INSTRUMENTS FOR OPEN RISKS MINIMIZING IN LEASING PORTFOLIO SECURITIZATION

Narong Anurak

Faculty of management science
Suan Sunandha Rajabhat University, Bangkok, Thailand
Narong.an@ssru.ac.th

The article discusses some features of the formation of a pool of leasing transactions for securitization purposes. The relationship between the level of open risk and the elements of the structure of the leasing transaction, including the advance payment, lease term, and the characteristics of the lease payment repayment schedule, is analyzed. Proposals for a set of tools to reduce open risk are presented. Identified nuances in which the use of a tool is the most effective.

Keywords: securitization, financing, leasing, pool of contracts, open risk.

Introduction

Throughout the entire period of development of the leasing market, the main method of financing leasing activities was bank lending.

However, the funds raised in the credit market are not able to fully satisfy the needs of leasing companies in financial resources. “The deficit in financing leasing in 2015 predetermined the use of various methods of funding leasing activities” [15, 318].

Despite the significant interest of leasing companies in alternative forms of attracting investments, only recently there has been a tendency to reduce the role of banks and the redistribution of funding sources in favor of stock market instruments.

One such tool is the securitization of lease payments. Market participants recognize that this mechanism allows not only diversifying funding sources, but also significantly reducing their cost [12, 162].

Famous Swiss securitization specialist H.P. Baer gave the following definition of securitization: “Asset securitization is an innovative technique (method) of financing, in which a diversified pool of financial assets is allocated from the balance of a bank or other enterprise, acquires legal independence by transferring to a specially created legal entity, which refinances it on the international market through issue of securities” [7, 87].

In the case of securitization of leasing assets, the lessor (originator) forms a pool of leasing agreements and sells them to a special legal entity (SPV - Special Purpose Vehicle). SPV issues bonds secured by cash flows from leasing transactions.

After the portfolio is sold by the originator of the securitization, the functions associated with the maintenance of leasing agreements are transferred to the service company. ABS bonds are more reliable than regular corporate bonds because they are secured by real assets. The high reliability of securitized bonds is largely due to the stability of cash flows under leasing agreements.
In the event of a default on individual projects, this stability may be impaired. In these cases, the leased asset is subject to seizure with subsequent sale. The proceeds from the sale of leased property are used to repay liabilities for ABS bonds [14, 34].

**Main focus of the study**

A serious risk is presented by situations related to the bankruptcy of the lessee, when the proceeds from the sale of property do not fully cover the remaining debt. In this case, direct losses arise, which may adversely affect the performance of obligations to holders of the entire pool of securitized bonds [3, 118].

An assessment of potential losses in the event of a lessee's default is necessary for each contract at the stage of forming a pool of transactions for securitization [2, 61].

A negative aspect of this approach is the deterioration in the quality of the assets of the leasing company after securitization, since first-class transactions fall into the pool and are debited from the balance sheet of the originator [13, 39].

Analysts at the Fitch Ratings rating agency note: “Applying securitization to the best assets causes certain difficulties for unsecured lenders” [3]. A positive factor in securitization is profit taking by the leasing company. In addition, there is a release of capital and improves the ratio of own and borrowed funds of the originator [6, 152].

A leasing company gets the opportunity to attract cheaper financing in the credit market [10, 92]. When securitizing mortgages or credit card loans, there is a transparent schedule of future cash receipts that can be used in full for payments on bonds. In the case of securitization of leasing assets, in addition to the cost of the leased asset and the leasing interest rate, other related costs are also added to the payment schedule, including insurance, maintenance of the leased asset, taxes, etc.

These expenses can be included both in separate payments and distributed over the entire lease term using the discount coefficient [1, 97].

Thus, the above costs can have a significant impact on the final schedule of lease payments. Currently, the most common in practice are three types of lease payment schedules [9, 145]:

1. Annuity. The lessee makes payments under the agreement in equal installments. The repayment of the main debt at the initial stage is slower than at the end of the lease term.
2. Differentiated - usually decreasing, that is, all costs relate to the period in which they are actually incurred. Repayment of the loan body is carried out in equal parts during the entire lease term.
3. Seasonal. The schedule takes into account the seasonality of activities and the features of the financial activities of the lessee. There are no unified standards regarding the calculation of leasing payment schedules in the market.

Each lessor performs the calculation in accordance with internal standards and features of leasing projects. “The correct uploading of portfolio data from the originator’s internal IT system directly affects the end result of portfolio analysis. Most banking IT systems are not adapted for analytical data processing for securitization purposes ”[11, 618].

This aspect is no less relevant for leasing companies, since the lease payment schedule has a more complex structure than a bank loan. In addition, to date, many lessors do not have software that correctly calculates the schedule of lease payments for complex transactions.
In such cases, calculations are carried out by specialists in the Excel program, and there is a risk that data in a limited amount falls into IT systems [5, 190]. If you have the necessary information, a detailed analysis of the dynamics and structure of leasing payments allows you to create an adjusted or “cleaned” cash flow schedule that can be sent directly to payments on bonds [8, 237].

In order to properly assess risks and minimize consequences in the event of default, it is necessary to conduct a comparative analysis of the “cleared” payment schedule and the residual market value of the leased asset in dynamics [4, 121]. Consider the potential losses in the event of the bankruptcy of the lessee on the example of a standard transaction.

At the initial stage of the project, the leased asset quickly loses its value. 12 months after the transfer of the property to the lessee, the liquidation value of the asset becomes less than the balance of the loan to be repaid. Thus, in the event of the bankruptcy of the lessee, losses will occur that will not be covered by the sale of the leased asset.

In the event of default, there are also additional costs associated with the seizure, legal support and storage of the leased asset until its implementation. But since the service company receives a fee for escorting the portfolio, which also includes additional costs for the seizure, storage and sale of the leased asset, we do not consider this risk.

Thus, with a differentiated payment schedule with even repayment of the loan body, the risk period is 28 months (from 12 to 40 months). Maximum losses do not exceed 4% of the initial value of the leased asset.

This example clearly demonstrates that the use of an annuity payment schedule compared to a differentiated one significantly affects the risks of the project. The time period of potential risk increased by one and a half times, maximum losses increased by almost three times.

Thus, the inclusion of this annuity payment transaction in the securitization pool seems extremely risky. Default on such a project can lead to serious losses and default on obligations to investors.

Despite the fact that, from the point of view of a leasing company, the credit risks of a project with annuity payments are acceptable, such a transaction is not suitable for securitization purposes. One of the tools to reduce risks in this situation may be to provide collateral in the form of a pledge of additional property or credit risk insurance in the amount of 11% of the initial cost of the leased asset.

If the lessor initially plans the subsequent securitization of the leasing project, then it is necessary to structure the transaction and optimize risks taking into account the requirements of securitization at the stage of concluding the leasing agreement. In this case, one of the most effective ways to reduce risks and potential losses is to conclude a leasing transaction for 48 months instead of the initial 60.

With a decrease in the lease term, repayment of the loan body is faster. Thus, reducing the lease term from 60 to 48 months allowed us to reduce the period of potential risk from 41 to 17 months, and the maximum loss from 11 to 2%.

A comparable effect is also achieved when the advance payment for the transaction is changed. However, in this case, the graph is uniformly compressed along the vertical axis. The greatest shift in absolute terms occurs with a minimum value along the X axis. Thus, this measure is more effective if an open risk arises at the initial stage of the project.
Conclusions

When forming a pool of securitized assets, it is necessary to carry out a detailed analysis of the dynamics of payments on leasing projects and build a schedule of “cleared” cash flows that can be used to pay off obligations on bonds.

Analysis of cash flows allows you to identify and assess potential losses in the event of default on a leasing transaction. The article discusses the relationship between the level of open risk and the elements of the structure of the leasing transaction, including advance payment, leasing term, features of the schedule of repayment of leasing payments.

The lessor has a set of tools that affect the profitability of the project and allow you to manage existing risks, including in order to include the project in the pool for subsequent securitization.

These tools are as follows:
- change in the term of the leasing transaction;
- change in the size of the advance payment;
- choice of the repayment schedule of leasing payments;
- pledging of additional security;
- insurance of credit risks in the amount of potential losses in the event of default.

Using a combination of these tools allows you to find the optimal balance of risks and profitability.

References