Securitization Basics
Understanding the Securitization Components and Process
Securitization - A Brief History
Goals Of This Presentation

• To help you in your practice by:
  • Providing an explanation as to each component of the securitization process; and
  • Providing an explanation as to how each component interacts with one another.
The Securitization Process

• Began with government sponsorship

• Spread to the private sector
The pool of illiquid underlying mortgage assets is transformed into tradable bonds. The pool is then transferred as a whole into a trust. The trust then issues a series of bonds, then these bonds are sold to investors.
Sold In Any Country in the World

Diversified Investment

 Tradable Bonds
In 2006, approximately sixty percent of the outstanding United States mortgage debt existed in these tradable bonds. (Chomsisengphet and Pennington-Cross (2006)).
Slicing the tradable bonds into bond classes

- From investment grade (AAA/Aaa through BBB/Baa3)
- To below investment grade (BB+/Ba 1 through B-/B3)
- To an unrated class which is subordinate to the lowest rated bond class (Z).
Investors Chose The Bond Classes

- Level of risk
- Yield
- Duration
Payment Is Made Accordingly

The “Waterfall”

BB+/Ba 1 through B-/B3

AAA/Aaa through BBB/Baa3

Z
Conflicting Interests

- Loan Origination vs. Continued Monitoring
- Low Interest Rates and Highly Leveraged Mortgages
- Additional Conflicts
Distinguished from "Portfolio Loan"

- Portfolio loans are originated by a lender and held on its balance sheet through maturity.
  - Generally due to a failure to meet underwriting guidelines.
REMIC and Required Compliance

- REMIC stands for real estate mortgage investment conduit.
- Function
- Compliance
Pooling and Servicing Agreement

- A securitized and transferred loan is then serviced in accordance with the Pooling and Servicing Agreement (PSA) and the applicable loan documents.
- Primary, Master and Special servicers are required to act in accordance with the “servicing standard” as defined in the applicable PSA.
Pooling and Servicing Agreement

- Standard of care, skill and diligence
- Allocation and distribution of loan proceeds and losses
- Details servicing of loans
Servicers (Industry Participants)

- Primary Servicer
- Master Servicer
- Special Servicer
Mortgage Electronic Registration System

- MERS for short
- Created by the mortgage banking industry to “streamline the mortgage process by using electronic commerce to eliminate paper”. (See www.mersinc.org)
- The mission of MERS is to “register every mortgage loan in the United States on the MERS® System” (See www.mersinc.org)
Acts as a nominee in the county land records for the lender and servicer. Any loan registered on the MERS® System is inoculated against future assignments because MERS remains the nominal mortgagee no matter how many times servicing is traded.
Mortgage Electronic Registration System

- Properly handling MERS in your practice
Concluding Thoughts