CORPORATE FINANCE

Getting your first securitization deal right: when to do what?

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Contents

Securitization objectives

- Differentiate funding sources
- Increase funding capabilities (volume)
- Attract long term funding
- Reduce funding costs
- Decrease credit risk on asset portfolio
- Matched funding: reduce liquidity risk
- Reduce capital requirements

The Decision Process

1) Identify company funding strategy
   - Securitization?

2) Working group
   - Identify assets
   - Check availability of data and IT requirements
   - Report back to the board: yes we found a suitable portfolio

…

3) Start securitization process
   - Six – nine months before funding needed
   - invite bank who will run the process

4) Closing dinner: Was the transaction successful?
   - Yes, all bonds sold, good spreads
   - Yes, not all bonds sold, but given the current market, very good
   - Delay, no dinner

The early stages: there is the money! data

Dry run of your securitization transaction

Why?

- More and better data means <u>cheaper</u> funding
- Transaction process will become more predictable
  - Timing
  - Placement: highest rated notes classes easiest to sell, especially in the current environment
  - More assets available for securitization (less ineligible assets)

How?

- Data check of pool tape
- Collection of historic performance information
  - Start collect the data <u>exactly</u> required by the rating agencies
    - vintage analysis
    - Split between default, loss, recovery, cure rate
    - Delinquencies (30 days, 60 days, 90 days)
    - Rating migrations

Structural elements

Step 1: Propose structure

- Parties to the transaction (Swap counterparty, liquidity provider, GIC provider, back-up servicer etc)
- Credit enhancement (internal and external)
- Notes' details (currency, interest rate, amortising or revolving notes etc)

Step 2: Check structure

- Legal issues: limited recourse, set-off and commingling risks etc
- Tax issues: withholding tax
- IT and data requirements:
  - Flagging

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What is a securitization financial model?

Input

Revenues

Current and expected portfolio characteristics and its growth projections

Securitization costs

Upfront costs (lead manager, rating agencies, advisors etc)

Running costs (rating agencies, servicer, back-up servicer, liquidity facility etc)

Interest rates on bonds

Risk based capital

Output

Return on Equity

Cost of funding

Structuring

Credit enhancement mechanisms

Waterfall structure

Risks hedging

Cost of swaps

RFP

RFP indicative structure	
Part	**Info to be included/ requested**
Purpose of request	– Scope of services and timing – Request to lead manager for: • Requirements for the transaction structure • Detailed breakdown of indicative costs • Road show, marketing strategy • Credentials and team
Originator	– Objectives and constraints – Portfolio details and forecast of growth – Lending criteria – IT systems description

Life after securitization

IT systems

- Data in accordance with rating agencies requirements?
- Flagging?
- How flagging influences other IT systems?

Servicing

- Does it differ from normal servicing?
- Post closing reporting?
- Developed procedures in place?

Are you prepared?

Human resources

- Is there available human resources for post closing support?
- Are you ready to manage interest rate risk?

Data… data… data

- Data available at early request?
- Arrears and default/ loss figures?

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Financial model: http://www.kpmg.ru/index.thtml/ru/services/advisory/fas/corporate/financing/secur/index.html