

Asset-Backed Securities

The Securitization Process

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Asset-Backed Securities

- The basic idea
- What's needed?
- The technique
- ABS around the world

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Range of Debt Markets

Illiquid Highly liquid

Nontradable private placement Tradable private placement Commercial paper Public issue Actively traded bonds

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Securitization: The Basic Structure

SPONSORING COMPANY

ACCOUNTS RECEIVABLE

SALE OR ASSIGNMENT

SPECIAL PURPOSE VEHICLE

ACCOUNTS RECEIVABLE

ISSUES ASSET-BACKED CERTIFICATES

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Securitization of Assets

- Securitization is the transformation of an illiquid asset into a security.
- For example, a group of consumer loans can be transformed into a publicly-issued debt security.
- A security is tradable, and therefore more liquid than the underlying loan or receivables. Securitization of assets can lower risk, add liquidity, and improve economic efficiency.

IMPLEMENTATION

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Securitization of Assets

BANK

Pooled mortgage loans

SPECIAL PURPOSE COMPANY OR TRUST

Asset-backed securities

INVESTORS

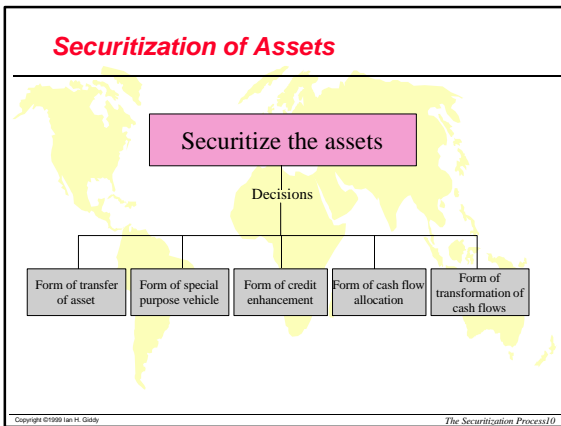
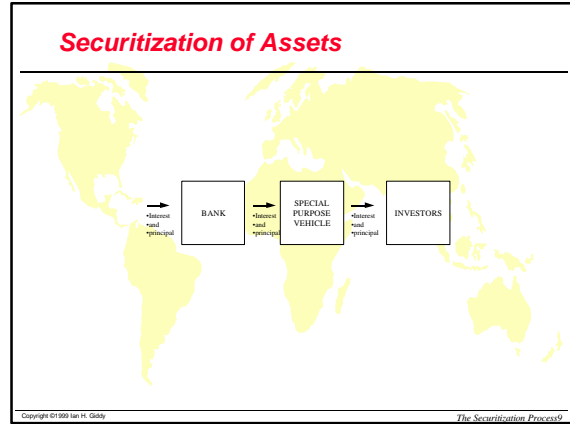
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Asset Securitization: Features

Key features are:

- ◆ pooling of a group of similar non-traded financial assets
- ◆ transfer of those assets to a special-purpose company which issues securities
- ◆ risk reduction by systematic risk assessment, by diversification, by partial guarantees, etc.
- ◆ division of the benefits (and risks) among investors on a pro-rata basis
- ◆ being offered in the form of a security (rather than, for example, as a portfolio of loans or receivables)
- ◆ on-going servicing of the underlying assets' cash flows through to the asset-backed security investors.

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Characteristics of Assets Needed to Securitize

The Pool of Assets Should Have:

- Volume which is sufficiently large and homogenous to facilitate statistical analysis
- A stable history of rates, defaults, delinquencies, prepayments and so forth
- Sufficient diversification--for example, geographic and socio-economic--to reduce vulnerability to economic stresses
- Basic lender's credit quality standards that are capable of being evaluated and approved by rating agencies and specialized financial guaranty companies
- Assets must be transferable and unencumbered

In short, the assets themselves must be sufficiently strong to support a high credit rating without the backing of the originating lender.

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Finance Company Limited

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Case Study: The Company (Finance Company Limited)

- Corporate commitment
- Management depth
- Track record (loan program administration)
- Internal systems (origination, servicing, and collection)
- Information (on company and collateral)
- Market position
- Origination capacity
- Technology

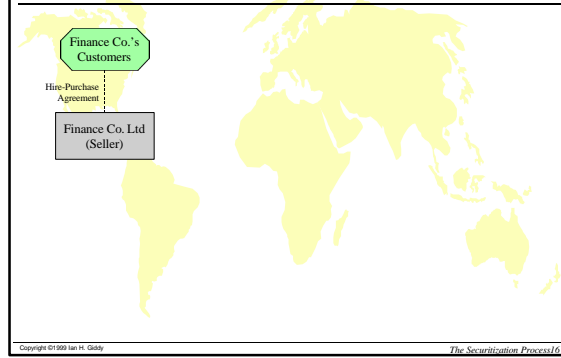
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What is the Technique for Creating Asset-Backed Securities?

- A lender originates loans, such as to a homeowner or corporation.
- The securitization structure is added. The bank or firm sells or assigns certain assets, such as consumer receivables, to a special purpose vehicle.
- The structure is legally insulated from management
- The SPV issues (usually) high-rated debt.

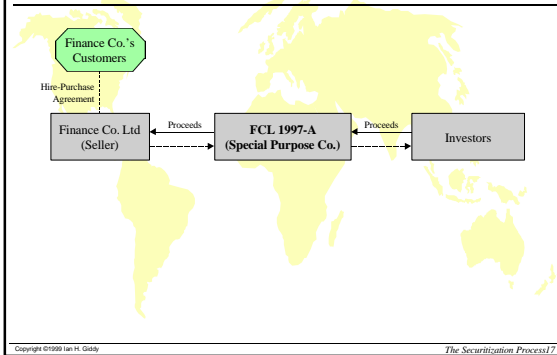
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Case Study: Initial Exchanges



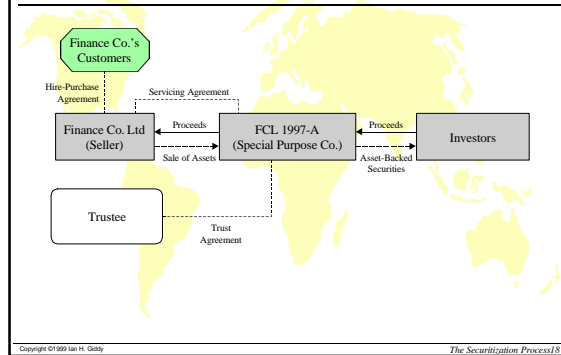
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Case Study: Initial Exchanges



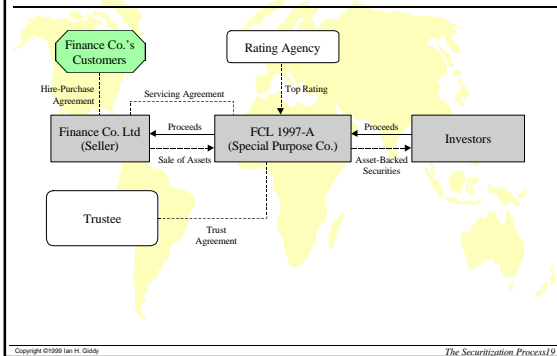
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Case Study: Initial Exchanges



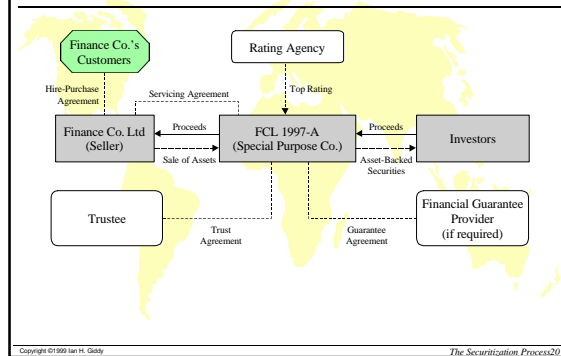
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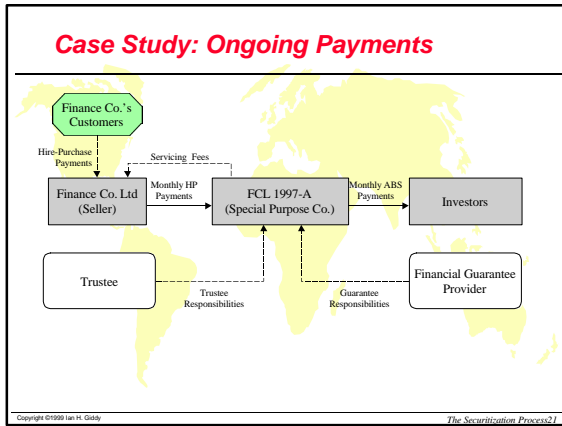


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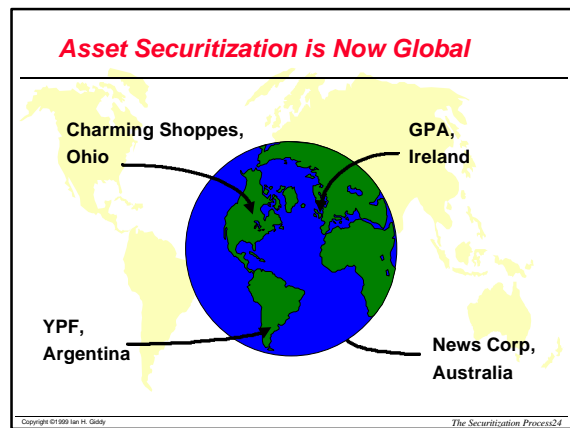
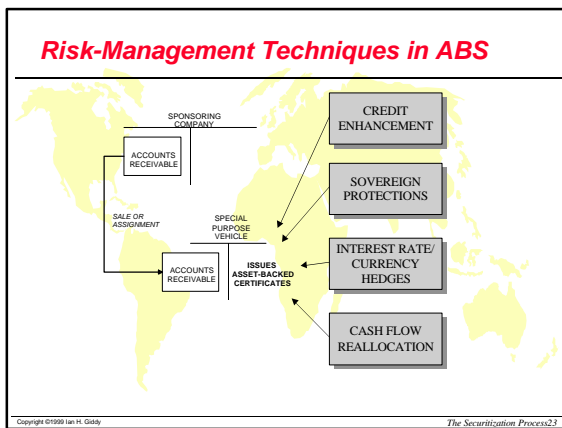
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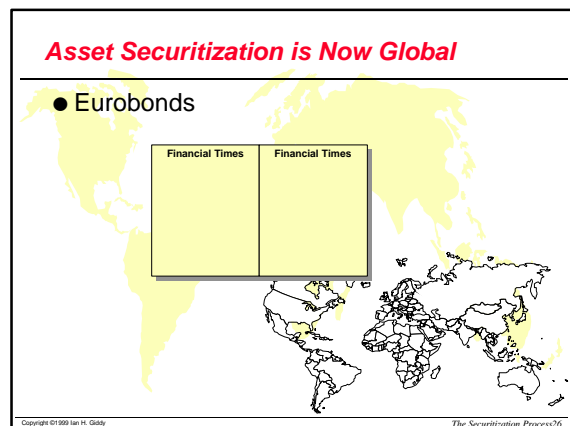
- ### Managing the Risks
- Credit risks
 - Liquidity risk
 - Servicer performance risk
 - Swap counterparty risk
 - Guarantor risk
 - Legal risks
 - Sovereign risk
 - Interest rate and currency risks
 - Prepayment risks
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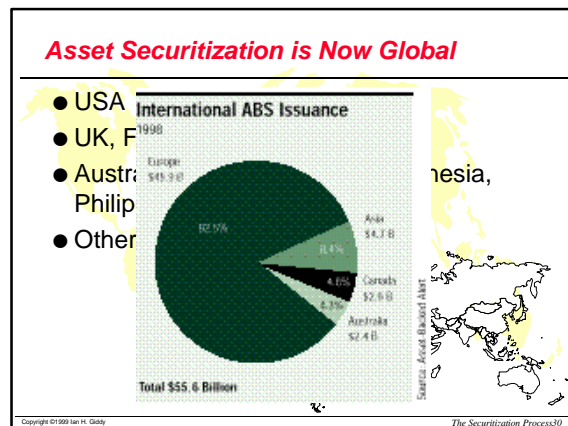
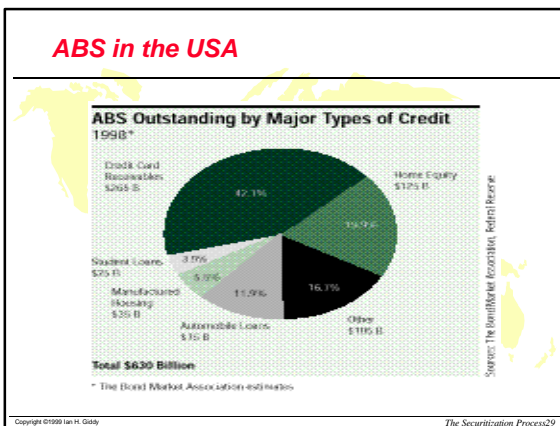
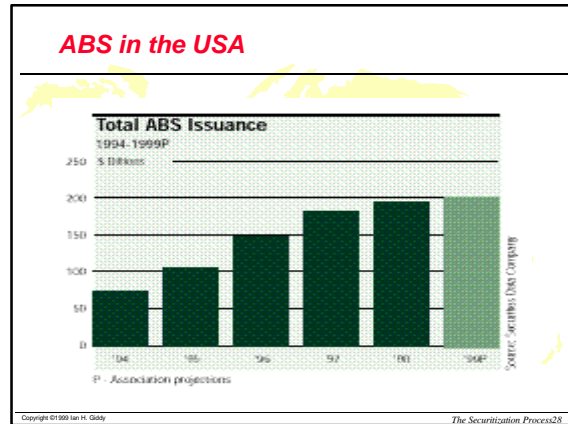
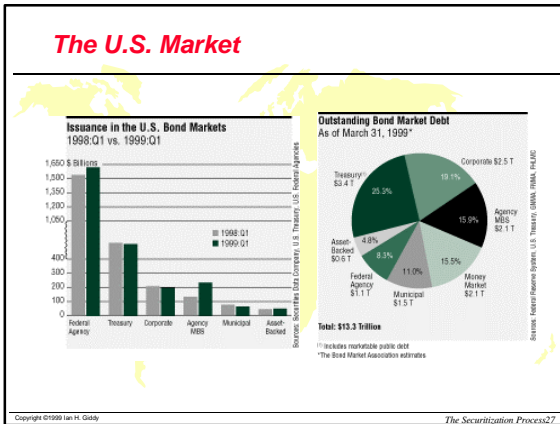


Asset Securitization is Now Global

- USA
- UK, France, other Europe
- Australia, Japan, Thailand, Indonesia, Philippines, India, etc
- Other developing countries

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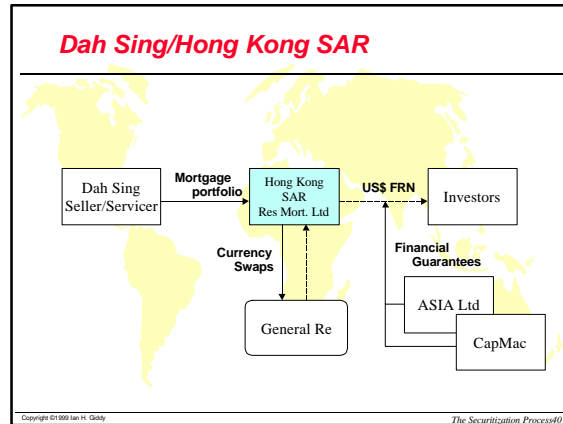
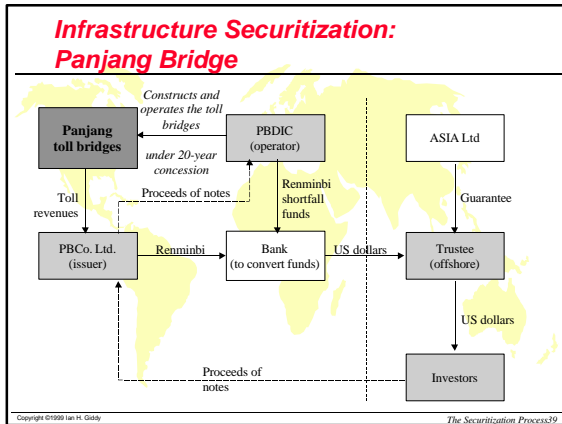
The Market in Europe

Figure 1. European MBS/ABS Issuance by Asset Type, 1997 and 1998 (Dollars in Billions)

Asset Type	1997	Pct. of Total	1998	Pct. of Total
MBS	\$11.0	24 %	\$22.7	49 %
CMBS	2.6	6	2.6	6
CBO/CLO	14.6	32	8.5	18
Other ABS	17.3	41	12.9	27

Source: Moody's Investors Services.

- ### Why Has the European MBS Market Not Developed Faster?
- Despite steady issuance since the mid-1980s, securitization volume in Europe has lagged US rates, for a variety of reasons:
- Many institutions have not faced strong incentives to remove assets from balance sheets, because of favorable funding rates and excess capital;
 - The severe recession in Europe in the early 1990s led to a sharp drop in loan originations, further diminishing pressure on balance sheets;
 - A lack of legal and regulatory frameworks hinders securitization;
 - Few analytic tools and an infrastructure exist for timely reporting of deal information to investors;
 - A diversity of mortgage terms and conditions from country to country, such as different prepayment penalties, diminish the appeal of MBSs backed by loans from one country to investors in other countries;
 - Currency differences have hindered cross-border transactions in the past; and
 - Many European investors have tended to focus on sovereign debt, rather than spread products.



Why Has the Asian ABS Market Not Developed Faster?

Despite a gradual increase since the early 1990s, securitization volume in Asia has lagged US and European rates, for a variety of reasons:

- A lack of legal and regulatory frameworks that would facilitate securitization;
- Tax obstacles to the transfer of financial assets and inter-company interest payments;
- Few analytic tools and an infrastructure exist for timely reporting of deal information to investors;
- A diversity of mortgage and hire-purchase terms and conditions from country to country;
- A wait-and-see approach by the monetary authorities who feared easier consumer credit conditions;
- Sovereign risk considerations have hindered cross-border transactions in the past;
- Many institutions have not faced strong incentives to remove assets from balance sheets, because of favorable funding rates and excess capital;
- The severe recession in Asia in the late 1990s led to a sharp drop in loan originations, further diminishing pressure on balance sheets.

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Belenus Securities

- What are the underlying assets?
- What types of securities have been issued?
- What is the legal structure? Who is the issuer? The sponsor? What is the issuer's relationship to the sponsor?
- Why was this deal done?

ABS in Europe: Case Study

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