

Preface

This book deals with a package of 4 subjects – securitisation, credit derivatives, operating lease, and real estate investment trusts, all bundled together under the title – structured finance. All the 4 financial instruments involve elements of structuring a financial product, and therefore, have elements of commonality.

Securitisation and structured finance are quite often used as interchangeable expressions, though, properly speaking, securitisation is a product that uses structured finance principles. Securitisation was into the thick of controversy in the aftermath of the 2007-8 financial crisis, and regulators world-over were busy examining what was wrong with the securitisation markets that made the financial world go into a tizzy. Obvious enough, the problem lay in the overheated state of the market, and the tremendous extent of leverage prevalent at the given point of time, rather than in the economic argument underlying structured finance. The default rates in home loans shooting up to unanticipated levels in 2007-8 period was the risk of an “unknown unknown”, and no one, including the rating agencies, had factored such a risk. Obvious enough, several of the AAA-rated securitisation tranches fell by the wayside, causing a complete withdrawal of confidence in the market.

While market sentiment is still not restored even as yet, regulators are trying to see what can be done to revive the market. The BCBS-IOSCO Task Force¹ is an example of regulatory efforts to get into the problems currently holding back the revival of securitisation markets.

The growth of credit derivatives has been strongly correlated to that of securitisation. The use of credit derivatives into securitisation led to the creation of synthetic CDOs, and later, index trading, which was clearly the hottest of the products in the structured finance space just before the markets broke down. Lot of people say that the sort of bespoke CDOs being creating and being lapped up by the market around that time had given enough indications that the markets were going overboard. Credit derivatives activity has not picked up as yet – BIS data till end-December 2013 shows a consistent decline both in single-name products as well as portfolio and index transactions².

The use of operating leasing as a structured product is not new – lease transactions have been around over several decades now. As in case of several financial instruments, leasing is a product of accounting standards. As the scope for off-balance sheet instruments has generally been narrowed down by standard-setters, operating leases as a time-tested off-balance-sheet instrument has recently gained attention. This is even as global standard-setters are reviewing lease accounting standards to eliminate the present distinction between financial and operating leases, and treat all leases like, with a right-to-use asset and obligation-to-pay liability. Yet, operating leases are not merely all about accounting cosmetics – the age of technology has created enormous possibilities of shared use of a variety of assets, and hence, asset or capacity sharing contracts are going to increase tremendously in time to come. So also, residual-value based contracts will continue to attract more interest.

The book also discusses real estate investment trusts as a device of funding commercial properties. While REITs started as a tax transparency vehicle in the USA in 1960s, lots of

¹ <http://www.iosco.org/news/pdf/IOSCONEWS337.pdf>

² <http://www.bis.org/statistics/dt1920a.pdf>

countries have recently enabled REITs to act as a tax transparent collective investment device to provide ownership capital to income-earning commercial real estate. REITs combine very well with commercial mortgage backed securities – a product discussed in the first part of the book.

The package of 4 products discussed at one place provides the reader with ability to gain insights into some of the hottest financial instruments of our time.

The emergence of this book within a very short span of time has been possible only due to enormous energy and dedication of my colleagues, in particular, Nidhi Bothra and Abhirup Ghosh. I am indebted to both of them.

As always, readers' feedback is an author's delight. Hence, I will be obliged if readers were to write a mail giving their constructive feedback.

Kolkata
29th September 2014

Vinod Kothari

About the author



Vinod Kothari, a Chartered Accountant and Company Secretary, is an internationally recognised author, trainer and consultant on specialised financial subjects, viz., securitisation, leasing, credit-derivatives, housing finance, accounting for financial instruments, banking regulations etc.

Vinod Kothari's *magnum opus*, Lease Financing and Hire Purchase, was first written at the young age of 23, and is still considered to be one of the most authentic sources of information on the subject. The book has been cited with approval by the judiciary in India.

In addition, Vinod Kothari has expertise in diverse field of knowledge. Some of his works on other subjects pertain to securitisation, housing finance, credit derivatives, and the SARFAESI Act. He is one of the editors of Ramaiya's Company Law, the most authentic text on company law in India. Besides, Vinod Kothari is also the co-author of a book with Frank Fabozzi, and has written chapters for Fabozzi's books, "*The Handbook of Finance*" and "*The Handbook of Fixed Income Securities*".

Besides a prominent author, Vinod Kothari is a trainer of international repute who has been conducting workshops all over the world, and for diverse groups such as the world's largest mortgage securitisation company in Washington, a group of quants in New York, investment arm of the European Union in Luxembourg, top law firm in India, tax officers in South Africa, leading rating agency in Malaysia, and investors in Australia. So far, more than 500 workshops have been conducted, some of them ranging 6 days at a stretch.

He is the author of the following books:

- Guide to Independent Directors, co-authored by Sikha Bansal, a Taxmann publication, 2014 Edition
- Understanding Companies Act, 2013 Edition
- Taxation of Lease Transactions in India, co-authored by Sikha Bansal, 2013 Edition
- Securitisation, Asset Reconstruction and Enforcement of Security Interests, Fourth Edition, a LexisNexis publication
- Guide to Housing Finance, 2013 Edition
- Author of Highlights and quick referencer and tables in "Corporate Laws" second edition, published by Lexis Nexis.
- Credit Derivatives and Structured Credit Trading, Wiley, 2009 edition
- Introduction to Securitisation by Frank J. Fabozzi and Vinod Kothari, Wiley, July 2008
- Securitisation: The Financial Instrument of the Future, Wiley, Fifth edition 2006
- Lease Financing and Hire purchase, Fourth edition, 1996
- Author of 3 Chapters in Handbook of Finance, (editor Frank Fabozzi), published by Wiley, USA
- Reviewing editor of seventeenth edition of A Ramiya's Company Law, a book running over 12000 pages

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