (just in case), and such compliance is costly.⁵⁸

This problem is being addressed by the American Law Institute, which drafted the U.C.C. that is followed by most states. A proposal to amend Article 9 is likely to be approved in a year or two.⁵⁹ The adjustment

⁵⁶ See U.C.C. Art. 8 (1995).

⁵⁷ See U.C.C. Art. 9.

⁵⁸ See 1 FRANKEL, *supra* note 15, § 7.22, at 264-70.

⁵⁹ See Alan M. Christenfeld & Shephard W. Melzer, *Get Ready for the New Article 9*, N.Y. L.J., Oct. 7, 1997, at 5.

machine grinds slowly. In the meantime, contract law, with its attendant costs, governs.

B. Sale or Borrowing?

Another issue that has long concerned the designers of securitization is the distinction between true sale and secured borrowing. To what extent can sellers of financial assets retain some of the risks involved in holding the financial assets, yet have the transaction classified as a sale? Sellers of financial assets would retain some of the risks involved in the loans that they sell because they can obtain higher prices for these assets since investors will demand lower returns.

However, the accounting profession and the regulators object to classifying a transaction in which sellers retain credit risk after a sale. For accountants, who are in charge of a true picture of the financial position of issuers, the removal of the loans from the sellers' books is misleading if a significant degree of risk from the loans remains with the sellers. For regulators, in charge of safety and soundness of regulated institutions, retention of the risks from assigned loans does not justify reduction of capital requirements or loan loss reserves.

A second setback to securitization occurred recently in *Octagon Gas Sys., Inc. v. Rimmer*, 995 F.2d 948 (10th Cir. 1993) in which the Tenth Circuit held that assignments of oil and gas interests that were securitized were vulnerable to bankruptcy of the assignor. Consequently, rating agencies today reduce their ratings of securities of assets that were securitized in Tenth Circuit territory and jurisdiction.

Private practitioners have worked out what seems to be a solution, though not a perfect one, which satisfies rating agencies. They have moved some of the main steps of securitization outside of the Tenth Circuit realm, to create a "reasonable relation" of the transaction to other jurisdictions, so that Tenth Circuit jurisdictions, such as Utah, will recognize the other laws as governing the transactions and apply those laws should a problem arise. These lawyers have established an SPV in Illinois. They provided that transaction payments will be made and received in Illinois and certain transaction records will be kept in Illinois. The rating agencies required and received legal opinions and documents that Utah recognized Illinois as the governing state law and a true sale opinion from Illinois and from the states which are the location of the company's subsidiaries selling their loans into the program. See Jack Wagler, *Overcoming Octagon: Part II*, ASSET SALES REP., Oct. 21, 1996, at 1.

Chile has passed a law that allows the originator or transferor to establish a subsidiary and states that the subsidiary is bankruptcy-proof – a clean, simple and pragmatic solution not tied to the history. See Charles E. Harrell et. al., *Securitization of Oil, Gas, and Other Natural Resource Assets: Emerging Financing Techniques*, 52 BUS. LAW. 885, 919 (1997).

For a number of years, regulators have imposed greater risk retention restrictions on banks than the accounting profession has imposed on non-regulated institutions. That created for regulated institutions a disadvantage vis-à-vis their competitors that made loans for securitization, such as finance companies.

The conflict was resolved in the Small Business Loan Securitization and Secondary Market Enhancement Act.⁶⁰ In the Act, Congress provided a level playing field for regulated banks and unregulated finance companies. Banks and finance companies are now subject to the same rules regarding the sale of financial assets with recourse and other risk retentions by sellers of financial assets.⁶¹

Among other reasons, the problem of sale versus borrowing also stems from the conversion of instruments that were considered loan contracts into securities. It has become far more important to recognize the transactions as sales of these instruments, to streamline the sale process, and make the consequences more predictable to meet market requirements. This resolution facilitates the sale of loans in paving their route to the markets. Market property law had the upper hand over regulators on this count.

V. ESTABLISHING SPECIAL PURPOSE VEHICLES (SPVS)

A. Protecting Investors From Failure of SPVs

SPVs serve three main purposes: (i) to convert non-standardized and unique financial assets, such as loans, into marketable standardized assets (securities); (ii) to protect the assets held by the SPVs from third-party claims, especially from those of the sellers' creditors;⁶² and (iii) to protect

⁶⁰ This Act formed part of the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, 108 Stat. 2160 (1994) (codified in scattered sections of 12 U.S.C., 15 U.S.C.); see Neill & Danforth, *supra* note 50, at 1.

⁶¹ See 12 U.S.C. § 1835 (1994).

⁶² This purpose is achieved by limiting SPVs' business to passive maintenance of the portfolio, and ensuring that the SPVs are strictly separated and not controlled by the seller of the assets or its related companies. Thus SPVs are currently passive holders of portfolios that are not actively managed. Some portfolios, however, may require more active management and continued monitoring of financial information. Right now, such actively managed portfolios would disqualify SPVs both under tax laws and under the exemption from the Investment Company Act of 1940. See 17 C.F.R. § 270.3a-7(a)(4) (1998). In addition, such active management may raise

SPVs from failure, that is from claims of the creditors of the SPVs themselves. Thus, the very existence of the SPVs denotes the ascendancy of markets. They are tools for converting financial instruments to marketable instruments, designed to reduce the costs of such conversion and limit the risks that SPVs can pose to investors.⁶³

1. Protecting Investors From Third-Party Claims

The second purpose of SPVs – protecting investors against third-party claims of the assets – is achieved in a number of ways and relates mainly to bankruptcy law, mediating between investors and sellers' creditors. This problem is not directly related to personal versus market law. Tax laws, that allow for pass-through tax treatment of SPVs⁶⁴ as well as an exemption for SPVs under the Investment Company Act of 1940, help strengthen these protections.⁶⁵ The United States policy is to encourage loan securitization,

demands for more intrusive regulation. Hence, for the time being it is unlikely that such SPVs will arise.

⁶³ See generally, Tamar Frankel, *Securitization of Loans: Asset-Backed Securities and Structured Financing*, THE FINANCIAL SERVICES REVOLUTION 215 (Clifford E. Kirsch ed., 1997).

⁶⁴ One important issue regarding SPVs is pass-through tax treatment. The entity is transparent and is not taxed, and passes on its earnings to the security holders, and they are taxed.

In general, entities are taxed on their earnings; their security holders, whether shareholders or bondholders, are taxed on the distributed dividends or interest. With respect to financial intermediaries like banks, insurance companies, mutual funds and other pooled investment vehicles, the Internal Revenue Code provides special treatment. Specifically, the Code provides for pooled investment vehicles a pass-through tax treatment. See, e.g., I.R.C. § 584(b) (1994) (pertaining to common trust funds); I.R.C. § 801 (pertaining to life insurance companies); I.R.C. § 831(a) (pertaining to other insurance companies); I.R.C. § 852 (West 1998) (pertaining to investment companies). One reason for this exception is that wealthy people who have large securities portfolios can hire an investment adviser and diversify their portfolio yet only pay tax on their income and transactions. Investment management vehicles are "poor people's" diversified investments, and just because the pools are regulated for the investors' protection they should not be penalized with a double taxation. Another rationale is that if a managed investment vehicle is taxed the taxation would constitute triple, not double, taxation because the income of such investment vehicles is usually paid by corporate entities that are taxed as well as their securities holders.

⁶⁵ The law allows a wide variety of organizational forms for SPVs: business trusts, limited partnerships, corporations, and limited liability companies. The choice of the

from mortgage-backed securities to small business loan-backed securities. Hence Congress has provided a pass-through tax treatment to SPVs holding mortgage pools (Real Estate Mortgage Investment Conduits ("REMIC")),⁶⁶ and made it easier to use SPVs organized as business trusts that offer pass-through tax treatment (Financial Asset Securitization Investment Trusts ("FASIT")),⁶⁷ including SPVs for securitizing construction loans and warehouse lines of credit.⁶⁸ The law may accommodate swaps and foreign currency hedges, that lessen the risk of many types of mortgage

organizational form is greatly affected by an exemption from the Investment Company Act of 1940 and by tax laws.

For a number of years SPVs had an ambiguous status under the Investment Company Act of 1940. The Securities and Exchange Commission viewed them as investment companies, but that Act is designed to regulate mutual funds and its constraints made it impossible to operate SPVs. The Commission has therefore granted applicants exemptions from some of the provisions of the Act, and these exemptions culminated in a rule that exempted certain SPVs from the definition of an investment company under the Act. *See* Investment Company Act Release No. 19,105, 17 C.F.R. § 270.3a-7 (1998).

The conditions in the exemption seem to have followed the best practices of the industry in structuring SPVs, and has resolved the problem. The design of the SPVs, however, must comply with the limitations and conditions of the rule. For example, SPVs may not offer redeemable securities, and their portfolios must be fairly fixed and not actively managed. The securities issued by the SPVs must be rated at a minimum level. Thus, the rule regulates the structure of SPVs. It should be noted that the law does not regulate the degree of market risk that the asset-backed securities pose for investors. On that score investors must rely on disclosure and make their own investment decisions.

⁶⁶ *See* Tax Reform Act of 1986, 26 U.S.C. §§ 860A-860G (1994 & Supp. 1998). The legislation provided relief from some of the restrictions on trusts. *See Legislative Proposal To Expand the REMIC Provisions of the Code To Include Nonmortgage Assets*, 46 TAX L. REV. 299, 313-14 (1991).

⁶⁷ *See* Small Business Job Protection Act of 1996, 26 U.S.C. §§ 860H-860K (1994 & Supp. 1998).

The legislation appears to permit SPVs organized as trusts to invest money from prepaid loans and replace them with new loans. *See FASIT May Be Ready for Prepayments*, NAT'L MORTGAGE NEWS, Oct. 21, 1996, at 24, available in LEXIS news Library, NMN File. REMICs do not allow rollovers, but FASITs do. *See id.*

⁶⁸ *See FASIT May Be Ready for Prepayments*, *supra* note 67.

Because FASITs were designed for credit cards and other open-end revolving debt instruments such as home equity lines of credit, the status of mortgages is not clear. FASITs do not resolve some problems of securitizing mortgages, such as construction loans, because these involve the risk that the buildings may not be completed. *See id.*

securitization, such as fixed rate interest payments.⁶⁹ All these steps help move personal loans on the road to marketable securities.

2. Protecting Investors Against Failure of SPVs

The third aspect of SPVs – protecting against failure of the SPVs – is linked to the difference between personal relations and market relations. SPVs are institutional intermediaries. They issue their own obligations to investors, and invest the money they receive from investors in the obligations of others. Institutional intermediaries can be classified in many ways. For the purpose of this discussion, they are distinguished by the type of obligations they issue and the type of obligations in which they invest, that is whether these obligations are created in personal relations or in market relations.

Under this classification, two prototype institutional intermediaries on the extremes of the spectrum are banks and investment companies. Banks mainly issue deposits and invest in loans, both created in personal relations. Investment companies issue marketable securities and invest in marketable securities. Banks originate loans; investment companies purchase their investment in the markets.

SPVs are hybrids of banks and investment companies. SPVs resemble investment companies because they issue marketable securities, and do not originate loans. They resemble banks because they hold loans or debts typically held by banks. These distinctions parallel the distinctions between personal transactions and market transactions.

3. Reducing Investors' Risks by Diversifying SPVs' Portfolios

SPVs can diversify their portfolios. This possibility is not always available to banks. Banks must compete over borrowers and maintain their relationship with the borrowers. In addition, if making loans in a particular industry or retail area may require expertise, banks may have difficulty in diversifying their loan portfolio in other areas. This problem is ameliorated by the development of a market for loans. Regardless of who makes the initial loans, the market for loans allows both banks and SPVs to diversify their portfolios. Thus, personal relations are established for making loans, but not for holding loans, and that solves the diversification difficulty.

⁶⁹ See *id.* Implementing regulations are now being prepared by the Treasury. See Financial Asset Securitization Investment Trusts (FASITs), Solicitation for Comments, 61 Fed. Reg. 56,647 (1996).

4. Credit Enhancement

SPVs can reduce investors' risks through credit enhancement. One problem relating to credit enhancement of asset-backed securities stems from the seller-assignor's interest in removing the loans off its books on the one hand, and the seller-assignor's interest in providing credit enhancement to investors, on the other hand. Credit enhancement underwrites some of the investors' risks. For the assignor, especially if it is a bank, providing rather than acquiring third-party credit enhancement may be less expensive.

We have already mentioned the difficulties in distinguishing between a true sale and borrowing. Congress has drawn the line in the Community Redevelopment Act of 1994.⁷⁰ However, the difficulties are not unique to securitization, but have become more prominent with the rise of this process.⁷¹ The problems do not relate directly to personal versus market relations. However, to the extent that credit enhancement could be bought in the markets, and there are signs that such instruments will be developed in the future, the question of whether the assignor can buy such instruments and provide them to the SPV may arise. Presumably, paying for these instruments is not the same as underwriting the risk.

Today, assignors can provide credit enhancement to investors by investing in the equity of the SPVs. That provides investors with a cushion when the assigned loans fail to a greater degree than expected. It also adds credibility to the assignors' information, showing that they put their money where their mouth is.⁷²

5. Conclusion

In securitization, the focus and policy balancing has shifted to markets. SPVs hold loans established by personal relations. However, the ability to buy the loans in the markets enables the sponsors of SPVs to diversify the portfolio risk. In addition, their structure allows SPVs to spread the risk of the portfolio among the different classes of securities that they issue and that results in matching liabilities and assets. Well-structured SPVs cannot fail. In that sense they are more similar to mutual funds than to

⁷⁰ See 12 U.S.C. § 1835.

⁷¹ Assignors also can provide credit enhancement by transferring additional collateral to the SPVs (together with investment in equity issued by the SPV). In both cases assignors can remove the loans off their books.

⁷² See 2 FRANKEL, *supra* note 15, § 24.4 (Supp. 1998) (citing REPORTING BY TRANSFERORS OF RECEIVABLES WITH RECOURSE, STATEMENT OF FIN. ACCT. STANDARDS No. 77 (Financial Acct. Standards Bd. 1983)).

banks, even though they hold bank-type assets. As one views credit enhancement issues, it seems that higher-risk underwriting instruments will be available in the markets, and to that extent, the personal nature of the credit enhancement may be diluted.

VI. DISTRIBUTING THE SPVS' SECURITIES

The difficulties in classifying SPVs' securities relate in part to the cross-boundaries between securities firms and banks. Today securities firms provide loans – interim or even permanent loans – and banks and other institutional lenders distribute securities or make loans for securitization. The traditional division between institutions and market intermediaries has been blurred, but the principles governing contract and securities laws have not merged. Application of laws to institutions on the basis of their historical specialization and limited activities no longer makes sense. Now applicable laws should be chosen by examining the transactions in which the institutions have engaged and their environment.

It was fairly clear that asset-backed securities were securities. However, other related questions arose regarding the applicability of securities acts on asset-backed securities. For example, who is the issuer of the securities? The SPV? The sponsor of the securitization process? Both? The distinctions are important because if bank sponsors are the issuers, the securities need not be registered under the Securities Act of 1933 because bank obligations are exempt from registration.⁷³ If SPVs are mere tools for securitization, and the sponsors, trustees and servicers initiate the process and possess the relevant information about the securities and the loans, they may be deemed the issuers.⁷⁴

The analysis of these situations must depend on the public policy underlying two different systems of law. The author believes that if a borrower-issuer is involved in preparing a distribution of securities directly, or indirectly through an SPV, and provides information to the public, it

⁷³ See 15 U.S.C. § 77c(a)(2).

⁷⁴ See *Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145*, Securities Act Release No. 6862, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 at 80,646 (Apr. 15, 1990) (providing that servicer or trustee may be deemed "issuer" for the purposes of rule 144A); Kutak Rock & Campbell, SEC No-Action Letter, 1990 SEC No-Act. LEXIS 1273 (Nov. 29, 1990) (providing that release does not cause analysis of issuer status to be different for privately placed mortgage-backed or asset-backed securities than public offerings).

should be subject, as an issuer, to the securities acts. But if a securities firm undertakes to underwrite the securities of the SPV, the firm should be subject to the securities acts. And if the firm and the borrower-issuer agreed on a loan, and the securities firm had the option to hold the loan or transfer it to an SPV and securitize it, contract law alone should apply to the loan and the securities laws should apply to the later distribution of the securities.⁷⁵

Some of the securities acts conflict with business realities and needs for securitization. In most cases, the Securities and Exchange Commission has adjusted the rules to accommodate the process. Thus, for mortgage-backed securities, the settlement date is longer than the period applicable to securities.⁷⁶ In addition, Rule 434 allows for provision of multiple documents to investors but excludes mortgage-backed securities because they do not lend themselves to such a form of disclosure.⁷⁷

Further, shelf registration is available to issuers of mortgage-backed securities,⁷⁸ and other asset-backed securities.⁷⁹ Moreover, Congress has preempted states' "blue sky" laws that limited or prohibited regulated institutions to invest in asset-backed securities.⁸⁰

One unresolved issue relates to the valuation of securitized loans and loans held by banks. In this area, institutional structure built on personal relations clashes with institutional structure built on market relations. The accounting profession has demanded that securitized loans and loans traded

⁷⁵ See *Realtek Indus. Inc. v. Nomura Sec.*, 939 F. Supp. 572, 579-80 (N.D. Ohio 1996).

⁷⁶ See Securities Transactions Settlement, Exchange Act Release No. 33,023 (Oct. 7, 1993), [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,232 at 84508 (codified at 17 C.F.R. § 240.15c6-1(a) (1998)) (excepting "government securities" from Rule 15c6-1).

⁷⁷ See 17 C.F.R. § 230.434(a); Prospectus Delivery; Securities Transactions Settlement, Securities Act Release No. 7168, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,620 at 86,572 (May 11, 1995).

⁷⁸ See Shelf Registration, Exchange Act Release No. 6499, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,449 at 86,342 (Nov. 17, 1983) (codified at 17 C.F.R. § 230.415(a)(1)(vii)).

⁷⁹ See Simplification of Registration Procedures for Primary Securities Offerings, Exchange Act Release No. 6943 [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,015 at 82,964 (July 16, 1992) (codified at 17 C.F.R. § 239.13(a)(4)) (excepting investment grade asset-backed securities from certain registrant requirements of Form S-3); 17 C.F.R. § 230.415(a)-(x) (permitting shelf registration for securities registered on Form S-3).

⁸⁰ See Secondary Mortgage Market Enhancement Act of 1984, 15 U.S.C. § 77r-1(b) (1994). Only a few states used the option to reinstate these laws.

in liquid markets will be "marked to market."⁸¹ The banks and bank regulators have objected strongly, and the proposal has not yet been adopted. Clearly, such marking to market of bank assets would create volatile bank portfolios that may not withstand the fixed obligations that banks carry. While banks wish to securitize their loans, legal constraints induce them and the bank regulators to characterize their securitized loans as loans and not as securities.⁸² Volatile market prices conflict with stable bank portfolios, and, some would say, with bank stability.⁸³

Also, as in the case of all securities, not all asset-backed securities are traded and not all such securities are traded in liquid markets. Asset-backed securities have a high share of illiquid markets, mainly because many such instruments are deemed high risk, as new and innovative.⁸⁴ Asset-backed securities therefore give rise to transition periods, when personal instruments have been converted to market instruments but do not have markets as yet.

VII. SERVICING THE SPVS' PORTFOLIOS

Generally, the originators of loans retain the right to service the loans after the loans are sold. This industry custom has developed throughout the years, starting with mortgage loans. Banks sold loans to gain liquidity but sought fee income to cover at least some of their costs; regulators supported this custom.⁸⁵ In addition, continued servicing by originators reduces the costs of notifying the borrowers of the assignments of their loans and the cost of endorsing the loan documents to other servicers.

Securitization has given rise to the transformation of servicing contracts – personal relations – into a species of property – market relations. The originator of loans can sell the loans and retain the servicing rights, or sell these rights. Unlike usual contracts, servicing contracts can be freely assigned, except if the new servicer is not qualified. These contracts have a

⁸¹ See 2 FRANKEL, *supra* note 15, § 24.9-.13 (Supp. 1998) (citing ACCOUNTING FOR CERTAIN INVESTMENTS IN DEBT AND EQUITY SECURITIES, STATEMENT OF FIN. ACCT. STANDARDS No. 115 (Financial Acct. Standards Bd. 1993)).

⁸² See 1 FRANKEL, *supra* note 15, §§ 7.7 - 7.8.

⁸³ See *id.* § 3.3.5.

⁸⁴ For example, when the first commercial mortgages were securitized no markets and no dealers were available for these types of securities, and that illiquidity raised concerns. See Uehlinger & Bartlett, *supra* note 55, at S24.

⁸⁵ See generally, 1 FRANKEL, *supra* note 15, § 7.10; Banking Circular 24 [1966-1973 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 95,308 (Apr. 16, 1970).

market and have encouraged the development of servicers with expertise and tools to service hundreds of thousands of borrowers. The property characteristics of servicing rights have ripened, as originators can add the value of their servicing contracts as assets on their balance sheet.

VIII. CONCLUSION

Conversion of personal to market relations presents problems in the securitization area. The benefits of this process are not without cost. Personal relations and protections can be lost, and institutional intermediaries whose businesses were based on personal relations have to restructure. Further, converting personal into market relations may require some hard policy decisions regarding whose interests should prevail. Some of the problems were resolved by law and some by the markets, and personal needs have not been completely ignored. While market transactions in mass-produced financial assets are sweeping the financial services field, consumers/investors are offered refined mass-produced products in ever greater variety to meet personal needs and tastes. "Personalized" market relations are taking the place of personal one-to-one relations. This, perhaps, is the answer.

