

Harnessing IT to smooth the way for securitisation

The smart use of appropriate IT can make a transaction possible that a few years ago would have been very difficult to execute, says Tim Nicolle of Demica.

Securitisation takes many forms and has become an increasingly important tool for the treasurer. In recent times, a tightening in the availability of credit has meant that raising finance in a secured way has become a focus. For most firms, with today's financial technology, this means borrowing via securitisation. This is one of the best ways to raise new debt or replace existing debt in a capital efficient and economic way.

This article focuses on securitisation in its broadest sense, principally when money is being raised (or risks managed) against the security of the assets of a business. For a treasurer, these assets could be simple trade receivables (invoices), stock items, rental flows, future flows (such as service charges or tolls) or receipts due under secured project financing arrangements. The principles set out are independent of the structure involved (whether it is a secured loan, a credit derivative, a bond transaction where the 'lenders' are investors in notes, a commercial paper (CP) conduit transaction and so on). From an IT perspective, the selection, tracking and reporting requirements are always basically the same.

All securitisable assets have one thing in common: they are items that are easily translated into cash at some future date. The securitisation transaction is based upon the principle that the lender is repaid from the cash that the asset turns into. There is no recourse back to the originator. This is why securitisation transactions are often off-balance sheet (as there is no debt actually owed by the originator itself).

IT challenge

From an IT perspective, there is usually one large challenge. Prior to the securitisation, everything belonged to the originator – after the securitisation, some of the originator's assets now

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'belong' to someone else (because they are pledged to repay the lenders). The challenge is therefore to change the originator's people, processes and systems from a single-company environment to a multi-company environment.

Unfortunately, the issue is usually more involved than simply tracking whose assets are whose. The lenders, who are relying upon particular assets for their repayment, will want to have a great deal of information about them – not just initially, but throughout the life of the transaction. The tracking and information flow extends also to the cash that the assets can turn into. Furthermore, most securitisations also require that maturing assets should be replaced with new assets to keep the transaction size relatively constant (known as 'substitution').



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The work involved from an IT and process perspective depends upon the nature of the assets more than the nature of the transaction to be completed. *Table 1* illustrates the main problems that are faced to track all of the flows that are involved.

Overcoming obstacles

The list of tasks and processes is initially intimidating and often the IT processes represent a substantial obstacle to the completion of the transaction. However, there is an increasing amount of new technology now available to make the securitisation easier and quicker to execute. A good example is trade receivables (invoices) securitisation, where securitised finance is raised against the customers' obligations to pay the invoices issued. There are now high-powered systems to organise all of the tracking and reporting that is involved.

A recent transaction executed for a large multi-national can illustrate how the new technology can break down the information barriers. The transaction focused on an organisation that had a large amount of expensive bank debt and a wish to refinance it. A trade receivables securitisation was determined to be the best route.

Unfortunately, the trade receivables information involved five million invoices spread among 35 operating firms in five time zones in three currencies. A system would be required to report on these receivables individually and on a daily basis with transfers also going into and out of the securitisation each day. Each operating company had its own static data and accounting systems. The work had to be done within a four-hour processing window each day.

To obtain a rapid implementation, several golden rules are followed:

- operating firms should not be required to change what they are

TABLE 1

Information life cycle

No.	Process	Action	Specifics
1.	Transfer	Selection of assets	Eligibility rules (permissive) – which assets can be considered for securitisation (eg: only UK assets with non-governmental obligors for customers not flagged as in dispute, in default or insolvent).
			Selection limits (restrictive) – from the available assets, what is the tolerance for particular risks or characteristics (eg: only \$10m of exposure to any one industrial sector or product type).
			Pricing rules are required that determine, given the characteristics of the asset, the price at which it is to be transferred into the securitisation.
			Limits are usually in a given currency, whereas underlying assets can be in a variety of currencies. This makes selection processes inherently complicated because baskets of exchange rates have to be maintained for given time periods and the right vintage of exchange rates used for the currency conversion.
		Pricing	The price may be different to the book value, and may have to be recorded.
			The date of transfer will be important and has to be recorded.
			If there are multiple currencies involved, the exchange rates on the transfer date may have to be recorded for subsequent exposure calculations.
		Transfer documents	An offer letter is required to initiate the transfer, usually with summary information.
			A detailed report identifying each asset to be transferred is needed to be appended to the offer letter.
			A key point is that assets can also be transferred out of a securitisation, which is often overlooked and this will require documentation to be produced reversing the securitisation.
2.	Asset tracking	Flagging	As a means of identifying whose assets are whose – maintained as assets are transferred in and are transferred out – note: ‘transfers out’ is often overlooked as it is rare but has to be catered for and occurs on breach of warranty or in some structures, on defaults or late payments.
			Flagging has to cater for assets increasing in size where the increase is sold, or not sold, or sold on different terms to other parts of the asset or on different dates (with different impacts on selection processes and reporting).
			Flagging has to cope with related assets appearing – eg: further transactions which are linked to the original and are not separable from the original, but which have a different record number and identity in the system.
3.	Asset performance	Collections	The lenders will be relying upon the cash that the securitised assets create for their repayment; the amount of cash collected, usually each day, has to be identified – coping with reversals and back-dated transactions
		Delinquency	Since the lenders are relying upon the performance of the assets, they will also have external measures of delinquency that have to be reported against (to provide an objective analysis of the state of their security)
		Default	Most transactions also have an external measure of defaults when non-payment occurs for a period of time, and this has to be reported against; in a trade receivables transaction, this can trigger a buy-back of the invoice involved for example.
			A further complication is that when a customer defaults that has a number of securitised financial obligations to the originator, each of the obligations (eg: invoices in trade receivables transaction) has to be flagged as a default.
		Non-cash collection	These are usually called ‘dilutions’ in a securitisation; dilutions occur when there are credit notes, rebates, returns or any mechanism by which a debt is forgiven without cash being received. These represent a real problem for the lenders (which are relying upon cash from the assets to repay the securitised debt). Systems have to be in place to track these amounts and relate them correctly between securitised and non-securitised transactions.

doing or keep any information that is important to the transaction;

- the scope of work was reduced to the minimum, principally by separating out the tasks carefully into generic, invoice-level processes and the rest of the calculations that happen at a summary level and can change periodically; and

- the likely operational errors were carefully analysed (based upon experience of similar implementations) and the system was created with interfaces, checks and procedures to design these out.

The key mechanism that was employed was based upon the princi-

ple that the performance of individual receivables can be determined by taking a complete copy of each sales ledger each day from each operating company. These sales ledger ‘snapshots’ were stored and analysed centrally. One database was set up that controlled the entire transaction and did all of the selection, flagging,

reporting and analysis. This was set up to a standard that satisfied lawyers, auditors and rating agencies. For example, it can be inferred that an invoice has repaid in full when it disappears from the sales ledger. If the amount declines, the invoice has repaid in part. If the amount increases, there is potentially a new asset (the incremental component) to consider financing. If a credit note is raised, this is tracked (with all of its increases and decreases) and so on.

An 'aliasing' system is used to deal with the fact that each operating company has its own names for customers, currencies, countries and so on. A map was built up and is maintained by the system to ensure that a single, company-wide view of the trade receivables (securitised and unsecuritised) is obtained. This is combined with cross-currency exchange rate information so the selection processes can operate in the programme currency (euro) despite invoices being in different underlying currencies.

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Benefits

Using the approach of the central system, the originator was able to achieve a rapid roll-out of the securitisation across the entire company. Managing the whole securitisation from one location without requiring the operating companies to do more than send in their data has had other benefits.

The originator has obtained an almost real-time view of the performance of his entire organisation. As a

source for management information, the central invoice database is of immense value. The lenders involved also felt more comfortable because they could look to a single central location for all information associated with the transaction. This meant that, in a worst case, they could establish exactly the position in relation to the underlying invoices almost instantly.

This transaction illustrates how IT is being used to enable a complex enterprise-wide securitisation. Instead of the IT becoming an obstacle, a smart use of appropriate software can add substantial value to the originator and make a transaction possible that a few years ago would have been very difficult to execute. ■

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