

Chapter 1 Introduction

Three decades ago, the first securitization product was introduced to the investing public in the United States by federal agencies. The support from government was strong and the overall economic environment in the U.S. was perfect for the creation and development of such a new derivative then. The dominant collateral in the beginning phase of the new era of financial instruments was mortgages, especially residential mortgages. This new alternative of financing was so popular that all kinds of financial asset, from real estate mortgages to credit card receivables, from rents of commercial buildings to automobile loans, from equipment leases to student borrowings, all pooled together, wrapped up, and flooded the market and was hugely successful.

Until the third quarter, 2003, in the U.S., total asset backed securities outstanding amounted to 1,680.6 billion USD¹ (see Exhibit 1) and total mortgage backed securities amounted to 3,370.7 billion USD compared with 3,161.3 billion USD outstanding U.S. treasury bills and coupons combined. There were so much attention and effort devoted to finding the reasons of such tremendous success of securitization products in America and to grasp why securitization had gained popularity as a financing alternative that capital markets in other countries all tried to duplicate it.

The motives are based on significant benefits of this value-added cosmetic surgery of traditional financial instruments, including lower cost of funds, source of liquidity, diversified funding source, earnings acceleration and management, off-balance sheet financing, and less public disclosure than competing methods of financing. We know all the ingredients of that recipe of success, but it is a totally different story when reproducing that success all over the world, especially in Asia.

Asia is so unique. Although the European securitization market has been mildly successful, there are much more differences between the two sides of the Pacific than those of the Atlantic. Asia faces highly dense populations, lower economic development and educational levels, higher savings rates, more conservative approach to adapting to new ideas, and totally different preferences for investing. As for securitization products to grow and prosper in the east, both timing and fundamental constructions are not as good as they were in the 70's in America or the in the 80's in Europe. Some Asian countries, such as Japan, had pretty significant

¹ Source: the Bond Market Association Website.

progress in developing MBS/ABS after reforming pivotal laws and regulations, but there are many others who haven't. Instead of broadly reviewing every Asian nation, let's focus on how securitization had progressed in the South Korea and Taiwan in recent years.

Both countries have similar cultural and economic characteristics and have achieved some early milestones for the development of securitization although the motives are quite different. Securitization in Korea was started for one goal: clearing up huge amount of non-performance loans of the banking system, while Taiwan's priority concern is to internationalize domestic financial market and attract more foreign institutional investors..

The banking industry in South Korea had supported Korea's giant enterprises, such as Hyundai and Samsung, to expand global business territories since the early 1980s, just after the Korea government loosened restrictions of financial institutions. The support was so strong, some may even say it was blind and lunatic, that more than 30% corporate loans were lent to the top 30 companies and 18% to the top 5 big enterprises in 1987. The average debttoequity ratio of Korea's empires was astonishingly as high as 500% in 1997, and at that time, the Asia Financial Crisis was just about to happen.

The Korea government took extreme actions after the crisis in the hope to reorganize the banking industry and rebuild Korea's economy from ground zero. Non-Performance Loan Management Fund was established, Korea Asset Management Corporation (KAMCO) was restructured, Act for the Establishment of Financial Supervisory Organizations was passed, and also Financial Supervisory Commission (FSC) took the responsibility of planning and execution. KAMCO bought ordinary NPL and loans to restructured enterprises followed by issuance of ABS to deal with these NPLs and problematic companies in 1997.

The whole restructuring of Korea's banking industry was quite successful, although there is still much that needs to be done. Korea's market has lost much of its shine in 2003 following a crisis of confidence in the country's credit card industry. Credit card charge-offs spiraled out of control, investor confidence plummeted and the nuclear threat from the north border suppressed market activities and the republic's rapid growth cross-border securitization market was effectively closed. In 2004, consumer finance ABS issuance is expected to dominate Korean ABS market while the default rate of the restructured loans will be particularly high. ABS investors in Korea will not be threatened though. It is believed that the Korean government will not let credit companies go under.

Taiwan, on the other hand, is a late participant in this financial innovation contest, but the banking system basically is healthier than Korea's: the mission of securitization in Taiwan is not to deal with garbage loans, which makes securitization less urgent and Taiwan can develop at a steady, solid pace. Taiwan Legislative Yuan had passed Financial Asset Securitization Regulations in 2002 and Real Estate Securitization Regulations in 2003. Their consecutive regulations, enforcement rules, and explanations will come later. Due to the slow pace of the legislation process and incomplete regulations and mandatory orders announced, this process stumbled in the beginning, as has been shown by the fact that, at the end of 2002, there was only one transaction approved by the authorities. Until December 2003, that's more than 18 months after the original basic regulations passed, the fundamental legal environment is finally somewhat mature for future steps.

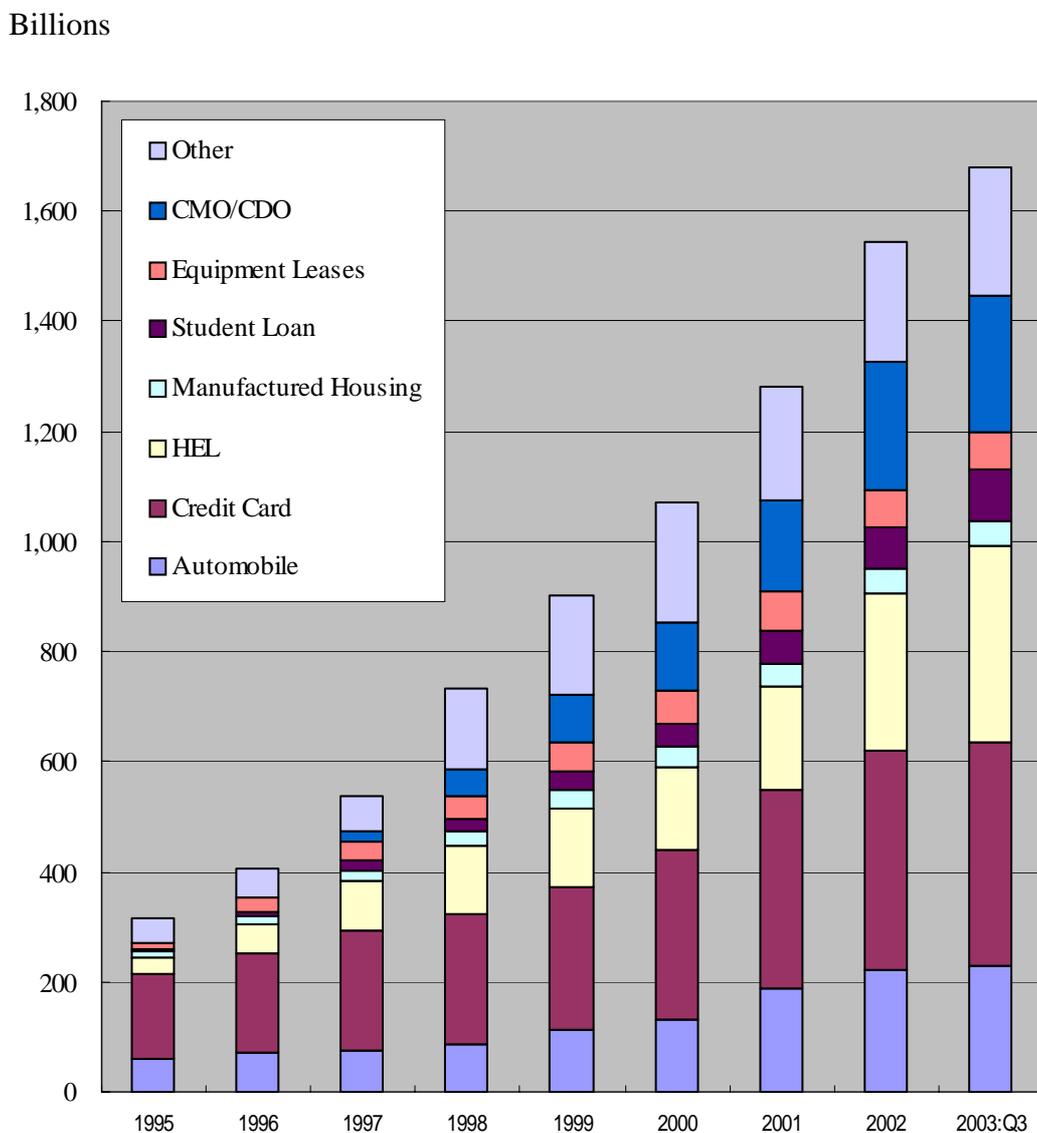
According to a press release released by Bureau of Monetary Affairs, dated Dec. 30, 2003, there are 6 securitization products approved and total amount is 37.6 billion NTD (see Exhibit 1-1). Assets that are pooled as collaterals include corporate loans (Industrial Bank of Taiwan and Credit Lyonnais), cash cards receivables (Cosmos Bank), and residential mortgages (Chinatrust Commercial Bank and First Commercial Bank). Market participators are looking forward for further improvement of legal conditions and new pooling and pricing techniques to come. The government also tried very hard to support and nourish this future star and potential solution of serious NPL problems in the banking system by allowing non-financial institutions, such as manufacturing companies and local governments, to be originators.

Other efforts include a separate tax bracket of 6% for interest income; more convenient and cost effective ways of noticing debtors; transferable mortgage subsidies; and a release of the restrictions of trustees selection for governmental originators. However, more infrastructure, research and development are needed for this market to flourish and this may be a more serious problem than former legislative insufficiency.

The retard of building up regulations and adjusting existing laws for securitization in Taiwan is caused by the incomplete prior planning, the difficulties of changing and creating related regulations and rules, the inefficiency of public sectors, and also, political dissensions. The completion of the legislation process for preliminary regulations surely is a major step for Taiwan's securitization, although there is still a long way to go even if the rules of this game were complete. Among all kinds of underlying assets which generate stable cash flows and can be securitized, the researcher believe credit card receivables will come under scrutiny in the near future.

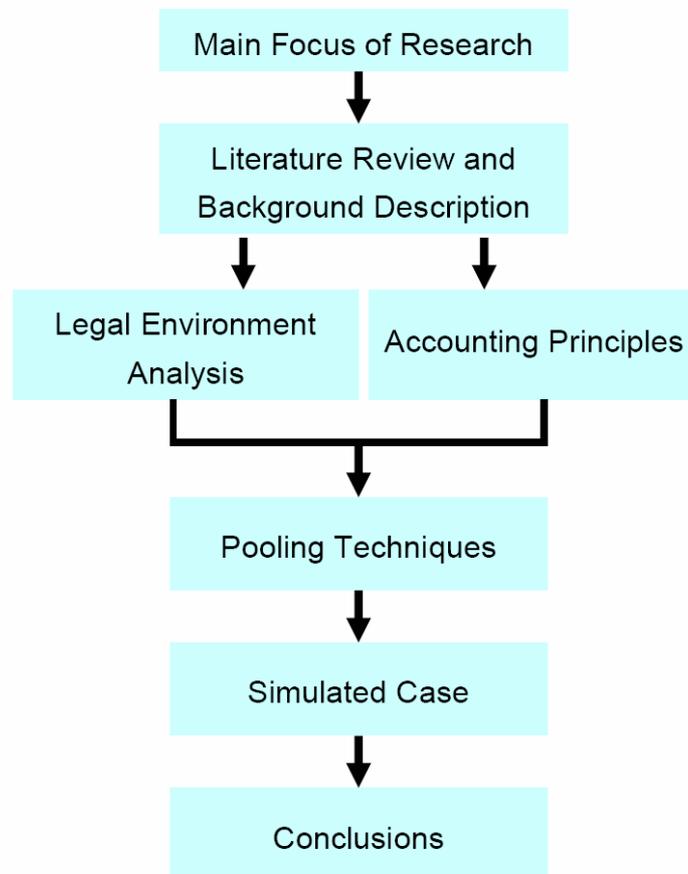
Hsieh (2002) introduced the development and expansion of securitization and credit card ABS in the U.S. market, explored structuring processes, and analyzed the merchandising of those products in the Taiwan market. It also emphasized the importance of larger players in the market. Problems to be solved are the relative small size of domestic banks, the withholding taxes discourage foreign investors to invest in local ABS, unfeasibility of master trust, not well-educated investors, strong rating agencies, and absence of credit card statistic data base. Huang (2002) designed a simulated credit card receivables securitization case and analyzed the benefit of financial institutions. These two researches were both published in June 2002 and as a result, they both didn't include the final edition of current securitization regulations.

Exhibit 1-1 ABS Outstanding (U.S.)



Source: Bond Market Website

Exhibit 1-2 Research Flow Chart



The researcher's primary concern is to analyze the special legal and accounting aspects in Taiwan and designing details of credit card backed certificates based on current laws, rules, and regulations and real cases in Taiwan not covered by previous research. The main focus of this research will be the practical essentials of securitizing credit card receivables, pooling techniques of such securities, and cash flow patterns. The main goal of this research was to construct practical logics and methods for securitizing credit card receivables in Taiwan. More than that, the researcher also intended to demonstrate some critical facts and insights about the general environment of securitization in Taiwan.

Exhibit 1-3 Approved Securitization Products in Taiwan

Collateral	Originator	Trustee	Amount	Region	Channel
Corporate Loans	Industrial Bank of Taiwan	The Land Bank of Taiwan	3.652 Billion	Domestic	Private Placement
Corporate Loans	Taipei Branch, Credit Lyonnais	Chinatrust Commercial Bank	8.8 Billion	Domestic	Public Offering & Private Placement
Corporate Loans	Industrial Bank of Taiwan	The Land Bank of Taiwan	3.2 Billion	Domestic	Public Offering & Private Placement
Residential Mortgages	Chinatrust Commercial Bank	Taipei Branch, Deutsche Bank	5.0 Billion	Domestic	Private Placement
Cash Card Receivables	Cosmos Bank	Taipei Branch, Deutsche Bank	11.56 Billion	Domestic & Overseas	Private Placement
Residential Mortgages	First Commercial Bank	Taipei Branch, Deutsche Bank	5.4 Billion	Domestic	Private Placement

Source: Press Release, Bureau of Monetary Affairs, Date : 12/30/2003

