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Optimal Tranching with Diverse Beliefs[☆]

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Abstract

In this paper, we consider the optimal selling strategy for an asset securitization originator (the issuer) when the potential buyers hold diverse beliefs. We find that the tranching process is beneficial to the issuer because it increases the total sale price. We also consider the optimal tranching strategy that maximizes the revenue of the issuer. This helps explain the widespread use of the tranching technique in the asset securitization practice. Our findings are also enlightening to understand the price bubble problem when the junior tranche is interpreted as a collateral.

Keywords: Optimal tranching, Diverse beliefs, Price bubble

JEL: D84, G12, G21

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