Securitization

New topic :-
Blockchain

Blockchain or Distributed ledger technology (DLT) is a peer to peer decentralized open ledger of transaction system with no trusted parties in Between. A blockchain generally uses a chain of blocks. with each block representing the digital information stored in public database ("the chain")

'PAIN' eg→₹140000/-

(P) (i) Every entry in this database is Permanent
(A) (ii) It is. Append only database which cannot be changed or altered. (existing को change नहीं कर सकते)
(I) (iii) All transactions are fully Irreversible
(N) (iv) Any change in a transaction is recorded in a New transaction (कोई भी changes करना है तो change नहीं कर सकते है बस new transaction को record करो)

Applications of Blockchain

(जहाँ जहाँ database को use करते है वहाँ वहाँ Blockchain को use कर सकते हैं)

(1) Financial services :-
It can used to provide a transaction log of any physical or digital asets such as laptops, automobiles, real estate etc (i.e for automotive trade lifecycle)

(2) Healthcare :- Blockchain provides secure sharing of data in healthcare industry by increasing the privacy and interoperability of the data by eliminating the interface of third party

(3) Government :-

It can be used where technical decentralization is necessary along with governance of govt like land registration, E-voting etc

Blockchain provides transparency and provides a better way to monitor and audit the transaction in these systems.

(4) Travel industry

It can be used for many transactions storing passport / other important docs, reservations, travel insurance etc

(5) Economic forecasts → we can use blockchain

to make financial and economic forecasts based on decentralized prediction markets, decentralized voting and stock trading.

Risk Associated with Blockchain (PURI)

P → Process Controls

Development and maintenance of process controls can be challenging due to absence of any central authority. So users of public blockchain may find it difficult to understand the IT controls implemented and its effectiveness.

U – updates Blockchain involves numerous data updates, the risk of information overload could challenge the required monitoring. Further, finding competent people to design and perform effective monitoring controls may be difficult.

R – Reliability

Reliability of financial transaction is depend-ent on the underlying technology. If the underlying consensus mechanism it is tampered with, then it could render the financial information to be inaccurate and unreliable.

In-charge

Different members may have different risk appetite that may lead to conflict while designing monitoring controls. Since no one party is in charge, it need to be defined who is responsible & accountable for managing risks in the blockchain

Tokenization

Tokenization is a process of converting tangible and intangible assets into blockchain tokens. It can be effective in conventional industries like real estate, artwork etc

Similarity b/w Securitization & Tokenization

Tokenization :- Attempt to convert illiquid assets into a liquid and tradable product (similar to securitization)

(1) Liquidity :- Both inject liquidity in the market for otherwise illiquid assets

(2) Diversification :- Both help investors to diversify their portfolio thus

(optimising)
managing risk and maximising return

(3) Trading :- Both are tradable and help to generate returns.

(4) New opportunities Both provide oppt for financial institution to Earn Income through fees.

Risks in Securitization :-

Credit/counterparty risk :- Risk of bankruptcy and non performance of services is the prime risk of investor.

Legal risks :- Securitization is recently developed concept (in India) and there is an absence of statutory provision or judicial precedents.
so any legal dispute can result in uncertain cash flows for investors.

Market risk :- It includes risk due to market related risks. It includes

- Macro-economic risk
  - Macro economic factors such as Industry downturns or adverse price movements
- Prepayment Risk
  - Reduces interest rates
- Interest rate risk
  - This risk prominent

can offset loan refinance

Increases prepayement of retail loans, resulting in reinvestment risk for investors

where the loans are based on floating rate and investor payouts are based on a fixed rate or viceversa.

- It results in an interest rate mismatch where pool of cash inflow may not be ~~to~~ sufficient to meet investor payouts.