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Preface

Securitization is growing in its reach, geographically and in terms of industry segments. Its relevance in integrating mortgage lending markets with the capital markets is well established world-over, but it is interesting to see application of securitization technology in traditional domains of corporate and project finance. In a much broader sense, securitization is a by-product of a larger tendency of the preponderance of the markets, because securitization builds that bridge whereby capital markets become connected to the market for application of funds.

Geographically, securitization is actively practiced in most developed and emerging markets. It is being advocated by multilateral developmental agencies too. Unarguably, securitization will continue to grow – there is no doubt about the *future* of this instrument, labelled in this book as the instrument of the future.

Securitization is a preferred form of funding – the preferential treatment owes itself to several of the oft-cited benefits, such as bankruptcy remoteness, off-balance sheet treatment and extended leverage. Most of these are derived from the technical nature of the instrument. The history of the development of any financial product initially emphasizes those technical benefits, which, in course of maturity of the product, either are ruled out or subjected to extensive limitations by regulations or accounting standards. This is beginning to happen in case of securitization as well. Bankruptcy remoteness has not been questioned on any significant scale, but accounting standards have put tougher conditions on off-balance sheet treatment. Over time, on-balance sheet treatment may put doubt as to bankruptcy remoteness as well; it may be questioned how something that remains on the balance sheet be excluded from the purview of bankruptcy court's jurisdiction. The process of maturity for any instrument is a tendency towards convergence, that is, from difference to indifference.

In presenting this new edition, I have received substantial support from many people, but I must mention one. Martin Rosenblatt, the world's number one expert on accounting for securitization, took time off to go through the whole of my chapter on accounting issues and made extensive suggestions for improvement. Martin, I will remain obliged.

This edition is being published by Wiley and the world's best financial publisher will surely make the book more accessible and readable. The title of the book is also being changed a bit – from *Securitisation: The Financial Instrument of the New Millennium* to *Securitization: The Financial Instrument of the Future.* I will look forward to constructive suggestions from readers.

Kolkata VINOD KOTHARI
May 22, 2006

Preface to second edition

The development of securitisation as a financial instrument, coupled with other devices such as derivatives and alternative risk transfers, is part of the transformation of global financial markets. From the traditional form of financial intermediation, markets are growing into financial commoditisation. Lending relationships are being converted into investment products at great pace and efficiency in many countries, with resultant benefits for the system as a whole.

Mortgage backed securities are already the second largest fixed income investment in the USA. Leave aside other developed financial markets, mortgage securitisation is attracting attention everywhere in the World – including emerging markets. This activity demonstrates that securitisation is not something that only pleases the maverick investment bankers and the world of high finance, but it does good to the society, as it connects housing finance markets with capital markets. The key benefit of securitisation is connectivity – it connects capital markets with housing finance markets, banking with insurance, private equity with bond markets and so on.

As the instrument becomes increasing important, industry players have to attend to some of its sensitive spots. I would utilize this opportunity to mention two of these here; though the book has dealt with these as well as other issues at length.

Soon after the Enron debacle, securitisation got associated with off-balance sheet financing and special purpose vehicles. In popular perception, off-balance sheet financing is something dubious, something curious, like the "invisible man", and special purpose vehicles are devices to achieve off-balance sheet financing. There is no doubt that accounting standards that exist in most parts of the World require securitisation to lead to off-balance sheet funding. Really speaking, no funding is completely off the balance sheet as what goes off the balance sheet of the bank is on the balance sheet of a special purpose entity. But, again in public perception, that special purpose vehicle is often an obscure and opaque entity.

Personally, I don't see why securitisation has to be off balance sheet. Synthetic securitisations do not lead to off the balance sheet assets, and they still serve the purpose of risk transfer. What is more important is bankruptcy protection. Accounting treatment cannot be an objective by itself – it is merely the consequence of a series of steps designed for bankruptcy remoteness. As long as asset-based, entity-independent ratings are possible, on-balance sheet accounting should be just as fine. We should seriously think in that direction.

The second area of public critique is sub prime lending. The popular perception is that banks originate more sub prime credits today than ever before, and the reason is that these loans are, soon after origination, parceled out into securitisation vehicles. Unsurprisingly, home equity lending is a large component of the asset-backed market in the United States. It is contended that the credit standards used by banks are not the same for the assets that stay on the books, as those for the securitisable assets.

The only way to check against this possibility is to maintain a strict fire wall between the lending desk and the securitisation desk. This is easier said than done, but that does not reduce the need to say it or the seriousness required to implement it.

Over the last 5- 6 years, my association with securitisation industry has been quite intensive, partly due to my website, and partly the interaction during my training courses and conferences. Some people say – I live and breathe securitisation. I add – I drink and eat it also! I hope this book strengthens my nexus with the industry which I so much cherish.

There are many personalities in the small world of securitisation from whom I draw tremendous inspiration and get unstinted support. To name them and to record my gratitude would be the least I could do in return. **Martin Rosenblatt** is a great source of information, and his span is not limited to accounting, where is an unrivalled expert. **Prof. Steven Schwarcz** is the grand man of securitisation law and has enriched me whenever required. **Mark Adelson** has tremendous depth in securitisation and I have benefited a lot from his writings. **Luke Mellor** is a remarkable personality who is always ready to help.

Manoj Mandal has done commendable hard work working on the script.

I would be a great pleasure if readers have something to share or say.

Calcutta
Sept 4, 2003 VINOD KOTHARI