Debt Securitization:

Meaning of Debt Securitization*:*

It is the process of converting mortgage loans together with future receivables into negotiable securities or assignable debt is called ‘securitization’. The Securitization process involves packaging designated pool of mortgages and receivables and selling these packages to the various investors in the form of securities which are collateralized by the underlying assets and their associated income streams.

Securitization is an off-balance sheet financing technique with the objective of mobilizing resources at a comparatively lower cost through a wider investor base, by removing loan assets from the balance sheet of the loan originator.

Securitization actually involves conversion of mortgages into securities which are tradable debt instruments. The securities, which are backed by the mortgages, are then freely traded in the market thereby giving rise to a secondary market. In this process, saver’s surpluses are channelized to meet borrower’s deficits. This also facilitates interregional and inter-sectorial flow of funds.

Debt Securitization Process:

The steps involved in Securitization process are the following:

(a) A company that wants to mobilize finance through securitization begins by identifying assets that can be used to raise funds.

(b) These assets typically represent rights to payment at future dates and are usually referred to as ‘receivables’.

(c) The company that owns the receivables is usually called the ‘originator’.

(d) The originator identifies the assets out of its portfolio for Securitization.

(e) The identification of assets will have to be done in a manner so that an optimum mix of homogeneous assets having almost same maturity forms the portfolio.

(f) Assets originated through trade receivables, lease rentals, housing loans, automobile loans, etc. according to their maturity pattern and interest rate risk are formed into a pool.

(g) The aforementioned identified and pooled assets are then transferred to a newly formed another institution called a ‘special purpose vehicle’ usually by way of a trust.

(h) Such trust usually, an investment banker, issues the securities to an investor.

(i) Once the assets are transferred, they are no longer held in the originator’s portfolio.

(j) After acquisition of the assets from originator, the SPV splits the pool into individual shares or securities and reimburse itself by selling these to investors.

(k) The securities, so issued, are known as ‘pay or pass through certificates’.

(l) The securities are normally without recourse to the originator, thus investor can hold only SPV for the principal repayment and interest recovery.

(m) In order to make the issue attractive, the SPV enters into credit enhancement procedures either by obtaining an insurance policy to cover the credit losses or by arranging a credit facility from a third party lender to cover the delayed payments.

(n) To increase marketability of the securitized assets in the form of securities, these may be rated by some reputed credit rating agencies.

(o) Credit rating increases the trading potentials of the certificate, thus its liquidity is enhanced.

(p) A merchant banker or syndicate of merchant bankers will be appointed for underwriting the whole issue.

(q) The securities have to be sold to the investors either by a public issue or by private placement.

(r) The pass through certificates before maturity are tradable in a secondary market to ensure liquidity for the investors.

(s) Once the end investor gets hold of these instruments created out of Securitization, he is to hold it for a specific maturity period which is well defined with all other related terms and conditions.

(t) On maturity, at the end, investors get redemption amount from the issuer along with interest due on the amount.