Asset-Backed Securities

The Securitization Process

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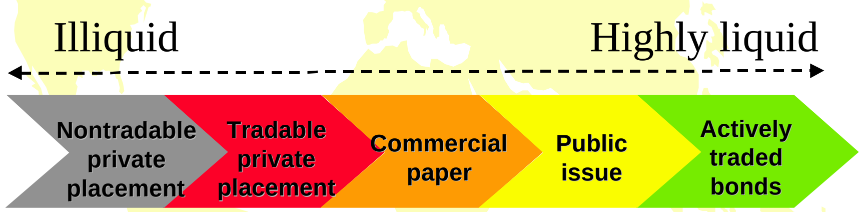
Asset-Backed Securities

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

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 publically-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.

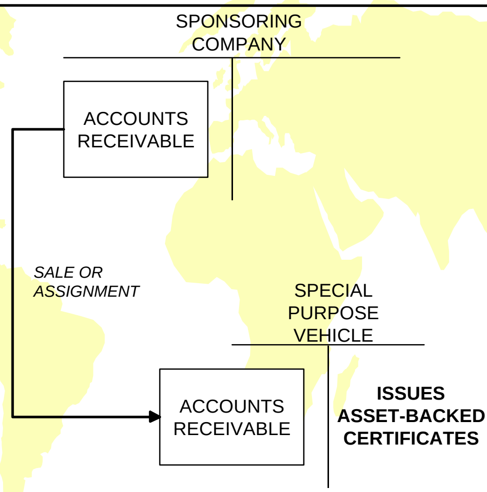
Range of Debt Markets



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.

Securitization: The Basic Structure



Is the Company Ready for ABS?

- Does the originator currently face a **high cost of funding** assets that would be recognized as sound, cash-generating assets if taken in isolation?
- Does it have a regulatory or **capital constraint** that makes freeing up the balance sheet important?
- Does it have **data** about the assets (required by rating agencies and financial guarantors)?
- Does it have the **servicing** process and systems that can meet the more demanding standards of the asset-backed market?
- Is the originator **willing** to undertake a complex, time-consuming transaction to obtain a broader, potentially cheaper, ongoing source of funding?

Is the Company Ready for ABS?

- 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

Are the Assets Suitable?

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.

The Process

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.

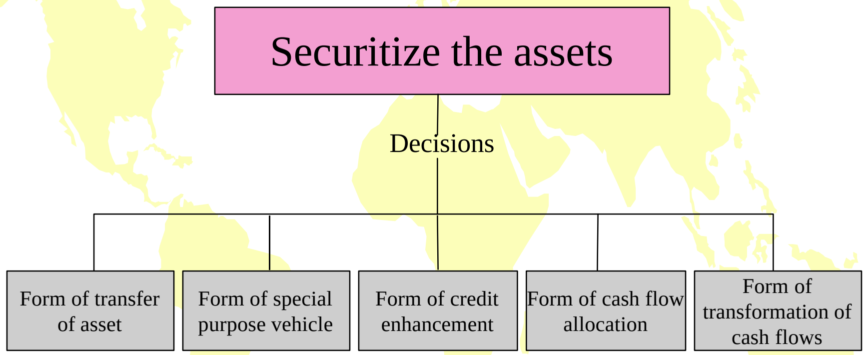
IMPLEMENTATION

Finance Company Limited

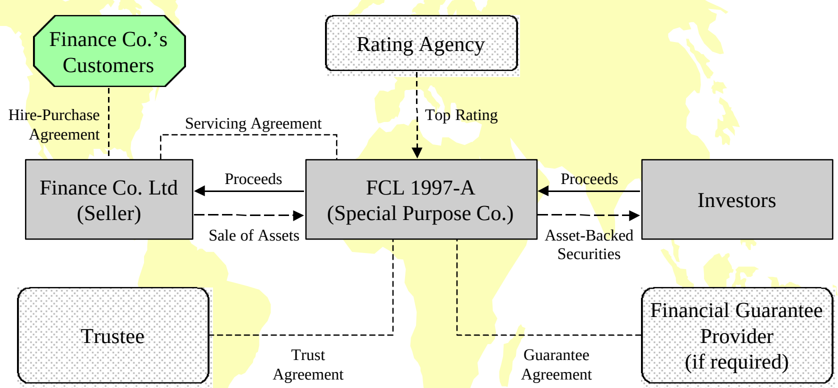
Case Study: The Company (Finance Company Limited)

- Finance company whose growth is constrained
- Has pool of automobile receivables
- Has track record
- Plans to use this as an ongoing source of financing

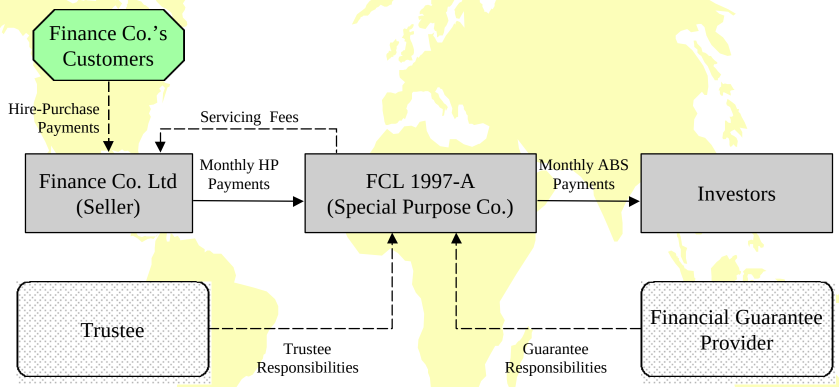
Key Decisions



Case Study: Initial Exchanges

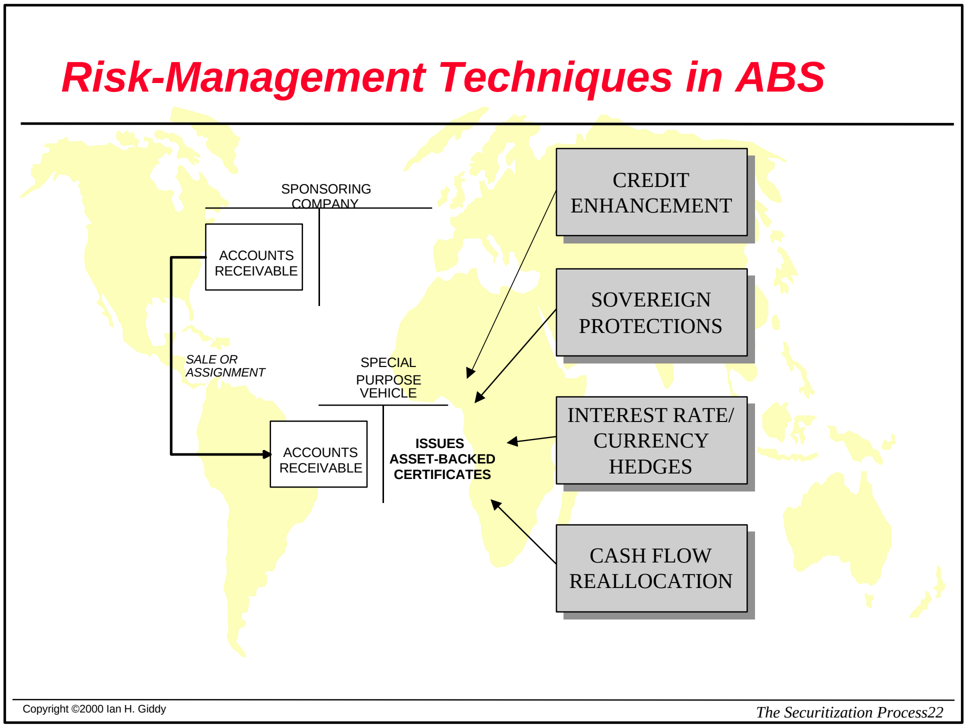


Case Study: Ongoing Payments



Getting a Rating: 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


Risk-Management Techniques in ABS
SPONSORING COMPANY
ACCOUNTS RECEIVABLE
SALE OR ASSIGNMENT
SPECIAL PURPOSE VEHICLE
ACCOUNTS RECEIVABLE
ISSUES ASSET-BACKED CERTIFICATES
CREDIT ENHANCEMENT
SOVEREIGN PROTECTIONS
INTEREST RATE/ CURRENCY HEDGES
CASH FLOW REALLOCATION
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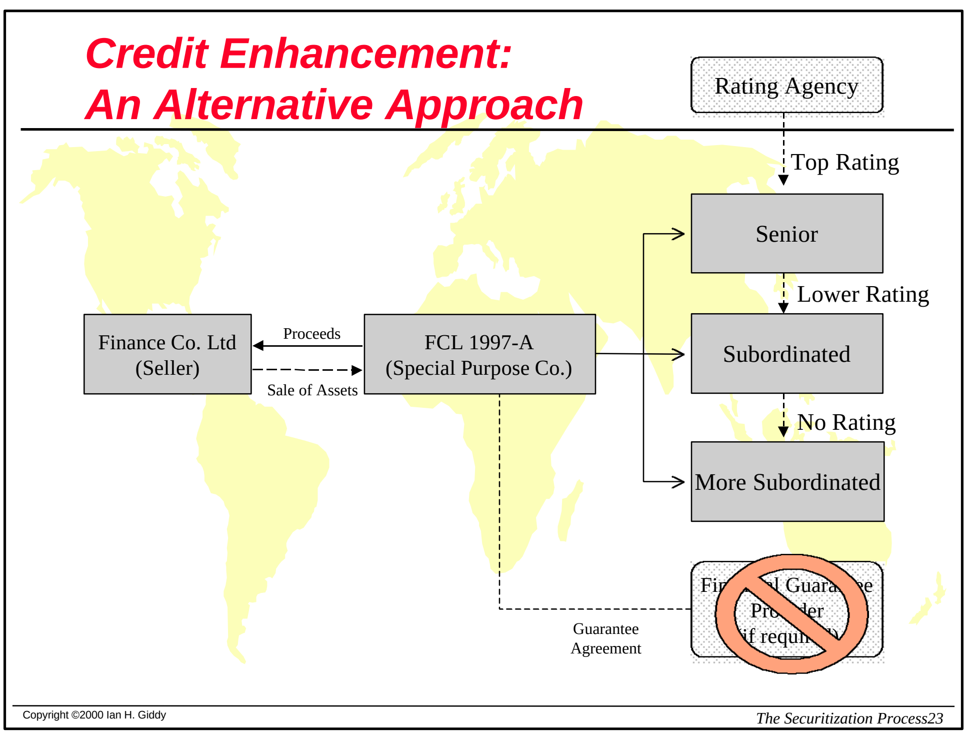
Credit Enhancement: An Alternative Approach
Rating Agency
Top Rating
Senior
Lower Rating
Subordinated
No Rating
More Subordinated
Finance Co. Ltd (Seller)
Proceeds
Sale of Assets
FCL 1997-A (Special Purpose Co.)
Guarantee Agreement
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Choose a Structure to Suit the Type of Assets to be Securitized

- Mortgage Securitization
- Non-Mortgage ABS
- Intangibles
- Infrastructure and Project Financing

Possible Time Frame

months

1
- Determination of structure
- Information Memorandum

2
- Commencement of documentation
- Detailed cash flow analysis
- Preparation for rating process

3
- Result of cash flow analysis
- Determination of eligible receivables

4
- Approach rating agencies and introduction of the structure envisaged
- Founding of the SPV

5
- Initiation of stock exchange approval process (in case of a Bond issuance)
- Draft of Offering Circular (in case of a Bond issuance)
- Comments of the Rating agencies (Rating confirmation)

6
- Determination of funding strategy
- Publication of Offering Circular (in case of a Bond issuance)
- Marketing (in case of a Bond issuance)

7
- Completion of documentation
- Purchase of receivables and issuance of securities

This schedule serves as an indication only and may vary from transaction to transaction.

One Bank's Assessment

- The implementation of a transaction usually takes between two and six months, provided all necessary data and information is readily available.
- This time frame does not take into account the rating process.