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A Comparative Analysis Securitization in South-East Asia

Nishant Kumar
Assistant Professor,
Deptt.of Business Administration,
University of Lucknow,
Lucknow

Geeta Singh
Research Scholar,
Deptt.of Business Administration,
University of Lucknow,
Lucknow,

Abstract

Securitization as a financial process has had significant impact on the world's financial system over last two decades. By integrating capital markets and giving a fillip to the utilization of financial resources through the purposeful involvement of mortgage originators, finance companies, investors and government, it has strengthened the trend towards disintermediation.

This paper attempts to evaluate and compare the features and trends in the process of securitization as practiced in select economies of south-east Asia, India, Korea and Singapore. The objective of the paper is to explore in detail, the similarities or differences, as the case may be, about a number of dimensions involved. Particularly the dimensions of entities involved, consequences of interest rate framework, eligibility criteria for assets to be securitized, asset classification prevalent in the country , motives of investors for various securitized products , institutional and regulatory differences, Government intervention and its implications, credit enhancement mechanism, performance monitoring of securitized assets have been explored to analyze the differences across above mentioned countries.

Keywords: Securitization, Asset classification, Mortgage originators, Disintermediation.

Introduction

The process of Securitization has been gaining momentum lately in emerging economies of south-east Asia. Especially post the Asian Crises in a number of countries like Malaysia, Indonesia, Korea etc., this financial innovation has been received and adopted well by the financial institutions in these countries. Over last decade, market for securitized assets have developed from a primitive stage to experimenting with complex structured devised to mitigate various risks involved. Although the basic motives and the fundamental deal structures may be apparently the same across a number of countries in south east Asia, but a deeper understanding and analysis of the literature available concerning structured securities reveals that there are marked differences as regards to the institutions, regulations, legal provisions as well as taxation practices. This paper tries to explore some of the features and trends prevalent in the markets for securitized assets in India, Korea and Singapore. The following aspects in particular have been dealt with for the purpose of comparative analysis**:** stage of markets, asset classes, and nature of parties involved in such deals, forms of credit enhancements, motive of the investors as well as government intervention as regards to investor protection.

Stage of Markets in India, Korea and Singapore

In India, this process has evidenced considerable activity in the last six years, particularly in the area of asset backed securitization where car loans and personal loans have been securitized by a number of lending institutions (Kothari, 2006).The volume in the primary market of securitized instruments has increased from 36 Billion Indian Rupees (INR) to 260 Billion INR in the four years from 2002 to 2008 marking an increase by almost 725%(Iyer.C.K, Tripati.G.C, 2010).

These instruments are relatively new in India and market for them is still in a nascent stage. Government controlled public sector banks and other financial institutions have yet to participate and open up for securitization. So far in India, a few private banks – major among them ICICI Bank Ltd, Citibank, and HDFC Bank, and a number of NBFCs have been actively engaged in the process of securitization.

Some examples of securitization in the Indian context are:

1. First securitization deal in India between Citibank and GIC Mutual Fund in 1991 for Rs 160 mn

2. L&T raised Rs 4,090 mn through the securitization of future lease rentals to raise capital for its power plant in 1999.
3. India's first securitization of personal loan by Citibank in 1999 for Rs 2,841 mn.
4. India's first mortgage backed securities issue (MBS) of Rs 597 mn by NHB and HDFC in 2001.
5. Securitization of aircraft receivables by Jet Airways for Rs 16,000 mn in 2001 through offshore SPV.
6. India's first sales tax deferrals securitization by Govt of Maharashtra in 2001 for Rs 1,500 mn.
7. India's first deal in the power sector by Karnataka Electricity Board for receivables worth Rs 1,940 mn and placed them with HUDCO.
8. India's first Collateralized Debt Obligation (CDO) deal by ICICI bank in 2002
9. India's first floating rate securitization issuance by Citigroup of Rs 2,810 mn in 2003. The fixed rate auto loan receivables of Citibank and Citicorp Finance India included in the securitization
10. India's first securitization of sovereign lease receivables by Indian Railway Finance Corporation (IRFC) of Rs 1,960 mn in 2005. The receivables consist of lease amounts payable by the ministry of railways to IRFC
11. India's largest securitization deal by ICICI bank of Rs 19,299 mn in 2007. The underlying asset pool was auto loan receivables. (www.securitization.net.com)

The above deals reveal that the process of securitization in India has been quite slow and only select entities and institutions have dared to use these securities.

In Korea the stage of securitization is still nascent but improving with the help government authority which monitors the market and also provides credit enhancement facility to the originator's securities. The size of the primary mortgage is increasing since 1997. At the end of 2001 the outstanding mortgage loan stood at 13.4% of GDP that was 73 trillion Yuan (Korea Mortgage Corporation, lee.joong-hee, 2006) and newly originated mortgage loan reached 5.4% of GDP which accounts 30 trillion Yuan. This ratio is rapidly increasing. Thus, as a result, mortgage backed securitization – around 70 - 80 %, has been a dominant mode here.

The idea of property-backed debt securitization is not new in Singapore. In fact, the first mortgage-backed bond (S$18.5 million) was issued in 1986 by a private developer, Hong Leong Holdings Limited; they pledged a first legal mortgage on its office building. However, there was a six-year gap before the next mortgage-backed bond (S$51 million) was issued. In 1992 the Orchard Parade Holdings, a listed arm of the Far East Organization, one of the largest property developers in Singapore issued this bond. Nonetheless it was only from 1994 that the market for mortgage backed bonds actually started to become active. Over the last few years, there were at least seventeen issues of mortgage-backed bonds. Monetary authority of Singapore (MAS) supervises the entire process and provides required guidelines for the same.

Processof Securitization across Countries

Securitization is the process of pooling and repackaging of homogenous illiquid financial assets into marketable securities that can be sold to investors. Securitization has emerged as an important means of financing in recent times.A typical securitization transaction consists of the following steps:

1. Creation of a special purpose vehicle to hold the financial assets underlying the securities;
2. Sale of the financial assets by the originator or holder of the assets to the special purpose Vehicle, which will hold the assets and realize the assets;
3. Issuance of securities by the SPV, to investors, against the financial assets held by it.

This process leads to the financial asset being taken off the balance sheet of the originator, thereby relieving pressures of capital adequacy, and provides immediate liquidity to the originator.

In India the originator should have the flexibility of choosing an appropriate legal structure for the SPV, either in the form of a company, a trust, a mutual fund, a statutory corporation, a society or a firm. However, it seems that a mutual fund (as it is bankruptcy proof, has an independent corporate existence with limited liability and perpetual succession, it is tax neutral and is a closely regulated entity) as an entity is best suited to act as a SPV in securitization of assets. The R H Patil committee has also called for rationalization of stamp duty to make it uniform at 0.1 per cent for all securitization deals. It also recommended that this subject should be brought under the Indian Stamps Act 1889 from the State Stamps Act (Kothari, 2006).

In Singapore, recent liberalization in the rulings relating to investment by employee benefit funds and other regulated financial intermediaries has led to the boom in the real estate market and the mortgage loan market. There are various forms of transfer - mainly commercial mortgage-backed transactions (CMBS), credit cards deals (ABS) and CDOs. Pooling of commercial mortgages for securitization purposes is a relatively new innovation. Now local commercial banks are also heading for securitizing their loans to diversify their risk and also to remove the balance sheet burden and therefore also try to avail the tax benefit. Three types of securitization vehicles have been used by Singapore's property companies to divest real estate assets – commercial mortgage-backed bonds, real estate investment trusts and commercial real estate backed securitization. These securities are transferable and can diversify the portfolios through commercial mortgages and these commercial mortgages are secured by real estate like office buildings, shopping malls, multi-family apartments, hotels, warehouses and factories, or mix developments with hybrid property use types.

The healthy liquidity position, the low default risks of commercial mortgages and the reluctance of banks to sever the good relationships with their corporate mortgagors are factors that hold many banks back on the idea of selling their valuable commercial mortgages (Sing.Foo.Tien, ONG. Eng, Seo, NAS, 2004). Instead, the banks are more prepared to use the securitization technology to hedge the credit risks in the corporate loans, so as to reduce the risk-weighted assets for their capital adequacy ratio requirement. The support from government through setting up a SMI (Secondary mortgage institution) to facilitate issuance of CMBS and to provide credit enhancements will be a strong push for more CMBS activities in Singapore (Kah,Hwa,NG,NAS,2004).

The growth of CMBS in Singapore is intimately associated with the growth of Real Estate Investment Trust activity.

In Korea the transfer of asset or receivables by the originator to SPV is normally without recourse that is pay – through and pass- through certificates. Korea has various securitized assets floated under different regulations like ABS,RMBS, Credit Card receivables, CDO,CDO squared, CLO, ABCP and CMBS. In Mortgage bond, which is defined as the bond secured by a mortgage on a property, is backed by real estate or physical equipment that can be liquidated. Mortgage Related Securities (MRS) refers to the sum of mortgage-backed security (MBS) and its derivatives. Trend of the ABS market has steadily been evolving since its establishment under the financial corporate restructuring promotion plan initiated in 1998. The demand for Collateralized Bond Obligations (CBOs) and Collateralized Loan Obligations (CLOs) was high immediately after the enactment of the ABS Act for the purpose of disposing of the enormous burden of Non Performing Loans (NPLs) at banks from 1999 to 2001(Bank of Korea,Kookmin Bank). KRW 17.7 trillion in primary CBOs and CLOs were issued and KRW 23.4 trillion in NPLs were securitized. Credit card ABS was the predecessor of CBOs and CLOs and accounted for nearly half of the volume in the ABS market; in 2001 and 2002, credit card ABS accounted for 47% of the KRW 90.7 trillion in ABS issued. However, the sudden increase in ABS issuance has given rise to side effects such as deterioration in asset quality. Although the ABS market has contracted since 2002, new types of assets such as receivables of airfares, steel, oil, and internet service fees are slated to be securitized and simultaneously the RMBS market has experienced two major changes since its inception in 2000. First, the Korea Housing Finance Corporation (KHFC) was established in March 2004 and wholly owned by the Korean government. It was created through a merger s(KoMoCo), which completed nine MBS transactions totaling KRW 2,877 billion(Lee.Joong Hee nd Sohan.Lee,1998). Second, the first offshore securities backed by Korean residential mortgages were issued in December 2002, and three transactions followed in 2004. After introducing long-term fixed-rate mortgages with maturities up to 20 years, KHFC issued KRW 3 trillion RMBS in 2004.

Factoring companies such as New State Capital and Woori Capital failed to issue additional RMBS after 2002 because of fierce competition with commercial banks. In a low interest rate environment, they could not accumulate an adequate volume of underlying assets for securitization because of high funding costs to originate mortgages. For the offshore RMBS transactions, Samsung Life Insurance and Korea First Bank completed four deals to explore a new funding source.

The CMBS market in Korea has been growing. As the ABS market matures, institutional investors feel comfortable investing in real estate-backed products, and general contractors with low credit ratings, to whom traditional real estate lenders hesitate to originate commercial mortgages, take advantage of off-balance sheet financing. In 2004 the issuance volume of CMBS backed by cash flows from real estate development projects more than doubled, and 37 transactions (22 per cent of the 170 ABS deals in 2004) were completed(The Bank of Korea, April 2012).

Securitization in India largely adopts a trust structure with the underlying assets being transferred by way of sale to a trustee company(Kothari,2006). The SPV, formed as a Trustee Company, issues securities that are either Pass through Certificates or Pay through Certificates (PTC). The trustee is the legal owner of the underlying assets in both the scenarios. The investors holding Pass through Certificates are entitled to a beneficial interest in the underlying assets held by the trustee. Investors holding Pay through Certificates are entitled to a beneficial interest only in the cash flows attained from the underlying securities to the extent of the obligation agreed with the holders of primary and secondary tranches of PTC.

The RBI guidelines inhibit credit enhancement in direct assignments, thereby diminishing the attractiveness of the route, leading to a shift to the pass through certificate (PTC) route. Transactions through the PTC route have accounted for more than 85 per cent of the total issuances since the guidelines were issued, as against less than 20 per cent in 2011-12. Total market volumes from May to mid-October 2012 were stable, at Rs 3,400 crore (38 transactions), as against Rs 3,500 crore (38 transactions) for the corresponding period of the 2011-12(www.kothari.com/india).

Government Intervention and Regulation

In February 2006, Reserve Bank of India issued the guidelines to prohibit originators from booking up profits upfront at the time of Securitization, stipulated a higher capital charge on credit enhancements provided, and disallowed release of credit enhancement during the course of transaction. The securitization activities in the country slowed down with onset of these guidelines and the originators started to assign loan pools to investors rather than transferring it to an SPE or SPV, thus staying outside the securitization. These guidelines can prove to be a severe blow to Indian securitization market, especially when most of the developed countries have wholeheartedly accepted Basle II norms and are enjoying capital relief for securitization.

In 2002, India enacted a law “Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002”, more commonly called SARFAESI Act. The act deals with an instrument called “security receipt”, but since only securitization or asset reconstruction companies under the SARFAESI Act can issue security receipts, the act is limited to asset reconstruction companies only. Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulation 2008 has also been amended in 2018 to incorporate provisions regarding listing of such financial products in India.(Sebi Regulations, October 2018.)

In Singapore the central bank MAS announces that any bank proposing to act as seller or manager, either solely or jointly with other parties, in a securitization transaction must obtain prior approval from the MAS. To ensure that bank conduct securitization transactions in a prudent manner, the guidelines empower the MAS to impose supervisory limits on the volume or types of assets that may be securitized.MAS may also raise the capital adequacy requirement of a bank, when the totality of its activities suggest that its overall level or concentration of risk has become excessive relative to its capital .Various disclosure requirement, separation requirement etc are mandatory.

In 2004, monetary authority of Singapore introduced a tax incentive scheme for Approved Special Purpose Vehicle (ASPVs) engaged in asset securitization transactions. The scheme helped to address possible tax disadvantages that a SPV may face, as a result of mismatches in timing between the receipt of income and the payment of expenses. Monetary authority of Singapore also introduced several tax incentives, specifically to promote the REIT market.

There are two laws that govern mortgage securitization in Korea: the Asset- Backed Securitization Act (ABS Act) and the Mortgage-Backed Securitization Company Act (MBS Company Act) (KoMoCo). The ABS Act was established in September 1998 to promote the restructuring of firms and financial companies. Under the law, a Special Purpose Vehicle (SPV) issues Asset-Backed Securities (ABS) based on assets transferred from the originator. Mortgages can also be securitized under the ABS Act. Nonetheless, the government enacted the MBS Company Act in January 1999 under the judgment that mortgage loans, which are basically sound long-term homogeneous assets, could be more effectively securitized by a reliable permanent entity rather than by a SPV with a limited life.

Conclusion

The securitization market in South East Asian economies, though in its infancy, holds great promise especially in the MBS and ABS areas. While more complex securitization transactions and public issuance of securitized instruments are still a distant dream, appropriate legislation and investor education can give the securitization market in these economies a much-needed thrust .The sophistication level needed to mitigate the various risks associated with the securitization deals is still in its developing stage as compared with American financial markets. Yet as a tool of intermediation and liquidity enhancer the process of securitization has been a favorable innovation across a number of South East Asian economies.

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