

Table of Contents

Part I	Securitization: Concepts & Markets	1
1.	Securitization and structured finance	3
	Basic meaning of securitization	4
	Asset securitization	4
	Some definitions of securitization	8
	Securitization of receivables	9
	Quick guide to jargon	10
	Securitization and asset-backed finance	12
	Securitization and structured finance	13
	Some quick features of securitization	14
	What receivables are securitizable	14
	Creation of security	15
	Special purpose vehicle	15
	Re-distribution of risks	16
	Rating	17
	The big picture of securitization of finance	17
	Changing structure of financial markets	17
	Securitization and financial disintermediation	22
	Securitization as a tool of risk management	25
	Economic impact of securitization	26
	1. Facilitates creation of markets in financial claims	26
	2. Disperses holding of financial assets	26
	3. Promotes savings	26
	4. Reduces costs	27
	5. Diversifies risk	27
	6. Focuses on use of resources, not their ownership	27
	7. Smooths the impact of recession	27
	The alchemy of securitization: is the sum of parts more than the whole?	28
	The alchemy of structured finance	28
	Risks inherent in securitization	30
	Notes	36
2.	Securitization: Methodology, structures, Motivators and Demotivators	59
	Modus operandi of securitization briefly explained	59
	Economic substance of securitization: Where does the alchemy lie?	62
	Features of securitization of receivables	63

viii Securitization

1. Mode of asset-based financing	63
2. Mode of structured financing	64
3. Securitization of claims against third parties	64
4. Limited Recourse	64
5. Asset features	65
6. Originator features	69
7. Issuer/SPV features	70
8. Investor features	71
Securitization and factoring	72
Securitization and ring fencing	72
Asset classes	73
Balance sheet and arbitrage transactions	74
Asset-backed securities and asset-backed commercial paper	74
Broad types of securitization structures	75
Cash vs. synthetic structures	75
True sale vs. secured loan structures	76
Pass-through vs. collateral structure	76
Discrete trust vs. master trust	77
Direct portfolio transfers	77
Pass-through structure	79
Pay-through structure	84
Economic argument against pay-throughs	86
Collateralized mortgage obligation bonds	87
Refinements in CMO structure	89
Revolving structure	91
Impact and suitability of the revolving structure	92
Future flows securitization	93
Advantages of securitization for the issuer	97
Advantages to the investors	102
Threats in securitization	104
Notes	106
3 The World of Securitization	108
History of securitization	108
Deeper in history	109
The U.S. mortgage market	109
Spreads over to non-mortgage assets	110
Securitization through recession	111
The life cycle of securitization	111
Present state of securitization	112
North America	112
Canada	114
Europe	115
United Kingdom	117
Germany	119
Italy	125

Table of Contents **ix**

Denmark	127
The Netherlands	128
France	130
Belgium	133
Portugal	136
Spain	138
Sweden	140
Finland	141
Switzerland	142
Luxembourg	142
Turkey	143
Latvia	144
Poland	145
Austria	146
Czech Republic	146
Hungary	146
Central and South America	147
Origin of securitization in Latin America	147
Mexico	148
Brazil	150
Asia	152
Japan	153
Singapore	157
Hong Kong	159
Thailand	161
Indonesia	166
South Korea	168
The People's Republic of China	170
Taiwan	173
Securitization in India	175
Pakistan	176
The Pacific	179
Australia	179
New Zealand	181
Trends in global securitization	183
Notes	186

Part II Financial substance and ratings 189

4. Structuring and credit-enhancing securitization transactions	191
Basics of securitization structuring	191
Structuring variables	193
Asset pool	193
Selection criteria	194
Identification of risks ⁴	195
Sources of credit support	196

x **Securitization**

Size of credit support	196
Financial structure – pass-through or reinvestment type	196
Classes of liabilities	197
Time tranching of liabilities	198
Pay down of securities	198
Liquidity support – need and sources	198
Any prepayment protection	199
Mitigation of other risks	199
Creation of cash reserve and investment	199
Structural protection triggers	200
Profit extraction methods	200
Clean up call	200
Parties involved	201
Primary parties	201
Supportive agencies	201
Steps in a securitization transaction	202
Initial feasibility study	203
Key appointments	204
Asset analysis and selection	204
Due diligence audit	205
Determination of the structure	206
Credit enhancements	206
Intervening reinvestments	207
Fixing the legal structure	207
Legal opinions	208
Rating	208
Offer	209
Appointment of servicer/administrator	209
Post completion routines	209
Ongoing reporting	209
Clean up call	210
Credit enhancements	210
First, second and subsequent loss	211
Internal and external credit enhancements	211
Originator credit enhancements	212
Excess spread or profit	212
Cash collateral	215
Credit-enhancing IO strip	216
Overcollateralization	216
Structural credit enhancements	218
Transaction-wide support vs. structural support	218
Third-party credit enhancements	219
Sources of external credit enhancements	219
Suitability of third-party enhancements	221
Sizing of credit enhancements	221
Confidence level for different ratings	222
Stress testing of retail portfolios	223

Table of Contents **xi**

Sizing of enhancement for wholesale portfolios	224
Stepping up credit enhancements	225
Liquidity enhancements	225
Pay-down structure	226
Choice of the pay-down method	227
Maturity of the securities	227
Profit extraction devices	228
Cashflow waterfall	229
Notes	230
5. Understanding the nature and risks of asset-backed securities	231
Asset-backed securities and the underlying collateral	231
Risks in asset-backed securities	233
Will the cashflow come in or the credit risks?	233
Who will get the cashflows in, or servicing risk?	233
Timing of the cashflow or prepayment risk	234
Liquidity of the transaction	234
Interest rate and other volatilities	234
Other risks	234
Modeling of asset risks	234
6. Understanding prepayment risk in asset backed securities	235
Prepayment as a risk	235
Nature of the prepayment option	236
Prepayment risk in asset-backed securities	238
Additional factors that cause	
prepayment of asset-backed securities	238
Analogy with callable securities	239
Impact of prepayment risk on the pool	239
Prepayment risk in mortgage pools	240
Turnover	241
Refinancing	243
Prepayment modelling	244
Static prepayment models	244
Annual and monthly prepayment rates	244
Various static prepayment models:	245
The PSA prepayment model	246
The CPR and other static models	249
Dynamic or econometric prepayment models	250
Establishing relation between interest rates and prepayment rates	251
Some econometric prepayment models	252
Projection of interest rates	255
Which interest rate matters?	255
Interest rate models	255
Prepayments for adjustable rate mortgages	256
Prepayment model for commercial mortgages	258

xii	Securitization	
	Prepayment models for non-U.S. pools	258
	Notes	259
7.	Understanding default risk in asset backed securities	261
	Nature of default risk – default as an option	261
	The option to default on mortgages	262
	LTV ratio	263
	Movement of the loan-to-value ratio over time	263
	Prevailing mortgage rates	263
	Housing prices	264
	Cost of default	264
	Non-economic factors	264
	Default rates as a function of seasoning	264
	Default risk for different securities	265
	Note	266
8.	Cashflow modeling for asset-backed securities	267
	Constructing the cashflow model	267
	Audit checks	269
	Understanding the asset and its repayment over time	269
	The factors that affect asset cashflows	270
	Incorporating prepayment in cashflow	271
	Incorporating delinquency	272
	Incorporating foreclosures and recoveries	272
	Incorporating the impact of seasoning on foreclosure	273
	The factors that affect the factors that affect cashflow	273
	Interest rate volatility and prepayment	274
	Understanding liabilities	275
	Claims on revenue and claims on principal	275
	Manner of repayment of liabilities	276
	Loss allocation	276
	Understanding transaction structure	276
	Excess spread as a credit enhancement	276
	Pooling excess spread into a reserve	278
	Incorporating a clean up call	279
	Modelling a real life case	279
	Example of an auto loan securitization	279
	Extracts from the rating pre-scale report	280
	Further assumptions	282
	Stress testing the model	283
	Level of stress to apply	284
9.	Securitization: Financial evaluation for the originator	285
	Securitization: The quantifiables and the non-quantifiables	285
	Securitization versus the unknown	286
	Securitization versus cost of borrowing	287

Table of Contents **xiii**

What is equity in case of securitization?	289
Relevance of debt-to-equity ratio	290
The NPV of originator's residual interest	291
A sequential paydown example	291
Proportional paydown example	293
Impact of prepayment	293
Factors affecting originator's residual interest	295
Expected value of originator's residual interest	296
10. Investor evaluation of asset-backed securities	297
Spreads inherent in asset-backed securities	298
Spreads for asset-backed securities	299
Understanding of Z spread	300
Comparing Z spread, NPV and yield	301
Understanding of duration	302
Understanding of convexity	304
Impact of prepayment on ABS investments	304
Impact of prepayment on duration	304
Prepayment and yield	305
Prepayment and negative convexity	306
Prepayment and Z spread	306
Computation of option-adjusted spread	307
Understanding default risk	308
Note	308
11. Rating of securitization transactions	309
Structured finance ratings vs. other fixed income ratings	309
Rating agency concerns	310
The rating process	314
Rating models	315
Rating approaches for retail assets and wholesale assets	316
Differences between structured finance and corporate finance ratings	316
What credit ratings do not rate	318
What rating upgrades of structured finance securities mean	318
Servicer evaluation	318
Role of ratings in structured finance	319
Some areas of critique	320
Notes	320
Part III Asset Classes	321
12. Residential mortgage-backed securitization	323
Mortgage funding systems	324
Government support to housing finance	326

xiv Securitization

Why secondary mortgage markets	327
Origin of the secondary mortgage markets	328
The secondary mortgage market in the U.S.	328
Overview of the U.S. RMBS market	332
Agency and non-agency market	335
Prime, Alt-A and other components	336
Secondary mortgage market in other countries	338
Structuring of RMBS transactions	339
Structure of agency-backed securitization	340
Structure of CMOs	342
U.K. RMBS	343
Case studies of RMBS	343
Case study of a U.S. RMBS: Bank of America Funding 2005-1 Trust	343
Case study: Abbey National's Holmes Financing	347
Home equity loans securitization	352
Manufactured home loans	353
Investing in the MBS market	353
Who invests in MBS?	353
Risks in investing in MBS	354
Mortgage bonds	357
Covered bonds and securitization – distinction	357
The covered bonds market	359
Structure of a pfandbrief	360
Rating of pfandbriefs by the rating agencies	361
Notes	361
13. Commercial mortgage-backed securitization	363
What is CMBS?	363
Differences between RMBS and CMBS	364
Typical features	365
CMBS and REITs	366
CMBS market	366
Development of the CMBS market	367
Types of cmbs	370
CMBS and construction financing	370
Balance sheet and conduit activity	371
Trophy asset vs. portfolio of assets	371
By property sectors	371
Structure of a CMBS transaction	372
Balloon loans	372
Typical credit enhancements	373
Refinancing risk: how is it factored in the transaction structure?	374
Diversification	375
Servicers	375
Case study: GMAC's 2001-WTC transaction	375
Collateral	376

Table of Contents **xv**

The loan	377
The certificates	379
Liquidity and credit enhancements	379
The aftermath	380
Case Study: Canary Wharf – A typical U.K. CMBS	381
Introduction to the transaction	381
Transaction structure	381
The properties	382
Cashflows	382
Investing in CMBS: Performance of cmbs	383
Prepayment protection in CRE loans	384
Delinquency in CMBS	384
Performance of CMBS vs. other collateral classes	385
Notes	386
14. Credit and securitization	387
Nature of credit card debt	388
An overview of the market	388
Transaction structure	389
Revolving asset structure	390
Seller's interest	390
Discrete and master trust structure	391
Development of the master trust structure	392
Delinked structure	392
Components of a credit card structure	394
Portfolio yield	394
Charge-offs	396
Payment rate	397
Servicing fee and base rate	398
Early amortization triggers	398
Subordination structure and C Class	399
Investor experience in credit cards	399
Commercial Financial Services	399
NextCard	399
Notes	400
15. Auto loan securitization	401
Forms of car funding	401
Auto loans securitization market	402
The U.S. market	402
Other countries	402
Collateral quality	403
Typical structures	404
Credit enhancements	404
Specific issues in auto loan securitization	404
Case study: Daimler-Chrysler Auto Trust	405

xvi	Securitization	
	The collateral	405
	Transaction structure	407
	Credit enhancements	407
	Cashflow waterfall	409
	Notes	409
16.	Equipment Lease Securitization	410
	Equipment leasing market	410
	Equipment lease securitization market	410
	Product structure	411
	Rating of equipment lease securitizations	411
	Residual value risk in equipment lease securitizations	412
	Investing in equipment lease securitizations	412
	Notes	412
17.	Collateralized Debt Obligations	413
	What is a CDO?	413
	Differences between CLOs and CBOs	414
	Typical structure of a CDO	414
	Types of CDOs	415
	Cash and synthetic CDOs	416
	CDO types based on collateral	416
	Balance sheet and arbitrage CDOs	417
	Par value and market value-based structures	417
	Growth of the CDO market	417
	European CDO market	418
	CDO market trends	419
	CDO market and the health of banking	419
	Balance sheet CDOs	420
	Traditional, cash CDOs	420
	Synthetic CDOs	422
	Arbitrage CDOs	423
	Meaning of an arbitrage CDO	423
	Illustration of arbitraging	423
	Emergence of arbitrage CDOs	424
	Difference between arbitrage CDOs and balance sheet CDOs	425
	Revolving period	426
	Market value CDOs	426
	Structure of a market value CDO	426
	Liabilities of cashflow and market value CDOs	427
	Ramp up period	427
	The CDO manager	428
	Qualities of the CDO manager	428
	The CDO manager's fees	433
	The CDO investors	434

Table of Contents **xvii**

The CDO trustee	434
Authorization of trades	434
Credit enhancer and swap counterparty	434
Typical credit enhancements in CDOs	435
Managing the assets of CDOs	436
Asset quality tests	436
Cashflow coverage tests	437
Over-collateralization and interest coverage ratios	437
What happens when tests are not met?	439
Cashflow waterfall	440
Resecuritization or structured finance cdos	441
Growth of structured product CDOs	441
Distressed debt CDOs	443
What is distressed debt?	443
Distressed debt CDOs and securitization of non-performing loans	444
Motivations	444
Credit enhancement levels	444
Typical issues in distressed debt CDOs	445
Evaluation of distressed debt CDO manager	445
Hedge fund cdos or fund of funds	446
Investing in CDOs	446
Investor motivations	446
Risks in CDO investment – structure and collateral risks	448
Correlation risk	448
Interest rate and basis mismatch	448
Cross currency risk	449
Liquidity risk	449
Ramp up risks	449
Reinvestment risks during the revolving period	449
Lack of granularity	450
Asset risks	450
Taxation of CDOs	450
Legal issues specific to CDOs	451
Bankruptcy remoteness	451
True sale opinion	451
Transfer of loans and perfection	451
Right of set off	452
Lender liability	453
CDOs and index trading	453
Current problems facing the CDO sector	453
Increasing downgrades and defaults	453
Accounting worries	455
De-leveraging	455

xviii Securitization

Rating agencies approaches to CDOs	455
S&P's CDO Evaluator	456
Moody's CDO ROM model	458
Fitch VECTOR model	458
Notes	459
18. Asset-backed commercial paper	461
Genesis of asset-backed commercial paper	461
The ABCP market	462
Types of ABCP conduits	464
What is a conduit?	464
Types of conduits	464
Traditional securitization and ABCP	466
ABCP collateral	466
Credit enhancement structure	466
Pool level and program level enhancement	467
De-leverage triggers	468
Liquidity support	469
Parties to an ABCP program	469
Program sponsor	469
Administrative agent	470
Manager	470
Placement agent	471
Issuing and paying agent	471
Rating of ABCP Conduits	471
Rating of the management	471
Credit quality of assets	471
Receivables eligibility criteria	472
Case study: Spinnaker Capital ABCP Program	472
Notes	473
19. Future flows securitization	475
What future flows are securitizable?	475
Some key features of future flows deals	476
Why future flow securitization?	477
Types of future flow deals	478
Domestic and cross-border future flows	478
Structural features	479
Subordination structures generally do not work	480
Over-collateralization and cash reserve	480
Early amortization triggers	480
Reps and warranties of the seller	481
Third-party guarantees a common feature	481
Existing asset, future income: a case of toll revenues securitization	481
Servicing risks in future flows	482
The future flows market	482

Table of Contents **xix**

Legal taxation and accounting issues	482
Experience with future flows	483
Notes	484
20. Whole business and operating revenues securitization	485
Market development	486
Methodology	487
Secured loan structure	487
Bankruptcy protection	487
Structural and Credit enhancements	489
Cashflow waterfall	490
The legal basis	491
Administrative receivership	491
Law of receivership	491
Fixed and floating charges	492
U.K. Insolvency law amendment and whole business transactions	493
Is a secured loan structure as safe as true sales?	494
Businesses where whole business securitization is possible	494
Why SPV in a whole business structure	496
Case study: South East Water (Finance) Ltd	496
Notes	500
21. Other miscellaneous asset classes	501
Securitization of intellectual property	501
Music royalties	502
Film financing	503
Drug royalties securitization	504
Others	505
Securitization of non-performing loans	505
The massive problem of bad loans	506
Resolution Trust Corp	507
Models in other countries	507
Kamco's Korean NPL securitization	508
European NPL securitizations	510
How does it actually happen?	510
Government receivables	511
Why securitization of government assets?	511
Deficit financing and securitization	511
European government revenues securitizations	512
Eurostat ruling	512
Italian securitizations	514
U.S. tobacco settlement receivables	515
Hong Kong toll revenues securitization	516
Financial future flows	516
Bank requirements for remittance securitization	516
Technological change and the remittance business	517

xx **Securitization**

Inventory securitization	517
Case study: Rosy Blue diamond inventory securitization	517
Potential products for inventory securitization	518
Insurance securitization	519
Motivations for insurance securitization	520
Transaction structure	520
Case study: Box Hill Life Finance	521
Notes	522

22. Synthetic securitization and other risk transfer devices **524**

Cash vs. synthetic securitization	524
Modus operandi	526
Structured credit risk transfer	526
Leveraged risk transfer	528
Advantages of synthetic securitization over cash transfers	530
Inefficiencies of a synthetic securitization	536
Distinction between cash-funded and synthetic securitization	537
Balance sheet and arbitrage synthetic securitization	538
Elements of balance sheet synthetic securitization	538
Originator	538
Obligor portfolio	539
Type of credit derivative	539
Credit events and loss computation	539
Special purpose vehicle	540
Assets of the SPV	541
Liabilities of the SPV	542
Non-SPV structures	542
Sizing of the credit enhancement	543
Swap calculation agent	544
Trustees	545
Super senior swap provider	545
Other swap counterparties	545
Arbitrage synthetic CDOs	546
Difference between arbitrage synthetic CDOs and balance sheet synthetic CDOs	547
Collateral manager	549
OC and IC triggers for synthetic CDOs	549
Application of OC and IC triggers to synthetic CDOs	549
Paydown structure	550
Sequential paydown	550
Pro-rata paydown	551
Fast-pay slow-pay structure	551
Evolution and growth of synthetic securitization	551
Synthetic RMBS	554
Synthetic CMBS	557

Table of Contents **xxi**

Synthetic retail assets	558
Hybrid securitizations	559
Investing in synthetic CDOs	559
Insurance risk securitization and other methods of alternative risk transfer	561
Alternative risk transfer	561
Insurance securitization	561
The cat bonds market	562
Illustration of the cat bonds technology	565
Equity call option	565
Insurance securitization by non-insurance companies	565
Notes	566

Part IV Technical and Operational Aspects 569**23. Legal issues in securitization 571**

The significance of legal issues in securitization	572
Why are securitization legal issues complicated?	572
Securitization: The big picture	573
Principal legal structures	574
What are the main legal issues?	575
Securitization and loan obligations	576
True sale or a mere tale	577
The true sale question	578
Background of the true sale question	578
The question of substantive transfer or financing arrangement	579
Case law on true sale	580
U.S. cases	581
U.K. cases	586
Canadian ruling in BC Tel's case	588
Safe harbor law	590
Safe harbor law in some states	591
International safe harbor law	592
The factors that make or mar a true sale	592
The role of language used by the parties	593
Recourse	593
Residual interest	595
Servicing by the seller	595
Uncertain sale consideration	596
Factors in determination of a sale	596
Requirements of valid transfer of receivables	596
Methods of transferring receivables	603
Legal systems and assignment of receivables	604
English common law	604
Roman-Dutch law or civil law	605

xxii Securitization

Procedure for assignment of actionable claims	606
Meaning of debt or actionable claims	607
Equitable assignment	610
What is equitable assignment?	610
Why equitable assignment	611
Problems with equitable assignment	612
Stamp duty on securitization: general	613
FAQs on stamp duty on securitization	613
Avoiding stamp duty by shifting jurisdiction	616
Situation of "receivables"	616
Position for multi-state properties	617
Stamp duties on transfer of Securities of the SPV	617
Stamp duty on securitization transactions: Indian case	618
Reduction of stamp duty by Maharashtra	619
Other states follow	619
Lessons from India	619
Stamp duty relaxations in other countries	621
Malaysia	621
Australia	622
Other countries	623
Secured loan structures	623
Fixed and floating charges	626
Secured loan structures vs. true sale structures	628
Legal issues in synthetic structures	628
Bankruptcy remote securitization	630
Structuring the SPV	633
Why an SPV?	633
Legal considerations	633
Organizational forms of SPVs	634
Corporations	634
Trusts	634
LLCs	635
Special forms	635
Bankruptcy remoteness of SPVs	636
Conditions for bankruptcy-remoteness	636
Limitations in constitutional documents	639
Ownership structure of the SPV	640
Multi-use SPVs	640
Consolidation of the SPV	641
Legal rights of the investor:	
legal nature of the investor's right	643
Legal nature of a future flow securitization	646
Assignability of future flows	647
Structuring future flows	648
Legal issues in arbitrage transactions	649
Ideal legal framework for securitization	650
Uncitral initiative for uniform law on assignment of receivables	651

Provisions of the laws of Australian States on assignment of debts	670
Notes	670
24. Legal documentation for securitization	673
Basic structure of documentation	673
The pooling and servicing agreement	674
Identification of asset to be assigned	674
Conveyance clause	677
Consideration for the transfer	679
Conditions precedent	680
Representations and warranties of the Seller	680
Continuing covenants of the seller	692
Clean-up call	695
Servicing covenants	695
Appointment, termination	696
Servicing standard and basic servicing functions	696
Consideration for servicing: Servicing fee	698
Mode of collections and servicer advances	699
Reporting requirements	701
Termination of servicer	701
The Trust Deed	703
Acceptance of trust	703
Definition of trust property	703
Issuance of certificates	704
Distribution of cashflow	704
Duties of the Trustee	705
Draft of the Investor Certificate	707
Notes	709
25. Operational issues in securitization	711
Significance of operational risks	711
Types of servicers	711
Servicer strengths	713
Staff strengths	713
Organizational structure	713
Training	714
Staff Turnover	714
Systems	714
Internal controls	715
Loan/asset administration	715
Servicer qualities	716
Consumer finance	716
Commercial finance servicers	717
Franchise loan servicers	717
Commercial Mortgage-Backed Finance Servicers	718

xxiv Securitization

Residential mortgage servicers	721
Servicing transition	725
Backup servicer	726
Reporting by the servicer	726
Role of trustees in operation of the transaction	726
Fraud risk	727
Notes	728
26. Tax issues in securitization	729
Concept of tax neutrality or tax transparency	730
When is securitization tax neutral?	731
Threats to tax neutrality	732
Substance of the transaction: sale or financing	732
Sale treatment/financing treatment	733
Situations in which financing treatment is applicable	734
Transfer of income, no transfer of asset	738
Tax treatment in the Originators' hands	739
Originator taxation where tax laws are not clear	740
Tax treatment of the Special Purpose vehicle (SPV)	742
Three alternative ways of taxing the SPV	742
Distinction between debt and equity: The crux of entity-level taxation	745
U.S. taxation rules for securitization	747
Grantor trusts	747
Owner trusts	749
REMIC rules	749
FASIT rules	750
Other entities	751
Thin capitalization rules and spv taxation	751
Taxation of SPVs where no specific provisions exist: India	752
Non-discretionary trust treatment	752
Representative capacity	753
Entity level tax	754
Deductibility of expenses by the spv	755
Tax treatment in the hands of the investors	756
Withholding taxes	757
An Indian ruling on the matter	758
Exemption from withholding tax	759
Notes	760
27. Accounting for securitization	761
Securitization accounting in flux	762
The Basic Accounting rule: Substance over form	763
Accounting for sale, or accounting for securitization?	764
Sale of financial assets versus sale of non-financial assets	764
Development of accounting principles on securitization	765

Table of Contents **xxv**

Sale treatment vs. loan treatment	766
Impact of sale vs. loan treatment	767
The basic philosophy: From retention of risk to a predominant characteristic	768
Unspinning the yarn: The components approach	769
Continuing involvement approach – the JWG version	770
Pre-conditions for sale treatment: A wrap-up of various accounting standards	772
The legal vs. substantive transfer:	
Applicability in “form” countries	775
Pre-conditions for sale accounting:	
A synthetic approach:	776
Legal/legally enforceable transfer of identifiable receivables	776
Legal transfer vs. revocable transfers or asset lending transactions:	778
Surrender of control	778
Arms-length transaction at fair values	783
Qualifying SPV14	783
Demonstrably distinct legal entity	784
Limits on permitted activities	784
What assets may be held by the SPE	784
When can QSPEs sell assets?	787
What if the SPE is not a QSPE?	788
More restrictions on QSPEs	788
Sale treatment – balance sheet and revenue impact	790
Dissecting the asset into components	791
Valuing the components	792
Example of component valuation	795
Allocation of the carrying value to components	797
Valuing the assets/liabilities created in securitization	799
Computation of gain or loss	800
What happens to the servicing asset?	802
What happens to the recourse liability?	804
Retained interest valuation in a real life case	805
Gain on sale accounting: Guesswork?	806
IAS 39 Revised and Securitization	807
1. De-recognition of fractional assets only under specific conditions	807
2. True sale is not a precondition	809
3. Risk and rewards given a new thrust	811
4. Hierarchy of conditions for de-recognition	812
5. The continuing involvement approach	814
6. Dealing with the servicing asset	815
7. Booking of gain on sale under continuing involvement approach	815
8. Examples of the continuing involvement approach	815
Financing treatment and linked treatment	817
Comparative view of sale and financing treatment	818
Disclosures by the originator	820
Accounting for the SPV	822

xxvi Securitization

Consolidation of spv accounts with the originator	823
SIC 12 on consolidation	823
Consolidation of variable interest entities under U.S. gaps	824
What is a variable interest entity?	825
What is a variable interest?	827
Consolidation based on variable interests	827
Exception for QSPEs	828
Impact of FIN 46 on structured finance	828
Attaining sale treatment for accounts and loan treatment for taxes	829
Accounting for revolving asset securitizations	829
Accounting for future flow securitization	830
Investor accounting	830
EITF 99-20	831
Other securitization accounting standards	833
Servicing rights and QSPE amendments	834
FAS 156 on servicing assets/liabilities	834
Amendments regarding QSPEs	837
Notes	850
28. Regulation AB: Securities regulation on asset-backed securities	854
Overview of SEC regulatory regime	854
Scope of Regulation AB	855
What is not covered in "ABS"	856
What if it is not covered by Regulation AB	856
Contents of the Prospectus	857
Servicers' reports	872
Notes	876
29. Regulatory and economic capital in securitization	877
The regulator's concerns	877
Background of regulatory concerns	878
GAAP accounting and RAP accounting	879
Legal transfer and regulatory issues	879
Risks and responsibilities in securitization	879
Overview of Basle-ii norms	882
Credit risk, market risk and operational risk	883
Three approaches to risk assessment	884
Basic approach to securitization	885
Pre-requisites for regulatory relief	886
Significance of Risk Transfer	886
Isolation and surrender of control	887
No Economic Recourse	887
Transferee to be SPE	888
Clean-up calls	889
Hands off approach	889

Table of Contents **xxvii**

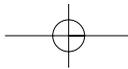
Generic principles for securitization	889
Capital rules under standardized approach	891
Capital rule for liquidity facilities	892
Capital rule for servicer advances	893
Capital rule for revolving securitizations	893
Internal ratings-based approach	896
Understanding the inputs: KIRB, L and T computation	897
Three situations under the IRB approach	898
U.S. regulatory requirements: Historical	905
Regulators talk risk	905
Risk-based Capital rules	907
November 2001 rules	908
Basle IA	913
FSA U.K.'s guidelines for capital relief	915
General	915
The "clean break" policy	915
Role of banks in securitization	916
Methods of transfer	916
Conditions for primary role	917
Capital treatment	920
Conditions for liquidity facility	921
Consultation paper on revised capital rules	922
EU Capital directive	922
Regulatory requirements in other countries	923
Securitization and economic capital	923
Meaning of economic capital	923
Expected and unexpected losses	924
How is economic capital computed	925
Regulatory arbitrage	926
Notes	927

Part V **929****30. Investing in securitization instruments** **931**

Distinguishing between securitization instruments and other fixed income investments	931
Irregular cashflows	931
Derived cashflows	932
Average maturity as a mark of duration	932
Callability and extension risk	932
Investors' concerns in securitization investments	932
Price discovery	932
Credit risk	933
Counterparty risk	935
Transaction legal risk	935

xxviii Securitization

Tax risk	936
Cashflow risk	936
Reinvestment risk/basis risk	936
Flow of information	936
Fraud	937
Performance of securitization investments	937
Performance of RMBS transactions	937
Performance of CMBS transactions	939
Performance of credit card ABS	942
Performance of other ABS classes	942
Default experience in structured finance instruments:	
What rating transitions do not reveal	946
Evaluation of an ABS Investment	946
Collateral evaluation	946
Credit enhancement	947
Cashflow mechanics	948
Legal structure	948
Links with the seller	948
Notes	948



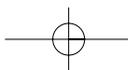
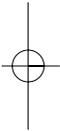
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Preface

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.

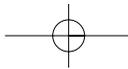
Securitization is a preferred form of funding – the preferential treatment owes itself to several of the oft-cited benefits, such as bankruptcy remoteness, off-balance sheet treatment and extended leverage. Most of these are derived from the technical nature of the instrument. The history of the development 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 *Securitisiation: 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
May 22, 2006

VINOD KOTHARI



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.

xxxii Securitization

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