**Quadrant II - Notes**

**Paper Code: COD128**

**Module Name: Securitisation-meaning, features, mechanism and types**

**Module No: 18**

The meaning of Securitization refers to conversion of illiquid assets into liquid assets.

Features of securitization

Marketability: instruments are structured in such a way that it is marketable.

Merchantable Quality: securitized products have saleable quality.

Wide Distribution: large number of audiences can subscribe to the instruments.

Commoditization: securitized instruments are trable as commodity.

Mechanism of securitization

In first stage, Bank pools the collateral kept by the borrower. It consists of mortgage or payment receivable. Banks are known as originator.

In second stage, originator will transfer the assets to special purpose vehicle. This are merchant banks. They will create instrument for subscription. They issue the following securities:

1. Pass through certificates: payments are received from assets such as housing loans.
2. Pay through certificates: when the assets mature the respective certificates will be paid.
3. Interest only certificate: The interest will be paid as per the earnings from the assets securitised.
4. Principal only certificates: Only the principal amount will be paid on the certificates from the realization of assets.

This stage is known as issue stages of securitization. Payments received from various assets are used for redeeming various credit instruments issued. For example, the housing loan may be collected with principal and interest and from its collection, debt instruments such as certificate of deposits will be met.

In credit rating stage of Securitization, the financial institutions issuing these debt instruments will have to undergo credit rating which is statutorily mandated in certain countries.

Types of Securitisation

Asset-Backed Securities (ABS)

* The bonds which are supported by underlying financial assets.
* It includes credit card debts, student loans, home-equity loans, auto loans, etc.

Residential Mortgage-Backed Securities (MBS)

* These bonds comprise of various mortgages like of property, land, house, jewellery and other valuables.

Commercial Mortgage-Backed Securities (CMBS)

* The bonds that are formed by bundling different commercial assets mortgage such as office building, industrial land, plant, factory, etc.

Collateralized Debt Obligations (CDO)

* The CDOs are the bonds designed by re-bundling the personal debts, to be marketed in the secondary market for prospective investors.

Future Flow Securitization

* The company issues these instruments over its debt’s receivable in a future period.