Module 4 · Securitization P14 · 4.1–4.4

SM pp. 147–155 (exercise 156–162). **4–6 marks every paper** (expected 5.6): **Q8(c) a 4-mark list in all 6 papers** + **MCQ (iv)** (D25, J26). Four SM lists cover every question; two have already repeated (parties D23 = J26; SPV securities J24 = D25). **Not yet repeated: limitations** (D24 only) and reasons / benefits (J25). No sums.

Paper	Q8(c) / long	MCQ
Jun'23	Q2(b) features of securitisation (6)	–
Dec'23 · Jun'26	**participants / parties** (also MQP Q8(c))	J26: role of the SPV · MQP: who is not a party
Jun'24 · Dec'25	**securities issued by the SPV**	J24: a debt-market instrument · D25: issued by a subsidiary = preferred stock certificates
Dec'24	**limitations**	–
Jun'25	why financial institutions securitise (benefits)	PTP: multiple-maturity certificate = pay-through

4.1 · MEANING AND BENEFITS (J23, J25)

Securitization: certain assets are pooled and repackaged into interest-bearing securities; the interest and principal from the assets pass to the purchasers of the securities. Illiquid assets → securities backed by them. [SM 147]

Why banks securitise: **(a) funding** — support rapid asset growth, diversify the funding mix and reduce its cost, reduce maturity mismatches; **(b) balance-sheet capital management** — regulatory and economic capital relief; **(c) risk management and credit-risk transfer** — assets sold to the SPV. **For investors**: diversification into sectors not in the regular bond market; different (sometimes superior) risk-reward; access to otherwise closed sectors. [SM 148–149]

4.2 · PARTICIPANTS (D23, J26, MQP)

a. **Originator** — creates / owns the receivables (e.g. a bank).
b. **Arranger** — designs and sets up the structure.
c. **Special purpose vehicle** — buys the assets for off-balance-sheet treatment; issues the securities.
d. **Investors** — institutions, insurers, pension and hedge funds, companies, HNIs.
e. **Servicers** — collect the receivables as SPV's agent for a fee.
f. **Rating agencies** — rate the SPV's capacity to pay.
g. **Enhancement providers** — credit enhancement for liquidity, marketability, safety.
h. **Regulators** — accounting, capital adequacy, SPV structure.

[SM 150]

4.3 · LIMITATIONS (D24 — DUE)

a. **Costly** in practice, especially in emerging markets.
b. **High initial cost** of the SPV → a minimum economic size.
c. **Asset-liability mismatch** passes to investors (pass-through repayment pattern).
d. **High disclosure** to regulators, servicers, trustees, rating agencies.
e. Only **better-quality receivables** can be securitised.
f. **No flexibility to restructure** debts — trustees have no discretion.
g. **Upfront booking of profits**, including estimated future profits.

[SM 153]

Mechanism (12 steps, short form): originator selects receivables → SPV formed → SPV acquires them → SPV issues securities (Class A, B, C = senior, mezzanine, junior) → servicer appointed (normally the originator) → obligors notified if required → servicer collects (escrow) and pays the SPV → SPV pays investors → defaults: losses in reverse order of seniority → clean-up by buy-back → originator's residual profit. [SM 152–153]

4.4 · SECURITIES ISSUED BY THE SPV (J24, D25)

a. **Pass-through certificates** — investors paid as and when the assets pay.
b. **Pay-through certificates** — multiple maturities; SPV reinvests to bridge gaps.
c. **Preferred stock certificates** — issued by a subsidiary against the parent's trade debts and consumer receivables.
d. **Asset-backed commercial paper** — SPV buys mortgage portfolios from several lenders.
e. **Interest-only certificates** and **principal-only certificates** (speculative).

Also ABS, MBS, CDOs (CBO, CLO, CRE CDO). [SM 154–155]

Practise these: Q8(c) D23, J24, D24, J25, D25, J26 · J23 Q2(b) · MQP Q8(c), Q1(iv) · PTP MCQ · MCQs J24 Q1(xiii), D25 Q1(iv), J26 Q1(iv) · SM exercise (SM 156–162) · ICMAI Practice Workbook: no problem on this module.