Asset Securitisation

- It is a process where loans and other receivables are packaged, underwritten and sold in the form of asset-backed securities
- The **assets** which can be securitised are:
  - Credit card receivables
  - Trade related receivables
  - Receivables from govt.
  - Real estate loans
  - Housing loans
  - Automobile loans etc.
- **Securitisation** is a **synthetic technique** to:
  - Convert asset into securities
  - Securities into liquidity
  - Liquidity into assets
  - And cycle goes on…
- Such a system provides flexibility of yield, pricing pattern, size risks and marketability of instruments which are used to the advantage of both borrowers and lenders (investors)
- **Pros**:
  - Turns illiquid assets into liquid ones
  - Frees up capital for the originator
  - Provides income for investors
  - Allows small investors to play
- **Cons**:
  - Investor assumes creditor role
  - Risk of default on underlying loans
  - Lack of transparency regarding assets
  - Early repayment damages investor's returns
- **How securitisation works?**
  - Company holding the assets – known as originator – gathers the data on the assets it would like to remove from its associated balance sheet
  - This gathered group of data is now called a reference portfolio
  - The originator then sells this portfolio to issuer who will create tradable securities
  - Created securities now represent stakes in the assets in the portfolio
  - Investors now buy these stakes for specified rate of return
  - By buying these securities, the investors officially take the role of a lender
  - Hence, securitisation allows the originator to remove specific assets from his balance sheets
  - Investors profit as they earn a rate of return