



**Islamic Securitization:
An Alternative to Avoid Subprime Crisis**

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IT APPEARS THE MORTGAGE CRISIS IS HAVING A FAIRY TALE ENDING.

SHARES IN GLUE ARE UP!

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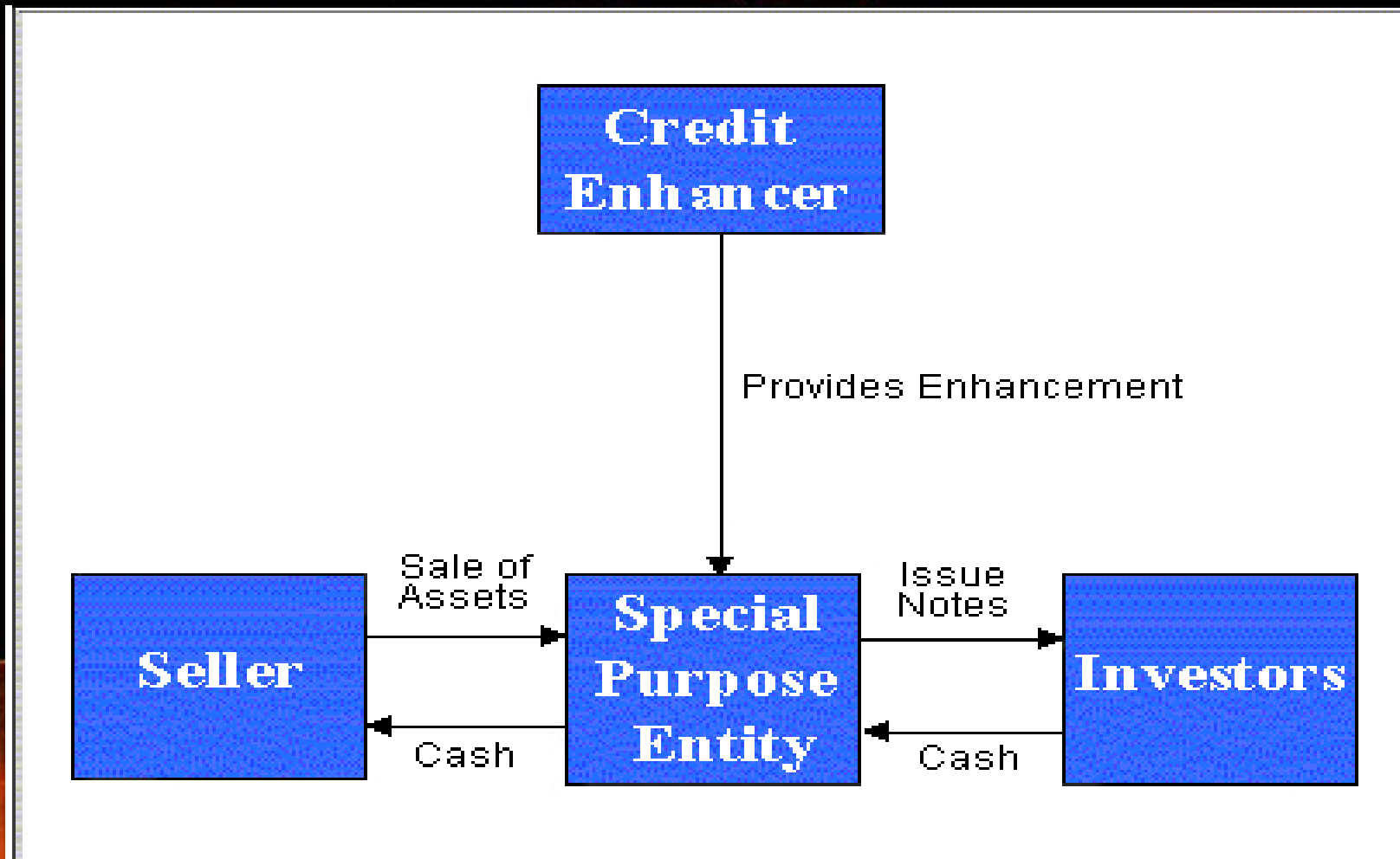
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What is Securitization ?





Conventional Securitization	Islamic Securitization
Debts are securitized: investor buy interest in the debts sold	Islamic securitization is asset based
Only possible when monetary debts are sold at discount	Here investors purchase portions of interest/ownership in the underlying tangible asset
Pricing is largely based on interest rate movement and credit risk/rating	Income paid to investor must come from employment of the asset in real business
Secondary trading of these securitized debts are norms of the day	
Investors are paid fixed coupons	Income/profit and cannot be fixed or guaranteed
In asset-backed securities assets means financial assets (money and debts)	Asset-backed securities must mean real tangible assets or at least combined assets where tangible portion is more than debt/money portions

Problems with Conventional Securitization

1. Predatory lending: Subprime borrowers can be financially unsophisticated – either unaware of all options available or unable to make the best choice between options.

2. Mortgage fraud: The originator, who sells a pool of mortgages to the arranger, has an information advantage over the arranger regarding quality of the borrower. An originator, collaborating with the borrower, may misrepresent the information on the application.

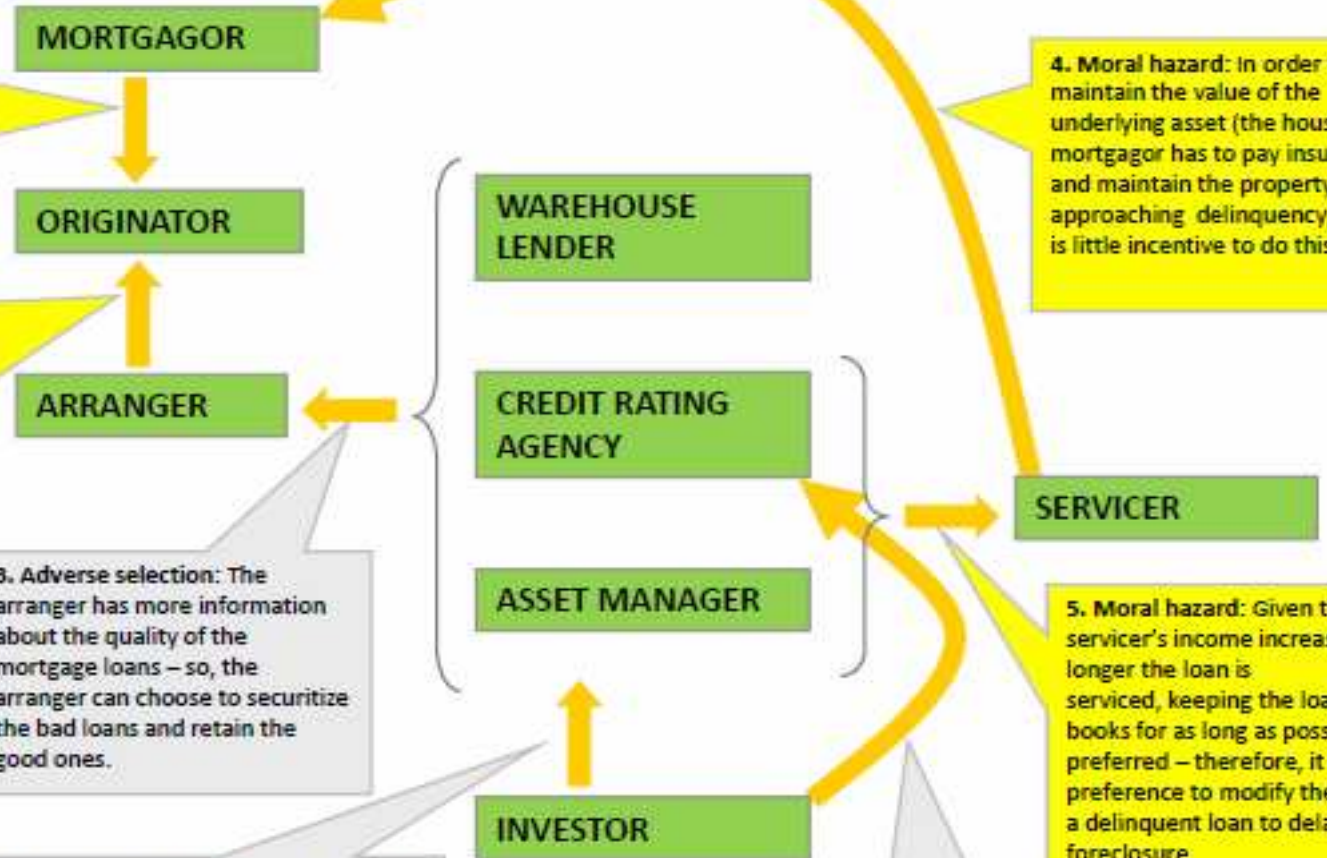
3. Adverse selection: The arranger has more information about the quality of the mortgage loans – so, the arranger can choose to securitize the bad loans and retain the good ones.

6. Principal-agent: While the investor provides funding for the mortgage-backed security, the asset manager conducts the due diligence on the investments and finds the best price for the trades – the asset manager may not take sufficient effort on behalf of the investor.

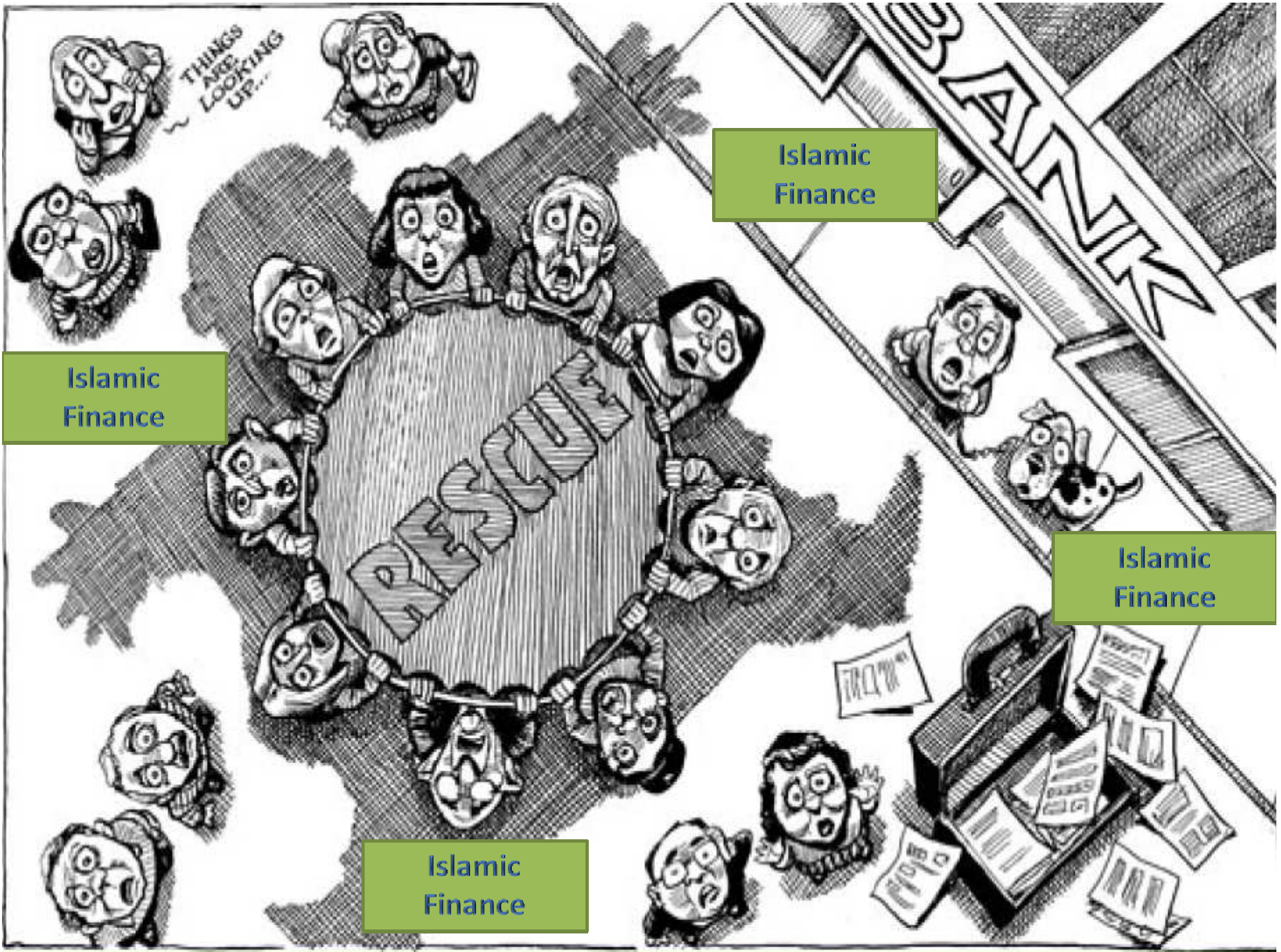
7. Model error: The rating agencies are paid by the arranger and not investors for their opinion. Their rating relies on models, which are susceptible to errors.

4. Moral hazard: In order to maintain the value of the underlying asset (the house), the mortgagor has to pay insurance and maintain the property. In, or approaching delinquency, there is little incentive to do this.

5. Moral hazard: Given that the servicer's income increases the longer the loan is serviced, keeping the loan on its books for as long as possible is preferred – therefore, it has a preference to modify the terms of a delinquent loan to delay foreclosure.



Source: Ashcraft and Schuermann (2007): "Understanding the Securitization of Subprime Mortgage Credit"



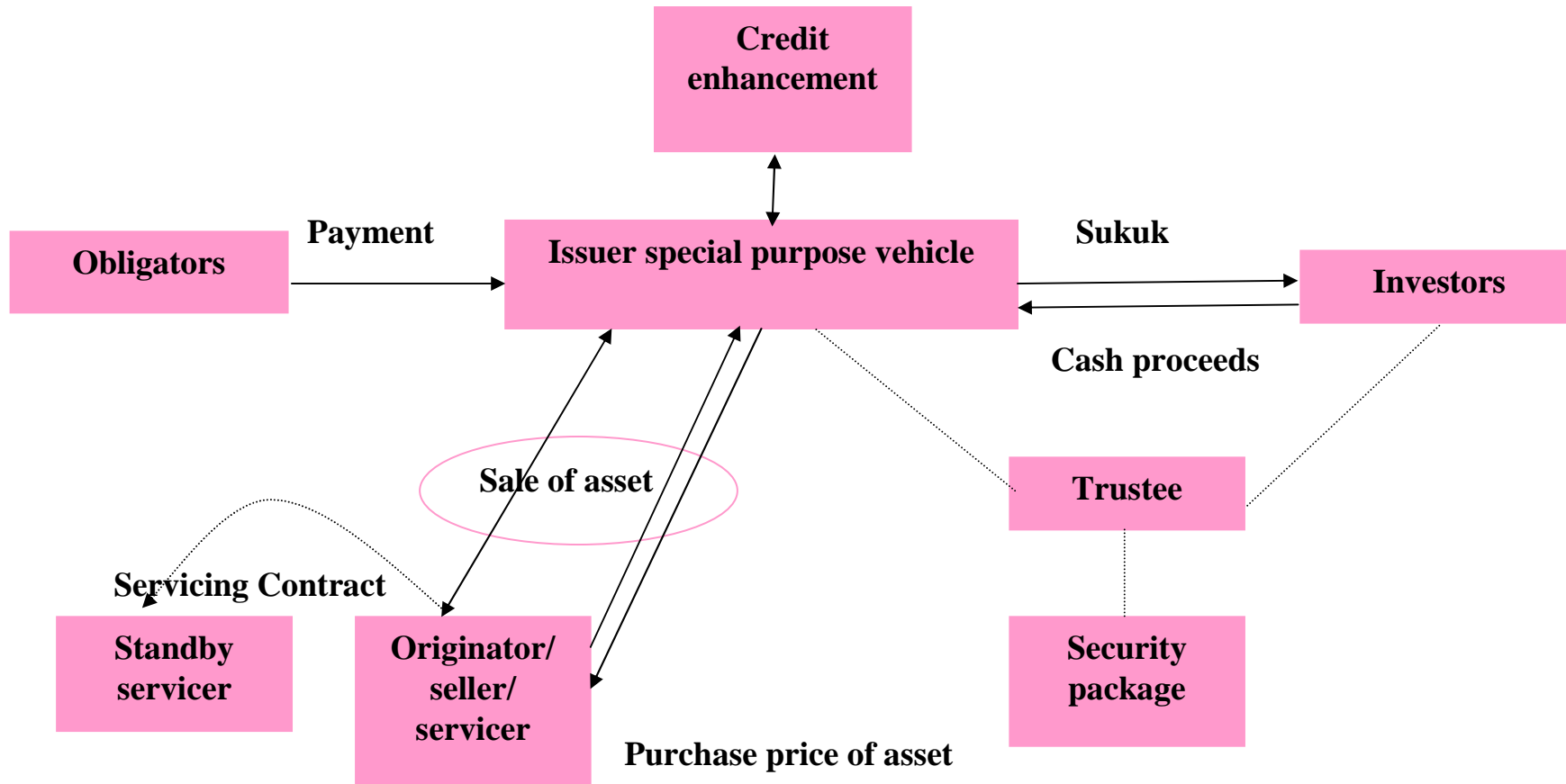
Islamic Finance

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Islamic Securitization Procedure

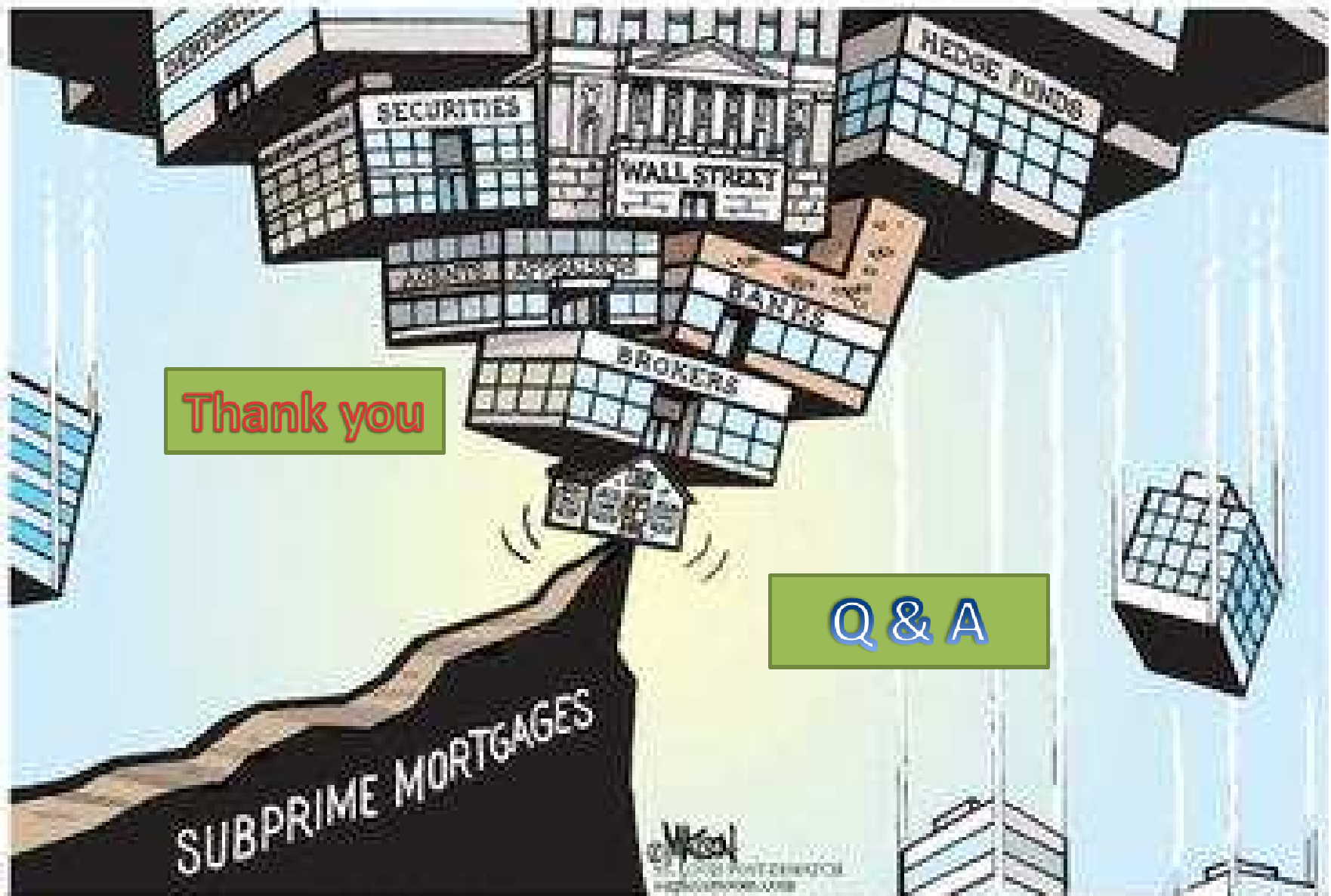


Advantages of Islamic Securitization

- **Real purpose behind raising funds via securitization**
- **Each transaction participant share in both the risk and return**
- **Collateral assets are not in form of debt**
- **The underlying assets and securitized obligations are not employed for speculative purposes**

Islamic Options for Subprime Mortgages

- **SUKUK BBA**
- **SUKUK IJARAH**



Thank you

Q & A

SUBPRIME MORTGAGES

"I THOUGHT WE WERE JUST BUYING A HOUSE!"

[Circle Cartoons](#)