Asset Backed Securities

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A. History of Securitization:

In 1934, the Housing Act was enacted, which provided for the establishment of a Federal Housing Administration (FHA). The Act provided for the insurance of home mortgage loans made by private lenders and for the chartering of national mortgage associations. The Act led to the establishment of National Mortgage Association of Washington in 1938, whose name was later changed to Federal National Mortgage Association.

According to the amendments made to the Act in 1968, the Federal National Mortgage Association was divided into two separate entities, the Government National Mortgage Association (Ginnie Mae) and the Federal National Mortgage Association (Fannie Mae). **Ginnie Mae** remained as a wholly owned government entity, while **Fannie Mae** became privately owned by retiring the government-held stock.

Securitization started in the early 1970s through the sale of mortgage loans by Ginnie Mae. The mission of Ginnie Mae is to support expanded affordable housing in the US by providing an efficient government-guaranteed secondary market vehicle, linking the capital markets with Federal housing markets.

Ginnie Mae **does not** loan money for mortgages but acts as a guarantor or a surety. Ginnie Mae does not issue, sell, buy mortgage-backed securities or purchase mortgage loans.

Ginnie Mae **manages a mortgage-backed securities program**, where it guarantees securities backed by pools of mortgages. These securities are called Mortgage-Backed Securities (MBS). These MBS are issued by certain private institutions that are approved by Ginnie Mae. The mortgages are insured by the Federal Housing Administration (FHA) or the Rural Housing Service (RHS) or are guaranteed by the Department of Veterans Affairs (VA).

Since the Mortgage Backed Securities are guaranteed by Ginnie Mae (they are backed by the full faith and credit of the United States), investors are assured of timely payments of scheduled principal and interest due on the pooled mortgages, that back their securities. These payments are guaranteed, even if borrowers or issuers, default on their obligations. Through investment in mortgage backed securities, investors increase the availability of mortgage credit, which helps more Americans buy their own homes.

In the 1980s, the market grew by the introduction of transactions by the quasi-governmental agencies, Federal Home Loan Mortgage Corporation (Freddie Mac) and Federal National Mortgage Association (Fannie Mae).

Freddie Mac and Fannie Mae buy mortgages from commercial banks, thrift institutions, mortgage banks and other primary lenders. Then, Freddie Mac and Fannie Mae, either hold these mortgages in their own portfolios or package them into mortgage-backed securities for re-sale to investors.

The secondary mortgage market operations play an important role in creating a ready supply of mortgage funds for American homebuyers. Later, capital markets became eager for more technologically advanced instruments to satisfy investors' demand, which gave rise to the evolution of more diverse mortgage products such as **Collateralized Mortgage Obligations** and non-mortgage-backed instruments or **Asset Backed Securities (ABS)**.

B. What Is Securitization?

Securitization is the conversion of receivables and cash flow generated from a collection (pool) of financial assets such as (mortgage loans, auto loans, credit card receivables and other assets) into securities that are backed by these assets. In other words, securitization is the "pooling of homogenous, financial, cash-flow producing, illiquid assets and issuing claims on those assets in the form of marketable securities."

The idea of securitization is to create a capital market product. It results in the creation of a "security", which is a marketable product. Asset Backed Securities (ABS) are considered both a fixed income and a derivative instrument. ABS qualify as a fixed income instrument because they generate a coupon income (not necessarily fixed) periodically, and qualify as a derivative, since they are a derived instrument from a plain vanilla instrument (a straightforward financial instrument such as a standard fixed-interest product with no sophisticated add-ons) being the underlying pool of assets.

C. What Is Asset Securitization?

Asset securitization is the issuance of a debt instrument backed by a revenue-producing asset of the issuing company. Asset securitization involves producing bearer asset-backed securities, which can be freely traded and which are secured by a portfolio of receivables. In order to ensure marketability, the instrument must have general acceptability as a store of value, hence, the security is generally either rated by credit rating agencies, or is guaranteed by an independent guarantor. Further, to ensure liquidity, the instrument is generally prepared in homogenous lots.

D. What Are The Types of Assets That Qualify to Back Securities?

Theoretically, any asset that has a revenue stream can be transformed into a marketable debt security. In practical terms, the vast majority of ABS are collateralized by loans and other financial assets.

E. Asset Backed Securities Can be Categorized into Mortgage and Non-Mortgage Securities:

1. Mortgage Securities:

Represent an ownership interest in mortgage loans made by financial institutions (savings and loans, commercial banks, mortgage companies) to finance the borrower's purchase of a home or other real estate. When these loans are pooled by issuers for sale to investors, mortgage securities are created. As the underlying mortgage loans are paid off by the homeowners, investors receive payments of interest and principal.

The most basic mortgage securities, known as **"Pass-Through"** securities represent a direct ownership interest in a pool of mortgage loans with each security entitled to a pro-rata share of the cash flow from the pool of mortgage loans. These mortgage securities can be pooled again to create collaterals for another type of mortgage security known as a Collateralized Mortgage Obligation (CMO), also known as "**Pay-Through"** security which is a more complex type than **"Pass-Through"**. This type allows cash flows to be directed, so that different classes of securities with different maturities and coupons can be created.

2. Non-Mortgage Securities:

Include new assets such as collateralized bond/loan obligations, non-performing loans, tax liens, small business loans, rental cars and franchises, asset-backed commercial paper, revolving consumer assets (credit cards), synthetic securities, auto loans and leases, home-equity loans[1], manufactured housing contracts[2], student loans, recreational vehicles, marine loans, commercial equipment and time share.

Pass-Through securities represent a direct ownership interest in a pool of mortgage loans with each security entitled to a pro-rata share of the cash flow from the pool of mortgage loans.

Referring to Graph 1 "Pass-Through" securities can be explained as follows:

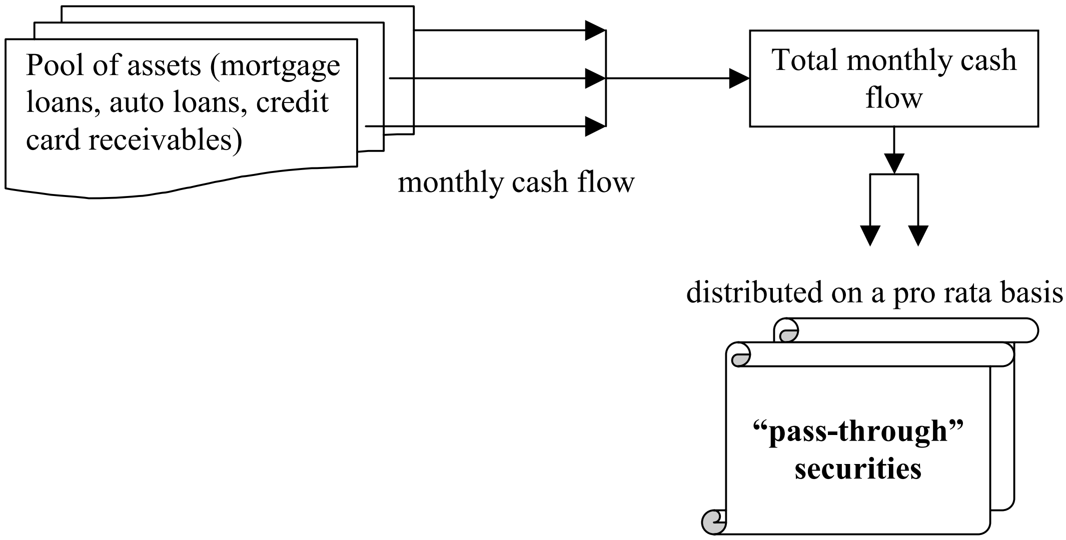
- A Pass-Through security is created when one or more holders of assets such as (mortgage loans, auto loans, credit card receivables and other assets) form a collection (pool) of assets. A pool may consist of several thousand or only a few assets.
- Shares or participation certificates in the pool are sold. The cash flow of the Pass-Through security depends on the cash flow of the underlying pool of assets and the monthly cash flow is distributed on a pro-rata basis. In this case the owner of the asset acts only as a service agent.

Sometimes, as is the case in the US, legal title to the assets is given to a trustee who only holds the trust property to protect it. The trustee does not have substantial managerial power. Pass-Through securities have the same credit risk of the assets backing it, in addition, to prepayment risk.

[1] Home Equity Loan: is a loan consisting of a lump sum borrowed at variable rate of interest (fixed loans are available) in which the homeowner pays off the debt in installments with part of each payment going toward the interest owed and part toward the principal or loan amount.

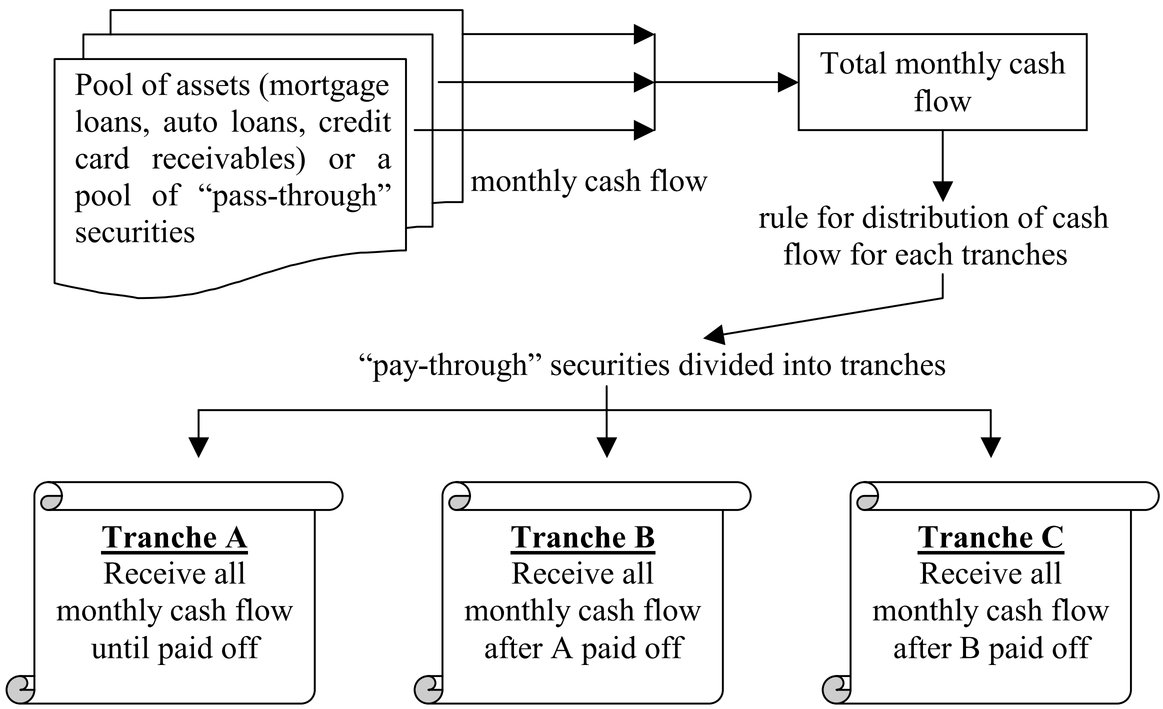
[2] Manufactured Housing Contracts: transactions that consist of pools of installment sale contracts and/or installment loan agreements. The contracts bear interest and borrowers make monthly payments of principal and interest which are expected to fully amortize the contract over periods of up to 30 years. The contracts are secured by liens on the manufactured home and, in some instances, the underlying land as well.

Graph 1:



As for **"Pay-Through"** securities, it can be backed by a pool of assets as the case for pass-through or can be backed by a pool of "pass-through" securities instead of directly using the assets. Pay-through securities are divided into different bond classes, called tranches, so as to create securities that have different cash flow and maturities and have the different exposure to pre-payment risk while having the same credit risk as being backed by the same assets.

Graph 2 below explains "Pass-Through" securities:



F. Special Purpose Vehicle

Companies usually use securitization as a borrowing instrument more than an investment instrument through creating another corporation or legal entity known as Special Purpose Vehicle (SPV) that is a subsidiary to the originating company. The originating company then transfers the assets to the SPV, which issues securities that are collateralized by the assets with the proceeds transferred back to the originating company. In some cases, the asset is actually sold to the SPV that issues the pay through securities. The SPV can be a subsidiary of an investment bank that buys the asset.

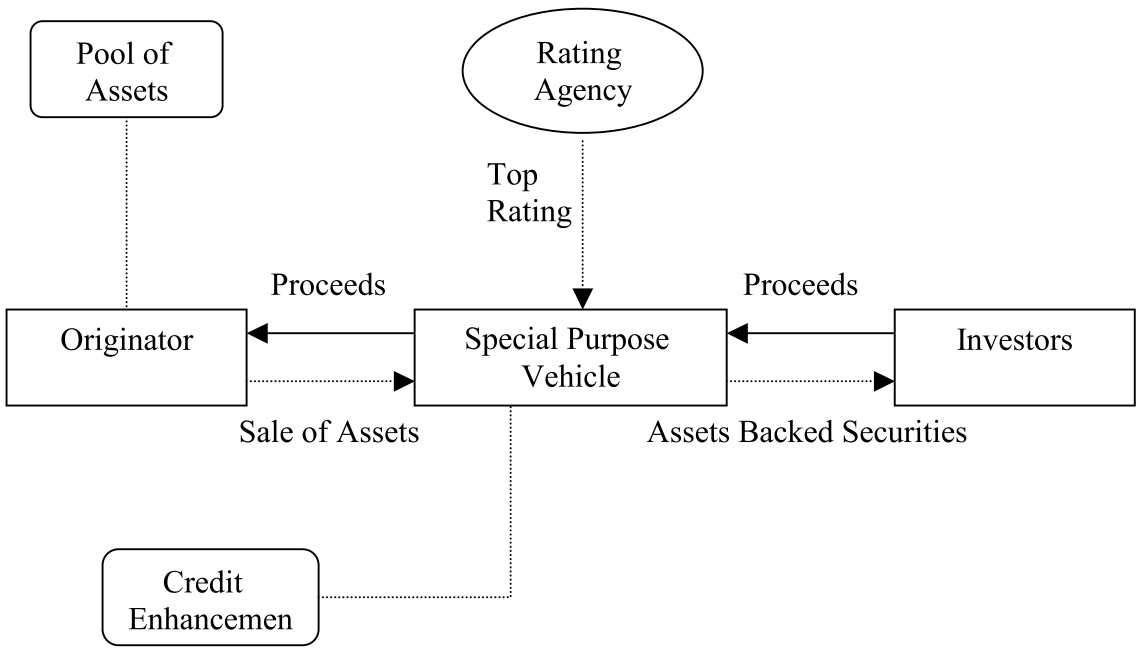
G. The Role of The Special Purpose Vehicle

The key question for investors first introduced to the ABS market is why does not a corporation simply issue a corporate bond or a note rather than an asset backed security?

To understand why, consider a (BBB) rated corporation that wants to raise a loan. The corporation can follow one of the following ways:

- It can issue a corporate bond, with funding cost to be whatever the benchmark Treasury yield is plus a yield spread for BBB issuers.
- Supposing that the corporation has receivables that are more than the amount it needs to borrow, it can use these receivables as collaterals for the bond issue. Although the bond will be collateralized, the funding cost will probably be the same as if it issued a corporate bond, that is because if the corporation defaults on any of its obligations, the creditors will go after all of its assets, including the receivables.
- The third way for the corporation will be to create an SPV and sell the receivables to it. That way the SPV will own the receivables, not the originating corporation, means that if the corporation is forced into bankruptcy, its creditors cannot go after the receivables as they are owned by the SPV. In addition when the SPV sells securities backed by the receivables, it can have whatever credit rating it wants for the securities, which usually will be higher than the credit rating of the originating corporation, which in turn lowers the funding cost.

It may seem strange that the SPV can get any rating it wants, but that is the case. The reason is that the SPV will show the characteristics of the collateral for the security (the receivables) to a rating agency. In turn, the rating agency will evaluate the credit quality of the collateral and inform the issuer what credit enhancements needed to obtain specific rating. Thus, the originating corporation which is BBB rated can obtain funding using its receivables as collateral to obtain a better credit rating for the securities issued. In fact, with enough credit enhancement it can issue a AAA rated security, as shown in Graph 3 below.



In summary, securitization takes place to make the illiquid assets of the firm available for investment. The assets are pooled to make the securitization large enough to be economical and to diversify risk. The SPV takes title to the assets and the cash-flows are "passed through" to the investors in the form of an asset backed security.

H. Why Do Issuers Need Securitization?

- The need for cash to grow and expand the business. Raising equity and borrowing through debt is difficult, expensive and can distort the financial leverage of a company. Equity and bonds are two sources of "on-balance-sheet" financing. Securitization, on the other hand, is an "off-balance-sheet" source of funds. According to the FASB, rules governing securitization (assuming all conditions are met) cash and proceeds from the sale of assets are added to assets, while the transferred asset itself is taken off the balance sheet.

- ABS offer increased liquidity through a broader market.

I. Why Do Investors Invest in Asset Based Securities?

- Securitization creates instruments with differing maturities, risks, coupons, which is appealing to investors. Securitization is a structured financial instrument i.e. tailored to the risk-return and maturity needs of investors, rather than a simple claim against an entity or asset.
- ABS offer a yield higher than instruments with comparable risk. This is due to the credit worthiness of the instruments (usually AAA rated) and the credit enhancement features.
- ABS offer a predictable cash-flow. Investors buy ABS with confidence that payments will occur at specified dates in the future.
- ABS are secured by the underlying assets, therefore they offer significant protection against downgrades by rating agencies to the issuer.

J. Why Is It Important to Employ The Services of A Financial Intermediary in The Process of Issuing ABS?

The traditional role of a financial intermediary is to avoid the difficulties which arise in a direct lender-borrower relation (the company and investors). The difficulties could be one or more of the following:

Transactional Difficulty: An average small investor usually has a small amount of money to lend, whereas the company's needs could be massive. The intermediary bank pools the funds from small investors to meet the typical needs of the company.

Informational Difficulty: An average small investor would not be aware of the borrower company or would not know how to appraise or manage the loan. The intermediary fills up this gap.

Perceived Risk: Investors usually perceive banks to be of a lesser risk compared to investing directly in a company, though in reality, the financial risk of the company is transposed on the bank. However, the bank is a pool of several such individual risks, and hence, the investors' preference of a bank to the borrower company is reasonable.

Securitization of assets is an answer to the previously mentioned difficulties and thus avoids the need for intermediation.

In particular, securitization avoids the transactional difficulty by breaking the large loan into marketable lots. Moreover, it avoids the informational difficulty because the securitized product is offered generally in a public offer and its features are well disclosed to the investors. In addition, it avoids the perceived risk difficulty, since the instrument is generally well-secured and is usually highly rated, which increases investors' protection.

K. Has Securitization Marginalized The Role of Intermediaries or Led to Financial Disintermediation?

Securitization **does not eliminate the need for the intermediation**, it merely redefines its role. The focus is shifted to the more essential function of a financial intermediary, including the following:

- Distribution of a financial product: In addition, securitization splits each of these intermediary functions apart, each to be performed by separate specialized agencies. The distribution function will be performed by the investment bank, appraisal function by a credit-rating agency, and management function possibly by a mutual fund, which manages the portfolio of security investments by the investors.
- Providing new products and services: such as the use of automobile loans or credit card receivables as assets backing issued securities.
- Transferring and distributing various risks via structured deals.
- Relying on intermediaries role as designated monitors of issuers to distinguish between high- and low-quality borrowers by providing third-party certifications of creditworthiness.

L. What Is The Impact of Securitization on The Capital Market?

- Securitization reduces transaction costs in the capital market by creating a market for financial claims, which otherwise, would have remained illiquid, i.e. limited trading.
- Securitization saves intermediation costs, since the specialized intermediary costs are service related and generally lower.

- Securitization promotes saving since it offers a security to investors with guaranteed interest or payments and an assurance of credit quality and safety nets in the form of trustees.
- Securitization leads to diversification of risk since it pools several financial assets with differing features together and offer them to investors. When the ownership of the asset becomes spread among a wide base of investors, it becomes diffused, thus reducing the inherent risk in financial transactions.
- Securitization promotes the idea of capitalists being trustees of resources and not owning them. Just as financial assets can be securitized, physical assets can also be securitized, which means that an entity can make use of physical resources without actually owning them.

The above benefits have led to an increase in the volume and value traded of ABS on the capital market. In year 1995, the value of ABS deals amounted to $ 316.3 billion, which increased greatly to $ 1,489.9 billion in the third quarter of year 2002.

M. Examples of Securitization in Some Emerging Markets

1- Malaysia

The origin of securitization in Malaysia can be traced to 1986 when the Government set up a mortgage financing body called National Mortgage Corp (Cagmas Bhd). Cagmas was formed on the model of Fannie Mae and Freddie Mac of USA. Accordingly, Cagmas functions as a Special Purpose Vehicle between the house mortgage lenders and investors of long term funds. Cagmas is by far the most important issuer of securitized instruments in Malaysia. The securities issued by Cagmas have acquired the name "cagmas bonds" in Malaysian market.

Apart from mortgages securitized by Cagmas, securitization for other assets has not been very strong in Malaysia, as the size of the Malaysian securitization market is estimated at RM 45.5 billion by the end of 1996.

On 10 April, 2001 the Securities Commission came out with mandatory guidelines on asset securitization. The guidelines permit only companies incorporated in Malaysia to offer asset-backed securities in Malaysia, either on public basis or on private basis. Although, a task force comprising market practitioners joined the Securities Commission's staff in formulating these guidelines, it did not keep up with the latest developments in the market such as synthetic securitizations and un-funded credit-derivative based transactions.

Furthermore, the guidelines require the originator to effectively transfer all rights and obligations in the assets to the Special Purpose Vehicle and not retain any residual beneficial interest in these assets. As a limited credit enhancement by the originator is almost a rule in securitizations, market practice in Malaysia will perhaps evolve on the style of the US securitizations where the security will be divided into two tranches tier with the first one being without recourse and without any enhancement, while the second to be with required enhancement.

There have been 3 ABS deals sold in Malaysia up to January 2002, that were worth a total of RM 1.23 billion. The issuers of these securities were all financial institutions, namely Arab Malaysian Merchant Bank Bhd, Commerce International Merchant Bankers Bhd, and bad debt management agency Pengurusan Danaharta Nasional Bhd.

2- Korea

Prior to the Asian crisis of 1997, some securitization deals were negotiated in Korea, but the real activity in securitization market has started picking up during 1999. One of the most high profile transactions took place in December 1998 by Korean Exim Bank. The bank was engaged in financing overseas operations of Korean companies and had receivables in foreign exchange. The bank securitized $ 265 million of receivables representing promissory notes drawn by its clients. The securities in that transaction were rated AAA.

Another initiative came from the Korean government as it set up a mortgage securitization body, on the lines of Fannie Mae, called Korea Mortgage Corp. (KOMOCO), which is a joint venture with International Financial Corporation (IFC) and some domestic banks. KOMOCO is expected to issue MBSs collateralized by mortgage loans acquired from National Housing Fund.

One of the main impediments that reduced the activity in securitization was the applicable law, which made the government issue a law named Asset Backed Securitization in 1998. The law was primarily intended to cover securitizations originated by financial institutions, including government-promoted financial institutions such as Korea Development Bank, Korean Exim Bank, Industrial Bank of

Korea, licensed financial institutions, merchant banks, insurance companies, securities companies, trust companies, etc.

The law organizes the activities of the Special Purpose Vehicles (SPV) that is organized as a limited liability company to manage the securitized assets. The securities to be issued by the SPV may be in the form of investment certificates, bonds, trust certificates, etc. The financial supervisory body (Financial Supervisory Commission) maintains control over securitization by Korean companies where it has the power to refuse registration or demand amendments.

The new law had a positive effect on the Korean market as it encouraged ABN Amro bank in October 2001, to bring into the market the Hanvit Bank deal was by ABN Amro bank. This $216 million, was the first Korean ABS issue to be backed by documentary credits granted by the bank to its manufacturing clients. Remarkably, this deal also included certain non-performing loans granted by the originator, and unlike the deals in the past, there was no third-party guarantee to back up the deal. The three tranches were rated AA and the main investors were pension funds, investment trust companies and two life insurance companies.

A little later, Morgan Stanley brought a real-estate NPL deal to the market where the underlying assets consisted of a pool of loans and properties purchased from Kamco. This was the first securitization of non-performing loans bought on a commercial basis for securitization and the securities were rated AAA.

The volume of the Korean ABS market amounted to $1.76 billion in 2001 according to Standard and Poor's.

3-Pakistan

Securitization has not taken off in Pakistan to any appreciable extent. The only significant securitization transaction in Pakistan so far is the 1997 securitization of net settlements receivables by Pakistan Telecom. Pakistan Telecom in the country's overseas telephony monopoly, and net settlement receivables arise when there are inward calls into Pakistan. Six international carriers such as AT&T who were expected to pay to Pakistan Telecom entered into notice-of-assignment agreements agreeing to pay into the collection account in favor of the SPV.

The ABS rules in 1999 opened up the securitization market in Pakistan through a regulatory order, which was considered a great effort. The rules allow any Public Limited Company (SPC) or a Trust (SPT) to register with the Securities & Exchange

Commission of Pakistan (SECP) for the purposes of becoming an SPV. The SERC is the regulator of equity and investment in Pakistan since 1997, as it governs matters of bankruptcy and schemes for mergers, while the Stock Exchange governs the compliance with listing and disclosure rules. In addition, according to the rules, a Public Limited Company (SPC) must have a paid up capital of at least one hundred thousand rupees in order to become an SPV.

The rules place certain obligations of periodic reporting upon the SPV and give the SECP powers to cancel the registration if the SPV fails to make a public offering of securities within a given time frame and in such manner as may be specified by it, while granting the certificate of registration. The Rules define "future receivables" to include all such receivables against which income may accrue or arise at a future date leaving the field for ABS wide open. External credit enhancement can be obtained for the securitization structure by means of insurances (to cover any losses on the pool of assets) or letters of credit from banks or corporate guarantees from a third party.

A SPV in Pakistan is generally prohibited from merging with, acquiring or taking over any other company or business, unless it has obtained the prior approval of the Commission or pledging any of the assets held by it, except for the benefit of the investors or making a loan or advancing money to any person except in connection with its normal business or participating in a joint account with others in any transaction or giving guarantees, indemnities or securities for any liability of a third party.

Securitization is still at an early stage in Pakistan. Indeed, income tax obstacles and lack of legal and regulatory framework have been the most persistent retardants for growth and development of the debt market. Although Pakistan faces inherent sovereign risk considerations, the presence of Fitch Ratings and the International Finance Corporation (IFC) as credit rating agencies has added to investor confidence in the capital and debt markets of Pakistan.

4- Singapore

One of the earliest transactions in Singapore was at the end of 1998, which was the securitization of real estate receivables by Neptune Orient Line. This was a sale and leaseback of an office property funded by a ten-years fixed rate mortgage backed bonds. Securitization transactions in Singapore have developed to involve commercial real estate, residential sales progress payment, credit card receivables, bonds and loans. By the end of year 2000, a total of S$ 1.92 billion worth of bonds have been sold in the domestic market via six commercial properties and one residential condominium.

One of the notable deals in Singapore market has been that by DBS Bank. This was an asset backed short-term notes program, in June 2000. In 1999, DBS Land, a property company, securitized three office buildings in three separate deals.

The Monetary Authority of Singapore (MAS) finalized the regulatory guidelines for capital adequacy treatment in case of securitization in 2000. The guidelines state that in case of mortgage loans, the transfer of receivables would also entail the transfer of the underlying mortgage, which would require compulsory registration with the Registrar of Titles and Deeds.

5- Brazil

Brazilian securitization market is still developing as not too many transactions have been reported to date, even though the government has taken legal initiatives to permit and promote securitization transactions.

Securitization in Brazil started in 1993 with transactions worth $180 million. The value of transactions increased to $190 million in 1995 and $715 million in 1996. A notable transaction in Brazil was the securitization of $100 million export receivables in 1997 by Trikem Overseas.

One of the earlier securitization transactions in the real estate sector, was the sale of receivables to cross-border investors in 1998 by Cidadela company, which used the proceeds to promote installment sales of real estate developed by it.

Brazil has developed its own model of Fannie Mae known as Cibrasec, which is a privately owned entity. It completed its first purchase of mortgage loans in 1998. In 1999 most of the securitization deals involved derivatives specially futures and forwards.

Standard and Poor's stated that the prospects for the securitization of existing assets in Brazil are favorable, despite the fact that present volume of eligible assets is relatively low.

The securitization law was enacted in Brazil in the late 1990s as a catalyst for change, since it allowed for mortgage foreclosures or auctions in Brazil, and also banks were authorized to transfer assets to non-financial institutions, which made investors more interested in investing in MBS and ABS in Brazil. The law permits the transfer of receivables to special purpose corporations, called (Financial Credits Securitization Companies). These companies, in turn, may either domestically or internationally issue shares or debentures, if it is permitted under the relevant law.

The Brazilian Securities Commission (CVM), issued special procedures for registering the issuance of debentures by securitization companies for public distribution. The prospectus of the issue must state clearly that all payments under the debentures are conditioned, and must also contain certain information regarding the underlying credits, such as their origin, the identity of the respective assignor. Moreover, the repurchase of receivables transferred to the SPV is not permitted.

Another notable legal initiative taken by the Brazilian Government is to make foreclosures of mortgages legal, which is expected to give boost to the real estate securitization market, which has so far been not very active.

6- South Africa

The history of securitization in South Africa dates back to 1989 when the first securitization issue was a R 250 million mortgage-backed security issued by the Allied Building Society (United Bank of South Africa Limited), in addition to two transactions that were worth R 335 billion, placed on the market in the late 1980s and early 1990s. Nevertheless, securitization is still not widely accepted in South Africa.

Recently securitization has been brought up again locally, and started attracting interest. This is due to recent developments such as the listing of the first securitization company (Sotta Securitization International) on the Johannesburg Stock Exchange in November 1998. It was the largest deal worth R 120 million in March 1999 with Lyons Property Company, mandated to securitize Lyons's lease agreements over five properties.

South African Securitization still faces some major obstacles in the market. The first obstacle is that investors still prefer to invest in listed companies with established track records. Second, there are legislative and accounting problems, because asset backed securities transactions are off-balance sheet, which is considered more risky than mortgages. Furthermore, there is no separate legislation for securitization, and no special entity, other than banks that are allowed to issue debt paper to fund operations. Thus, the securitization process by a Special Purpose Vehicle must be routed through a bank. In addition, debt issued must be denominated at Rand 1 million or more, which does not help promote secondary market liquidity. Finally, banks have sufficient capital in their balance sheets, and want to grow rather than sell off assets.

7- Poland

The Polish Investment Bank managed in August 1999, what is believed to be the first structured finance transaction in the Polish capital markets. The Z 10 million asset backed commercial paper issue was backed by the Z 50 million trade receivables owned by a pharmaceutical company called Urtica.

A report in December 2002 by Fitch IBCA stated that while securitization as a legal concept is not developed in Poland, there is marked interest by both the private sector financial community as well as the Polish regulatory authorities. Accordingly, the status of securitization is at an early stage.

Bank assets typically represent the bulk of securitizations and are thus most likely to be involved in Poland's expected securitization programs, which are expected to achieve the aim of raising capital. On the other hand, un-funded programs achieve the aim of relieving the capital adequacy ratio through substantially reducing credit default risk from the bank's financials. In both cases, the future seems to provide even more motivation for such transactions, as the new Basle Accord's CAR is expected to rise.

However, there are number of obstacles, such as confidentiality laws, where no information about clients may be released by banks to a third party without the clients' written approval to disclose such information. Accordingly, credit event information cannot be released. Practically, it is rather unlikely to obtain such an approval from current clients and the incorporation of a consent clause into new lending contracts will be difficult. In terms of consumer assets, apart from banking secrecy, there are strict regulations regarding the protection of individual data.

N. Securitization in Arab Countries

The Union of the Arab Banks introduced the securitization concept to the Arab banking market since 1995, after this new financial tool spread in various international markets and it was noted as an important financial instrument that could increase cash flows and decrease portfolios risk of banks.

Experts believe that securitization has become an important engine to reform financial systems in Arab countries, which requires revolution in the financial and banking services industry.
Securitization has several benefits including reducing stagnation in the housing sector, increasing liquidity for the banking sector, providing long-term finance with low cost for the household sector, stimulating capital markets that suffer from lack of liquidity, establishing new specialized financial enterprises, improving capital adequacy of banks through the sale of credit portfolios related to illiquid financial assets, decreasing general risk of banks etc .
Securitization allows governments to finance infrastructure projects in a better way and get better and lower funding from international markets. The success of securitization requires providing the necessary tax, accounting, credit etc. rules and regulations to motivate and develop this market. It also requires effective coordination between the different entities to guarantee the non-existence of contradictory rules or/and regulations that might impede the securitization process.

O. Securitization in Egypt

Securitization activity was addressed in Article 11 in Chapter 3 of the Mortgage Financing Law No. 148 for Year 2001. The law aims to activate the mortgage market in Egypt through granting loans to middle and low income class citizens to purchase small apartments at the beginning of their lives. The law is expected to encourage housing companies to build and market, small apartments, to citizens for preferential rates. The law will help provide long-term finance for housing. One of the most important objectives of the law is activate the mortgage and real estate stagnate market that is estimated to be more than LE 500 billion. The increase in activity in the mortgage market is expected to be reflected in a boom in the economy.

According to Chapter Three “Listing mortgage guarantee restriction and rights resulting from a financing agreement”, a financier is allowed to transfer his rights in a financing agreement to one of the authorities that undertake securitization. These authorities should be established by a Decree issued by the Minister of Foreign Trade after the approval of the Capital Market Authority. The entity authorized to undertake securitization is committed to settle all liabilities raising from the securities issued when they are due.

Despite the issuance of the Mortgage Financing Law, it has not been implemented up to date. Some of the main obstacles in the law according to experts are:-

- Article 11 of the law requires financier to guarantee the fulfillment of the rights resulting from issuing securities by the entity authorized to undertake securitization, and continue collection of investors rights in these securities, despite the fact that the financier transferred these rights in the beginning to another authority that handles securitization.
- The law states that the financier can transfer the rights to one of the securitization companies, but there is not a law that organizes securitisation activities in Egypt. An important subject that should be covered by this law how to value the properties that would be financed by securitization.
- The law states that the company that is given a license to practice mortgage financing activities should be an Egyptian corporation with an authorized capital, not less than LE 20 million, and a paid up capital LE 10 million. Capital adequacy ratio must be 20 times the lending portfolio of the company, the percent of current assets to current liabilities must not be less than 5%, and that the financial statements have to be submitted to the administrative authority and audited by two auditors, that are listed in a record that is held by the administrative authority, which is updated every six months. These rules were set to guarantee the establishment of financially adequate companies that would be able to finance securtization. These conditions might refrain certain financial institutions from joining the mortgage financing activity.
- The securitization model that is applicable in the US, which links the mortgage financing operations to banks was not implemented in Egypt where banks are not allowed to engage directly in mortgage financing operations, but they could establish companies that carry out securitization. This may lead to non-financial companies entering the mortgage financing field, which includes lending third parties, which is one of the core of banks' activities.
- Mortgage companies are required to finance long-term debts up to thirty years or more, which need substantial financial resources and might impede the entrance of financial institutions in this market. Comparing mortgage lending

in Egypt and in the United States, it can be note the Government National Mortgage Association (Ginnie Mae) was established in the United States to manage the program of mortgage backed securities by means of being the guarantor of the securities backed by the mortgage loans. In the 1980s, the market grew by the introduction of transactions by the quasi-governmental agencies, Freddie Mac and Fannie Mae, which are two semi-governmental enterprises that bought mortgages from commercial banks, thrift institutions, mortgage banks etc. Then, Freddie Mac and Fannie Mae either held these mortgages in their own portfolios or packaged them into mortgage-backed securities for re-sale to investors. This shows the importance of the presence of corporations like Freddie Mac and Fannie Mae in Egypt, to provide essential and long-term financing for commercial banks, mortgage banks that carry out the financing of securitization. By being semi-governmental organizations, this ensures investors that they will not lose their rights if they invested in asset backed securities their rights.

- A Regulatory Authority was established to supervise securitization and mortgage loans in Egypt. This Regulatory Authority needs the necessary expertise and tools to be able to conduct its supervision. The activities of mortgage financing may include supervising banks, which is under the jurisdiction of the Central Bank of Egypt, which could lead to dual regulation.

In order to implement mortgage financing activities and securitization in Egypt, it is necessary to solve these legal obstacles.

P. Appendix:

Originator: the company that securitizes its assets. The name signifies the fact that the entity is responsible for originating the claims that are to be ultimately securitized.

Asset-backed securitization: existing claims/assets/receivables to be securitized by the originator. If the claims that the originator securitizes are expected claims over time, i.e. receivables to arise in the future, then the securitized assets are referred to as future flows securitization.

It is important that the transfer of receivables by the originator is a legal transfer of the receivables to a separate entity, and not a borrowing on the security of the receivables.

The transfer of receivables has to be a true sale of the receivables, and not merely a financing against the security of the receivables. In legal jargon, transfer of receivables is called assignment of receivables.

Special Purpose Vehicle (SPV) or a Special Purpose Entity (SPE) is the intermediary that holds the receivables on behalf of the end investors. This entity is created solely for the purpose of this transaction since it is impossible to transfer such receivables to the investors directly, since the receivables are as diverse as the investors themselves. Besides, the base of investors could keep changing as the resulting security is essentially a marketable security.

Since the originator transfers the assets to the SPV, which in turn holds the assets on behalf of the investors and issues to the investors its own securities, the SPV is also called the issuer.

Bankruptcy Remote Transfer refers to the fact that the transfer of assets from the originator to the SPV shields it from any risks associated with the originator. If the originator were to go bankrupt or face any kind of financial distress, investors would continue to receive interest or payments from the assets they invested in.