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Securitization Outline

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enhancement
by risk distribution
by reallocation by equity

Securitization

I. Introduction: a definition; securitization is a new financing arrangement or institution that is changing traditional financial institutions. not a definition

II. The evolution and explanation of the existence of securitization.

commercial paper

A. Government guarantees: Ginnie Maes, Freddie Macs, and Fannie Maes.Securitization starts in the public sector.

1. Rationale behind the advent of these programs.

a. pressure from Savings and Loans

b. economic conditions

c. provide more funds for mortgages(give people what they prefer-- fixed rate mortgages.

2. Transitional Gains Gap

3. Did Government create the market or just innovate faster than the private market due to cost conditions, economies of scale or some efficiency.

B. Private sector issues of securities backed by pools of single family mortgages (passthroughs, paythroughs and mortgage backed bonds)

1. Why did it take so long before the private sector started securitizing all on its own (more than 10 years)

Separate Room #.

Technology:
a) Communication
b) computation
c) information processing retrieval

technology allows for substitution away from intermediaries

a. needed an established market.

b. needed the appropriate technology

c. the impact of regulations and regulatory changed.

d. the connections of globalization

2. Prepayment risk and developement of CMOs.

C. New assets being securitized (in chronological order)

D. Penn Square as a prototype for business lending

1. car loans

2. receivables

3. leases

4. credit card accounts

5. commercial mortgages

III. Securitization has changed the number of players and methods involved in financial transactions.

A. Mortgages

function in financing

Basic
a) paper creation
b) enhancement
c) funding

all in the intermediary

1. The change from 3 players involved (lender, financial intermediary who issues mortgage and mortgage holder) to 7 players involved (the original three plus the investment banker or underwriter, the trustee, the guarantor, and the ultimate investor.)

not necessary

a. What are the implications of this?

with respect to what

2 securitization

multiple pieces of paper

a) paper creation

complex of liabilities

b) underwriting
c) trustee
d) insurance (mortgage)

synthetic
e) [illegible]

f) secondary market makers

up to 5 or 6 different sets of institutions in market forward

b. Mortgage holder probably won't know the difference.

B. Businesses have option to bypass traditional funding sources and deal directly with the securities market.

Company or costs that collects paper for # companies

1. If receivables have better credit rating than company, then company has possibility to obtain funds at a lower cost through bundling their receivables and selling them as securities.

a. securitization opens up additional funding avenues; it also can lessen entry barriers. explain

Must (GMAC or Heller) x buying the services of the securitizer rather than a company with receivables

b. if securitization is used will there be any impact on the company's stock prices; is the company more subject to failure.

2. Builders and Real Estate Developers

a. more homes are built within the guidelines that satisfy FHA regulations so the mortgages can be used for Ginnie Maes and Freddie Macs.

need to distinguish the builder as individual selling "Mortgage Bonds" from true securitization "basket" asset

b. new funding sources are open: can securitize leases from office building to finance construction or refinance existing office buildings and then securitize the mortgages.

IV. Why does securitization exist? In other words why is it desirable?

Coase exists therefore it is desirable? Come on expert! This good!!

A. In Coase's zero transaction cost world, securitization would have no purpose because those who value mortgages most would issue them; however in the real world those who specialize in mortgages, S & L's, have short term liabilities and long term assets (a

What language is this

mismatching problem). Institutional investors who need long term assets would value having the mortgages on their portfolio. Securitization allows those who value the assets the most to own them even if they lack the resources to originate them.

really: p26

V. Lack of Regulations;the existence of trouble spots

A. Since securitization involves so many different types of financial institutions, there is not on regulatory body over the whole process.

Entrepreneurs lie. Bankers lie. Customers lie

B. Possible and inherent dangers. Stealing

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1. Epic : an example of securitization gone awry.

VI. The impact on financial institutions; What we can expect to see in the future.

A. Likely regulatory changes could encourage securitization and thus further the specialization of financial institutions.

1. increasing the capital requirements to 7%

2. FSLIC is in big trouble so possible merging with FDIC, then all commercial banks would also share in the costs of supporting the S & L's.

costs: costs of doing business through traditional channels > through new channel

exposure to losses > through new channels than existing.

Risk adjusted valuation