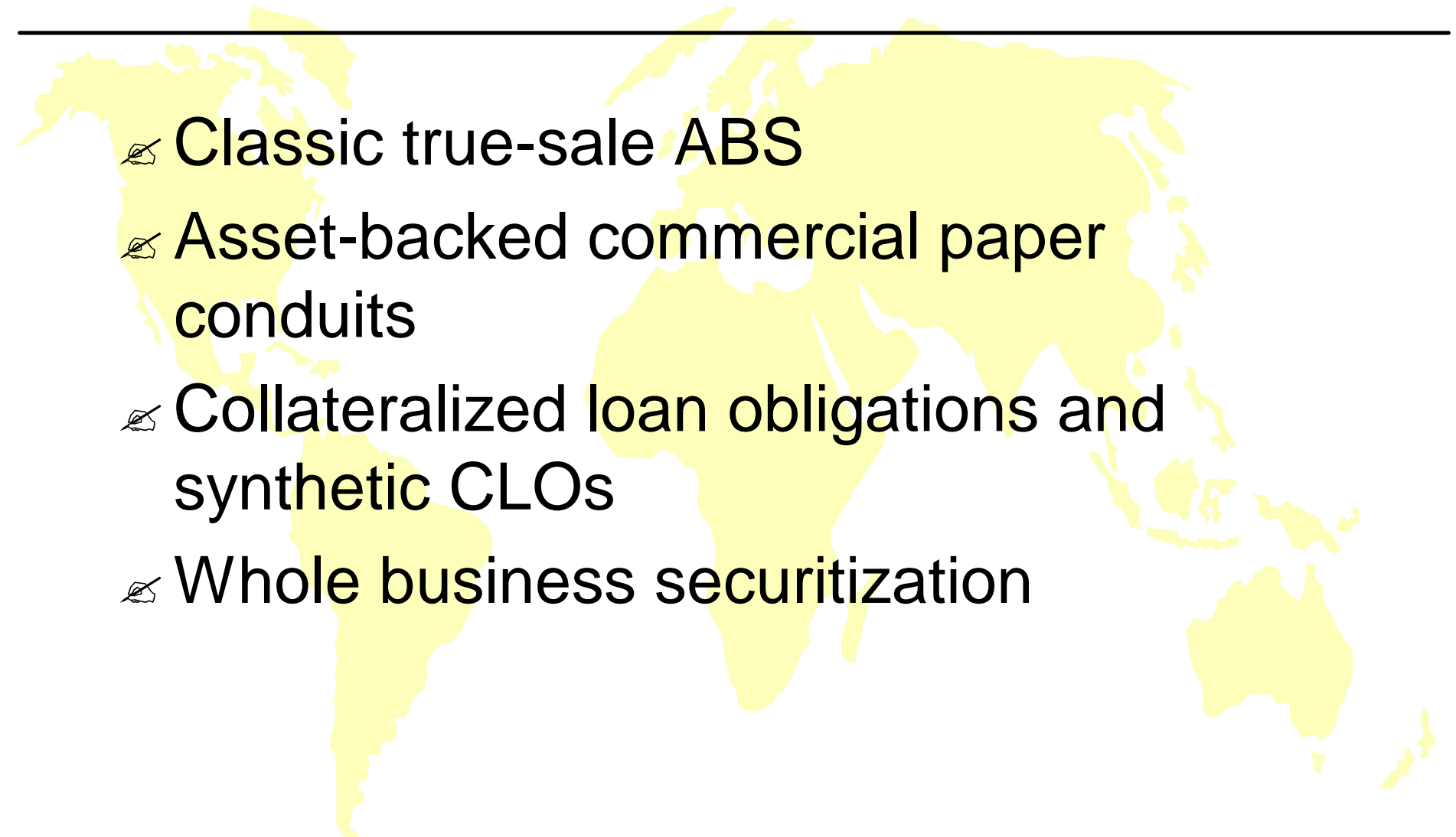


Asset-Backed Securities

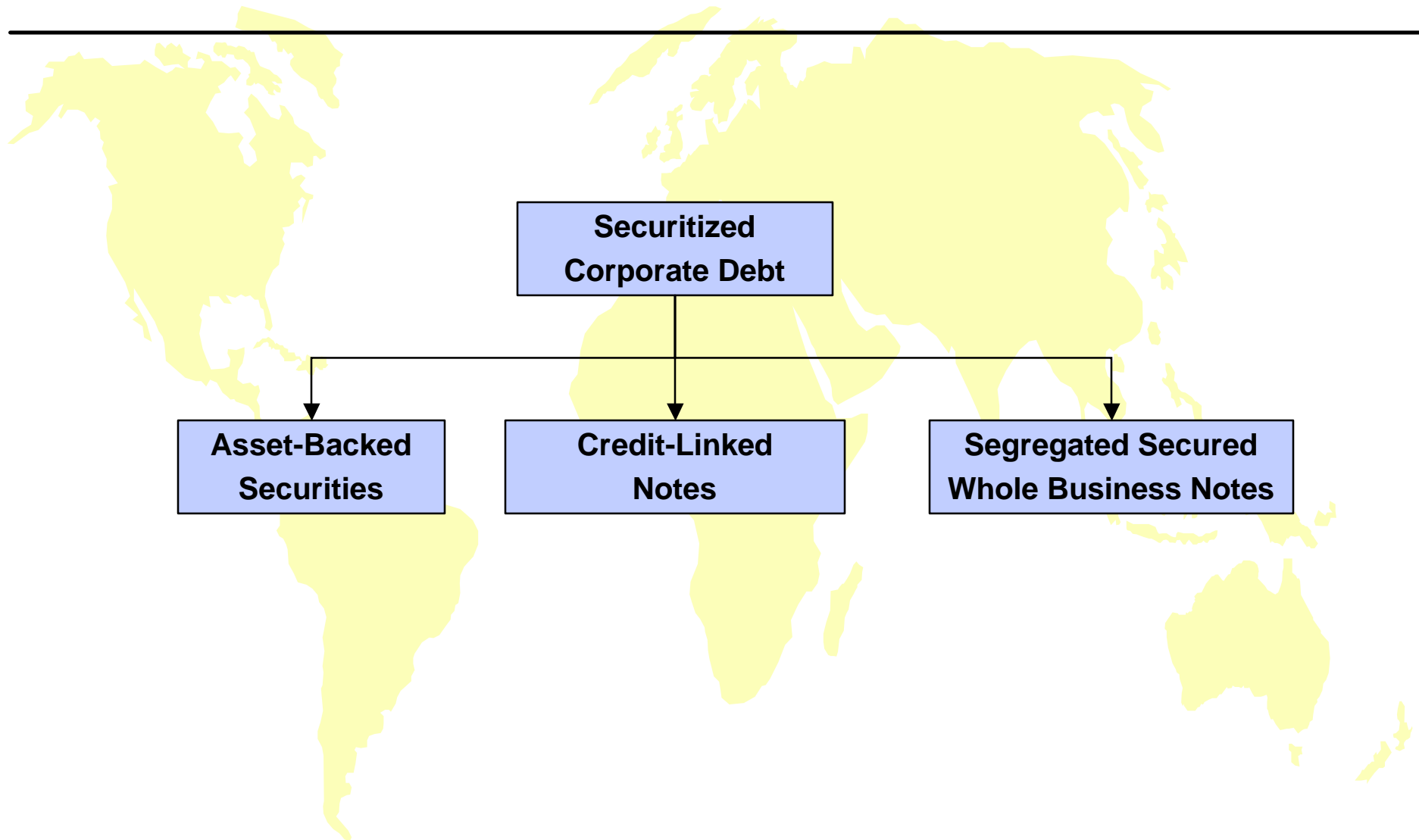
***Asset-Backed Securities:
Applications***

Prof. Ian Giddy
Stern School of Business
New York University

Applications and Variations

- 
- ✍ Classic true-sale ABS
 - ✍ Asset-backed commercial paper conduits
 - ✍ Collateralized loan obligations and synthetic CLOs
 - ✍ Whole business securitization

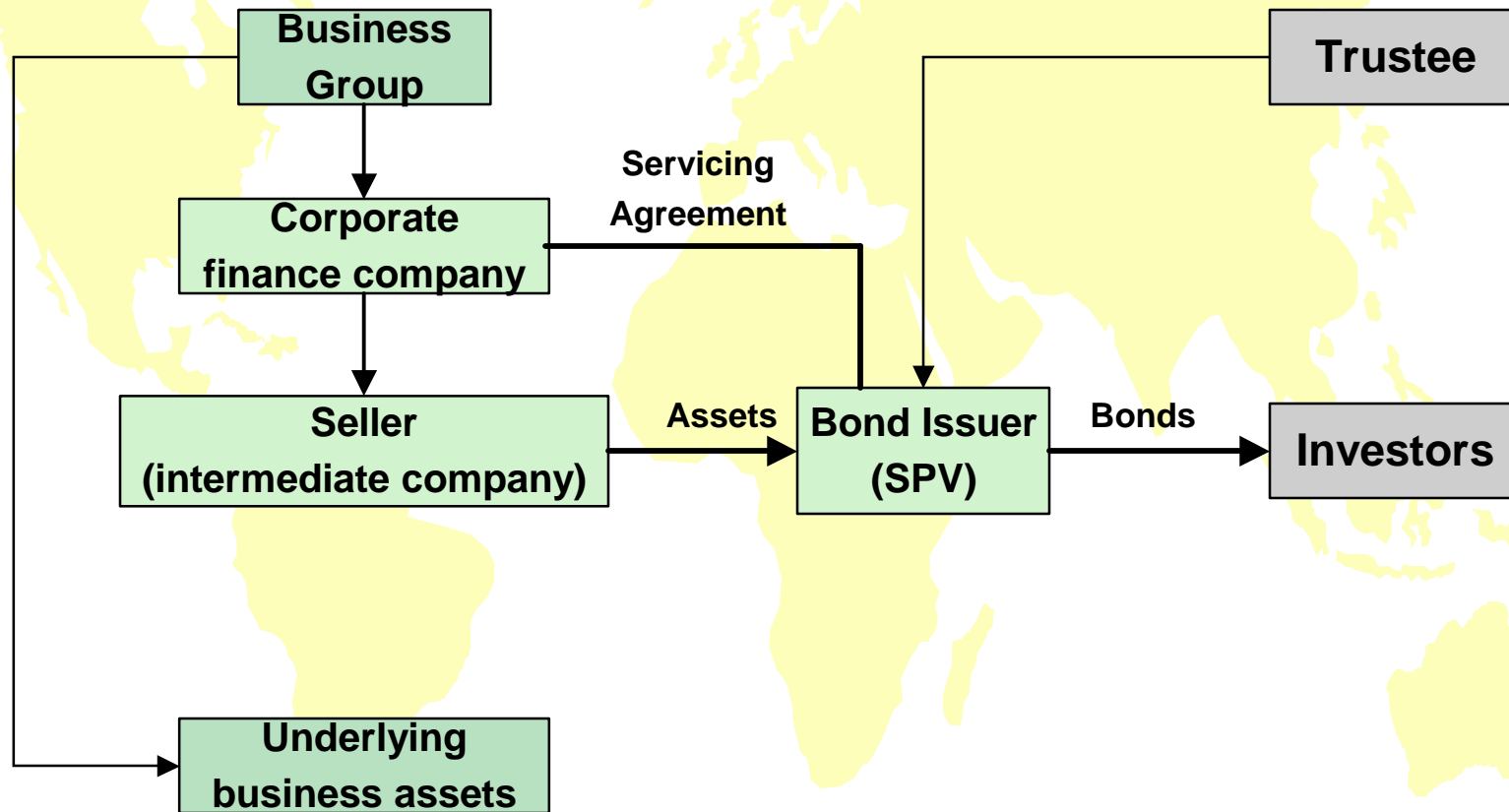
Corporate Cash Flow Financing



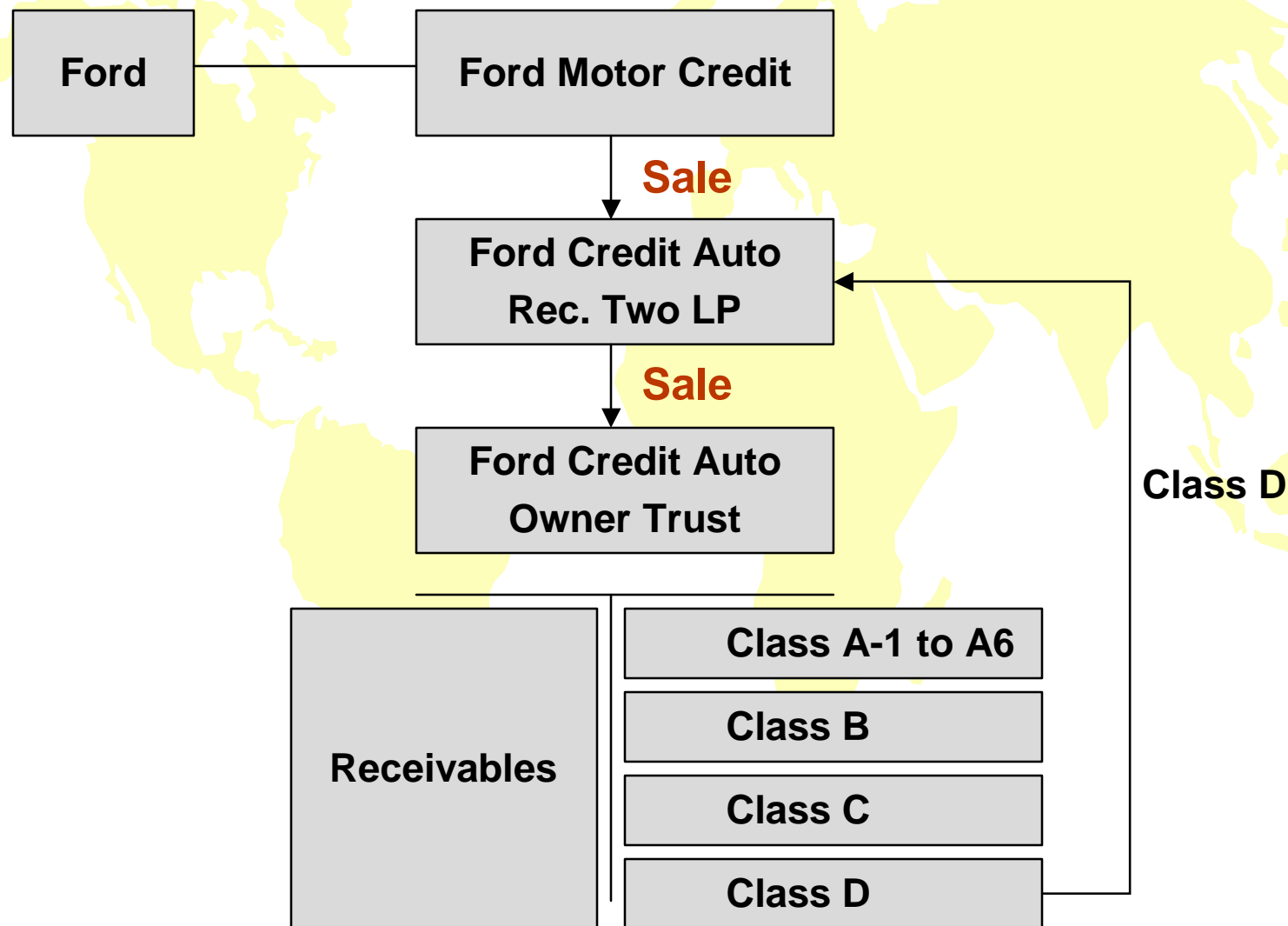
Vintage Asset Securitization

- ✍ The transfer must be a true sale, or its legal equivalent. If originator is only pledging the assets to secure a debt, this would be regarded as collateralized financing in which the originator would stay directly indebted to the investor.
- ✍ The assets must be owned by a special-purpose corporation, whose ownership of the sold assets is likely to survive bankruptcy of the seller.
- ✍ The special-purpose vehicle that owns the assets must be independent

Vintage ABS Structure



Ford Structure



Asset-Backed Securities

***Securitization of
Trade Receivables***

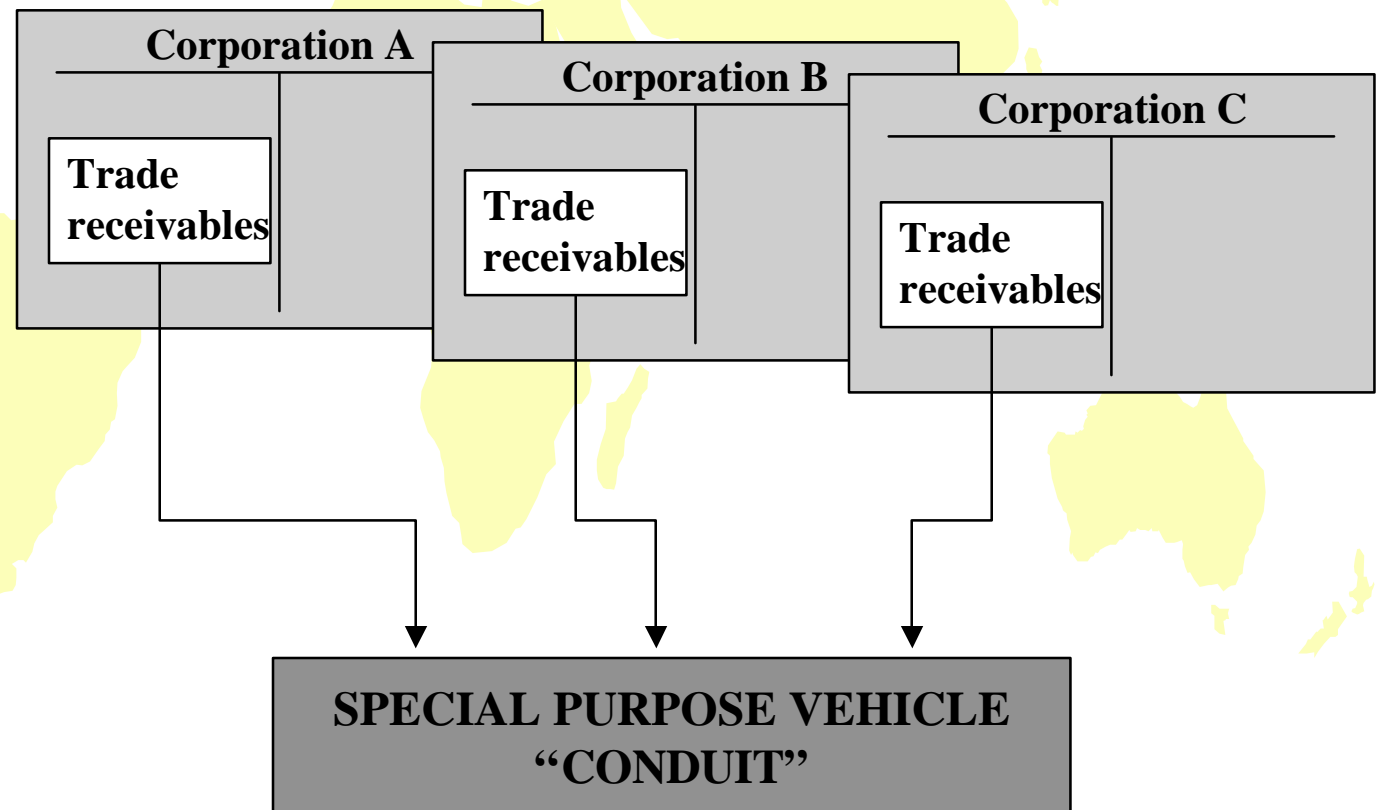
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Stern School of Business
New York University

Trade Receivable Backed CP

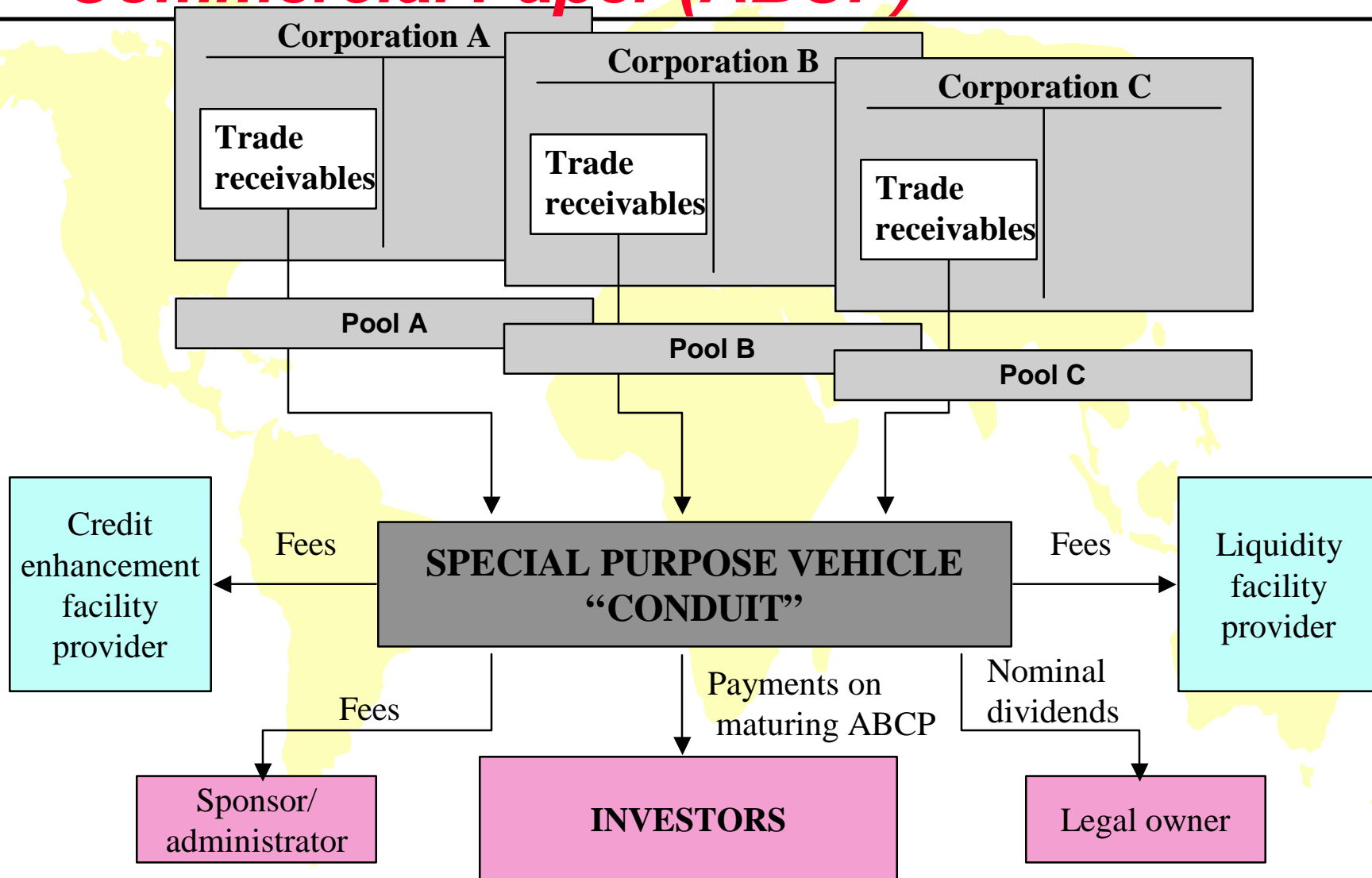
- ✍ Over \$500 billion outstanding in US alone
- ✍ Key feature is pooling of different companies' trade receivables, allowing smaller companies to take advantage of ABS market
- ✍ Need two-tier legal structure – SPV at level of each company's receivables pool, and at multi-company program (the “conduit”)

Two Kinds of ABCP

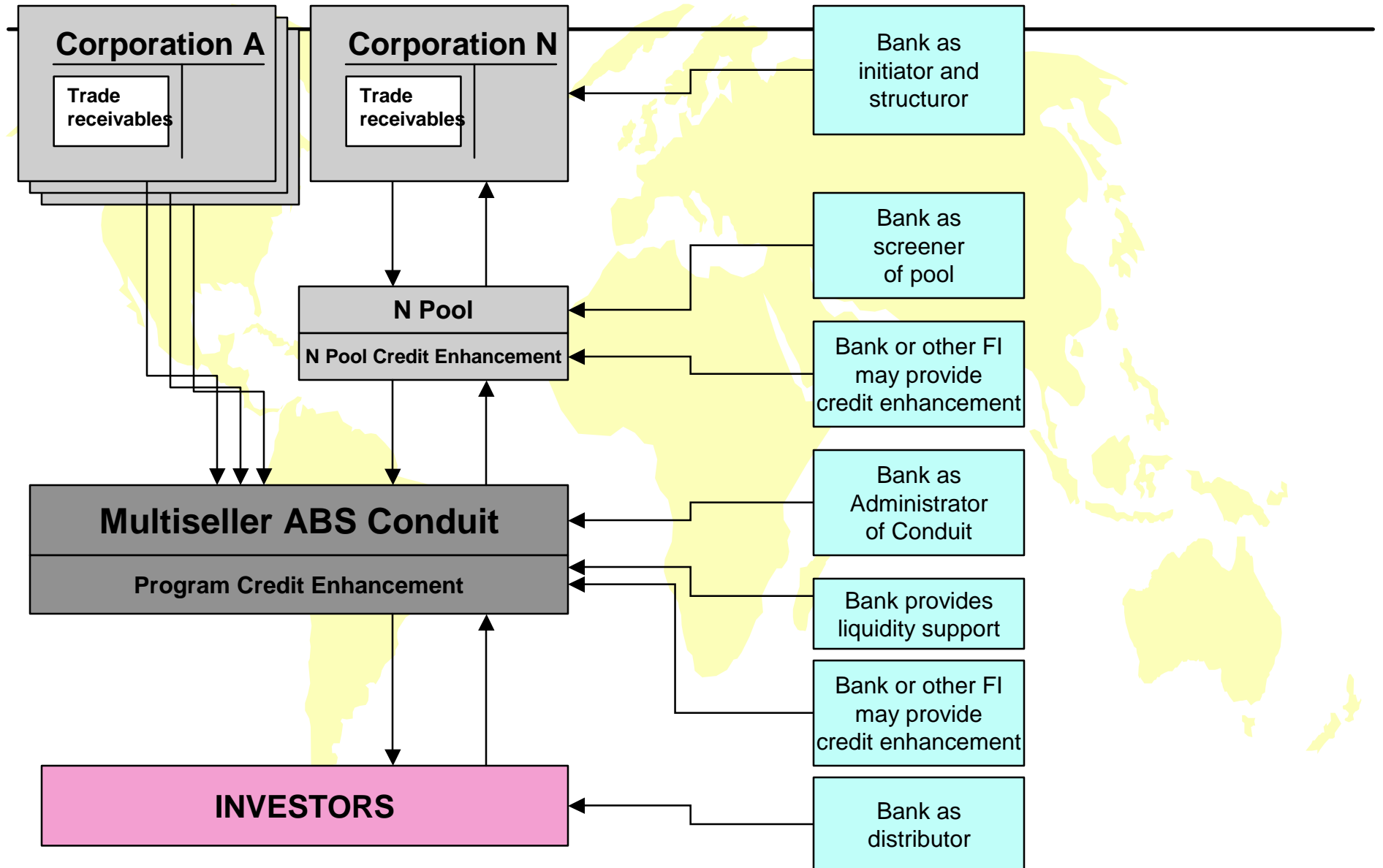
- ✍ Single-seller ABCP
- ✍ Multiseller ABCP



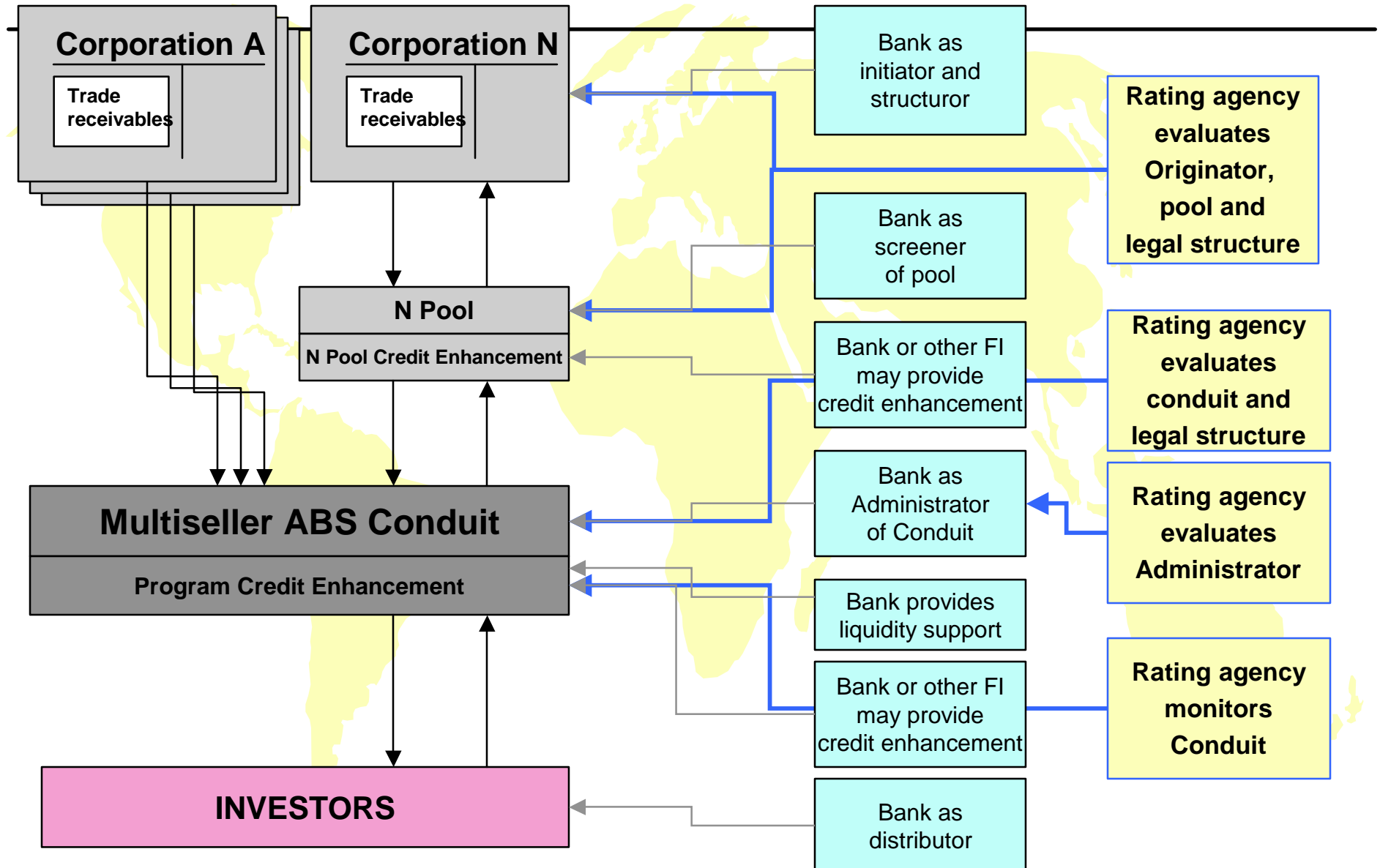
Trade Receivable-Backed Commercial Paper (ABCP)



ABCP: Role of Banker



ABCP: Role of Rating Agency

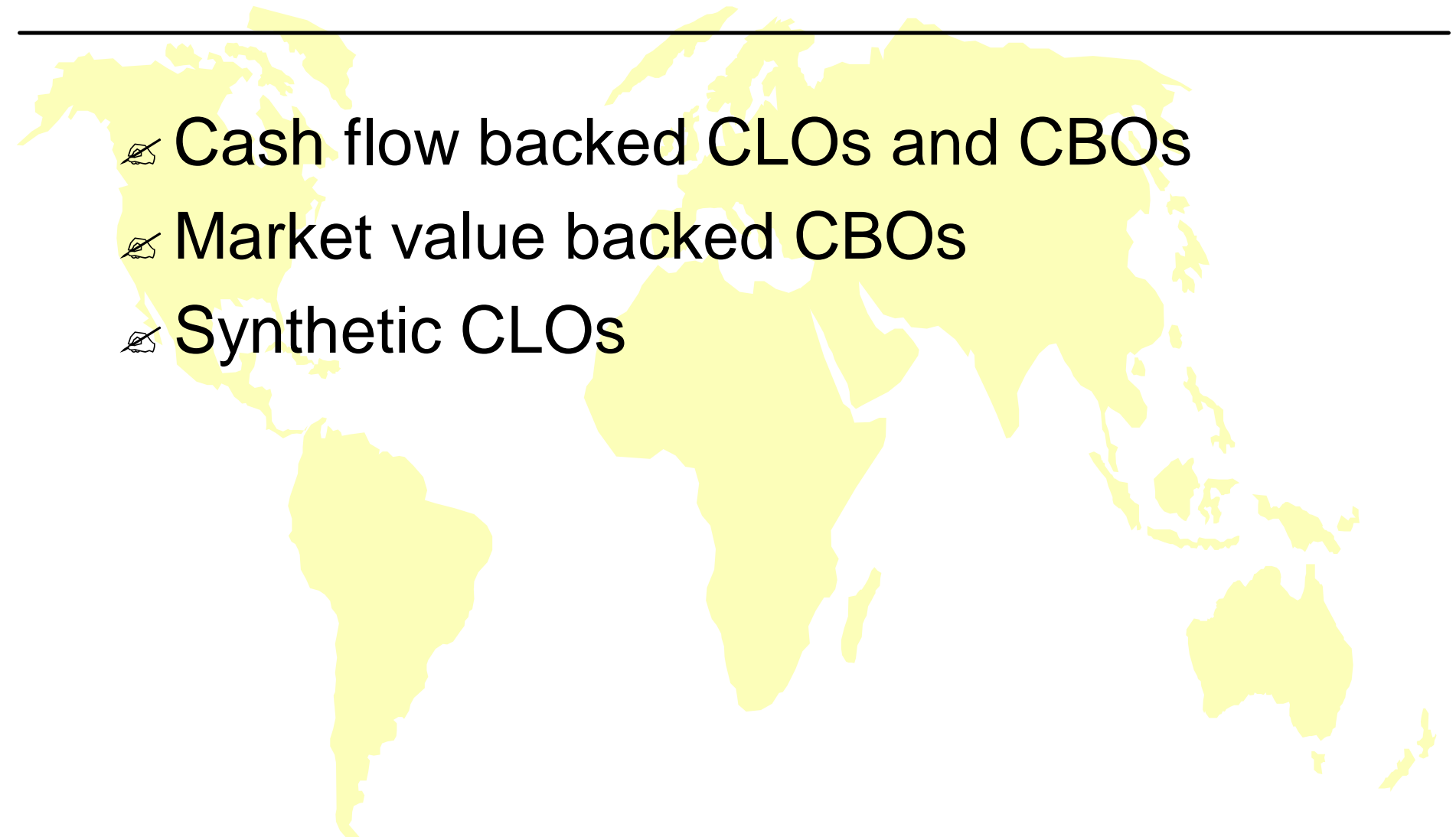


Asset-Backed Securities

***Collateralized
Debt Obligations***

Prof. Ian Giddy
Stern School of Business
New York University

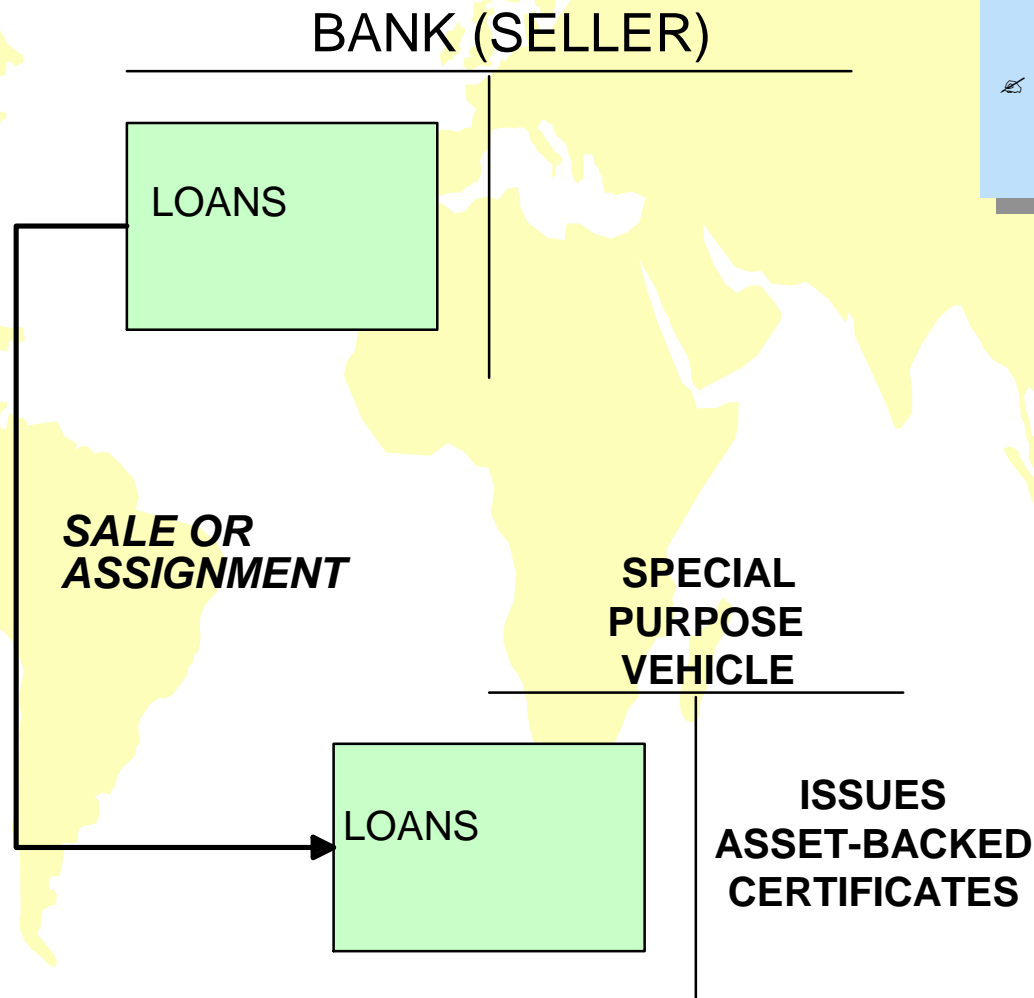
Collateralized Debt Obligations

- 
- ✍ Cash flow backed CLOs and CBOs
 - ✍ Market value backed CBOs
 - ✍ Synthetic CLOs

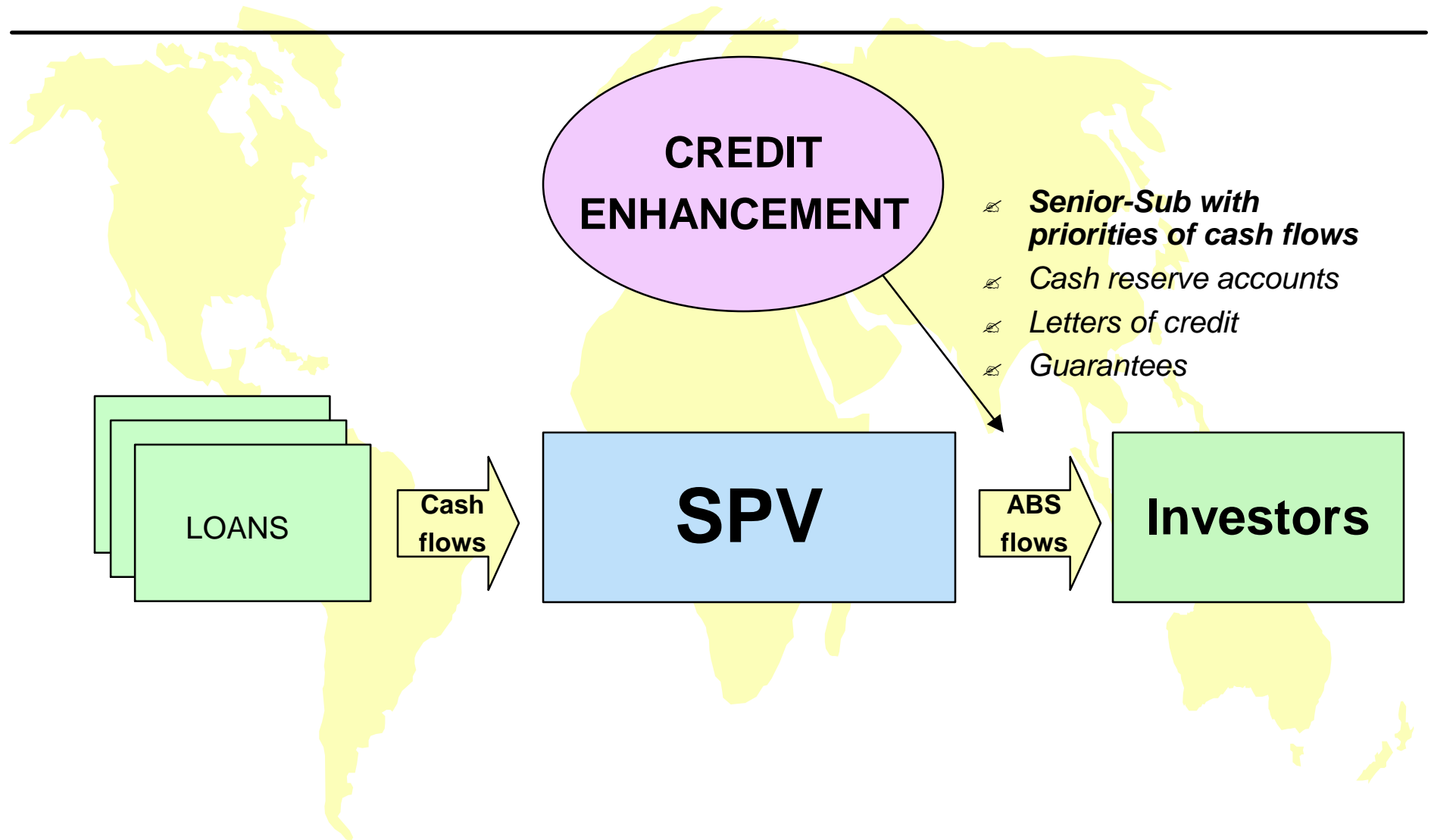
Cash Flow Backed CLOs

Motivations:

- ✍ Free up capital
- ✍ Lower cost of funding
- ✍ Distressed loan arbitrage (3rd party sponsors)



Cash flow Backed CLOs



Senior-Sub CLO Structure

Sample CLO Balance Sheet

(\$ Mil.)

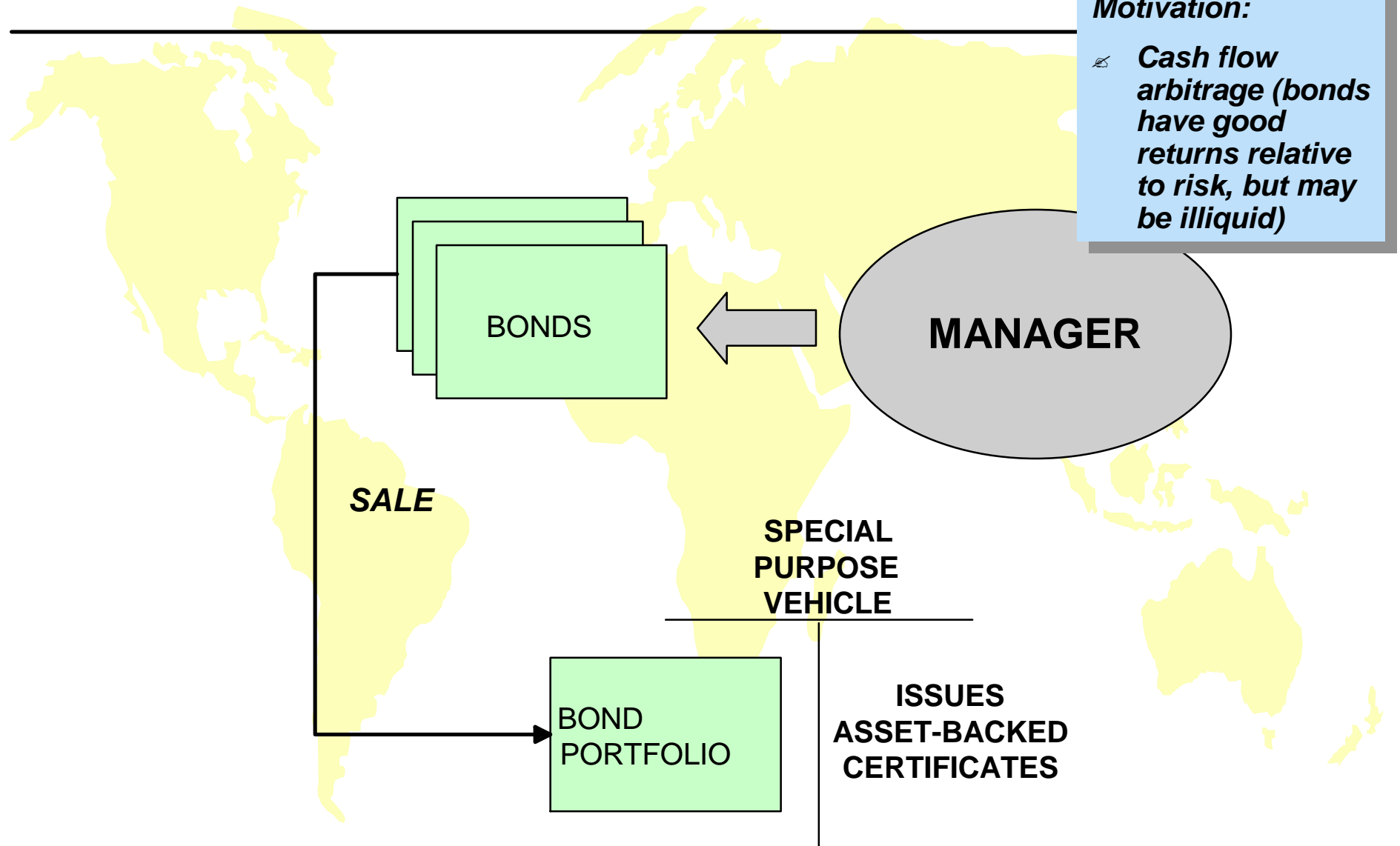
Assets (Loans)	Liabilities (Notes)	Rating	%
5,000	4,650	'AAA/AA'	93
—	100	'A'	2
—	100	'BBB'	2
—	150*	—	3
5,000	5,000		

*Equity, not rated. CLO – Collateralized loan obligation.

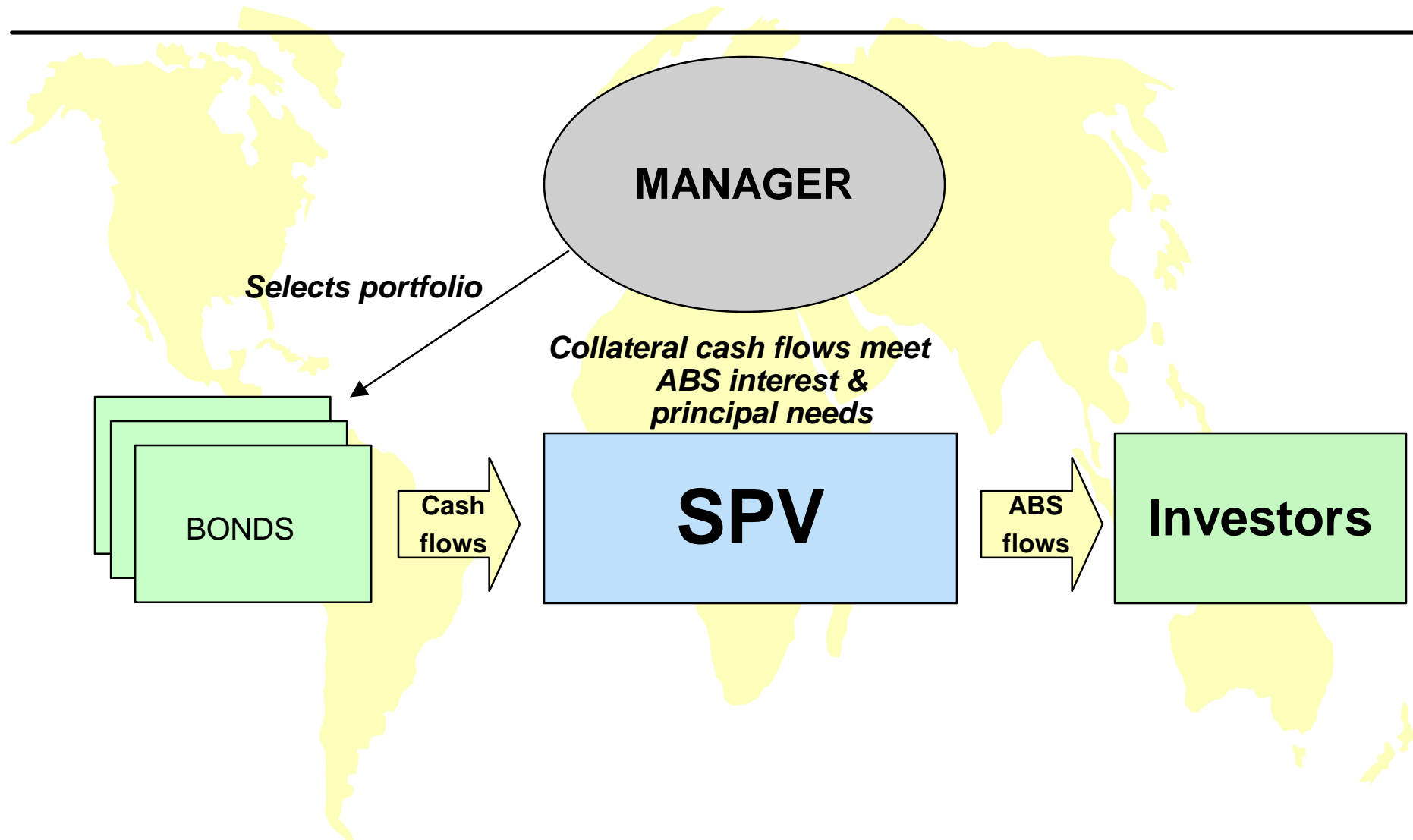
Cash Flow Backed CBOs

Motivation:

✍ **Cash flow
arbitrage (bonds
have good
returns relative
to risk, but may
be illiquid)**



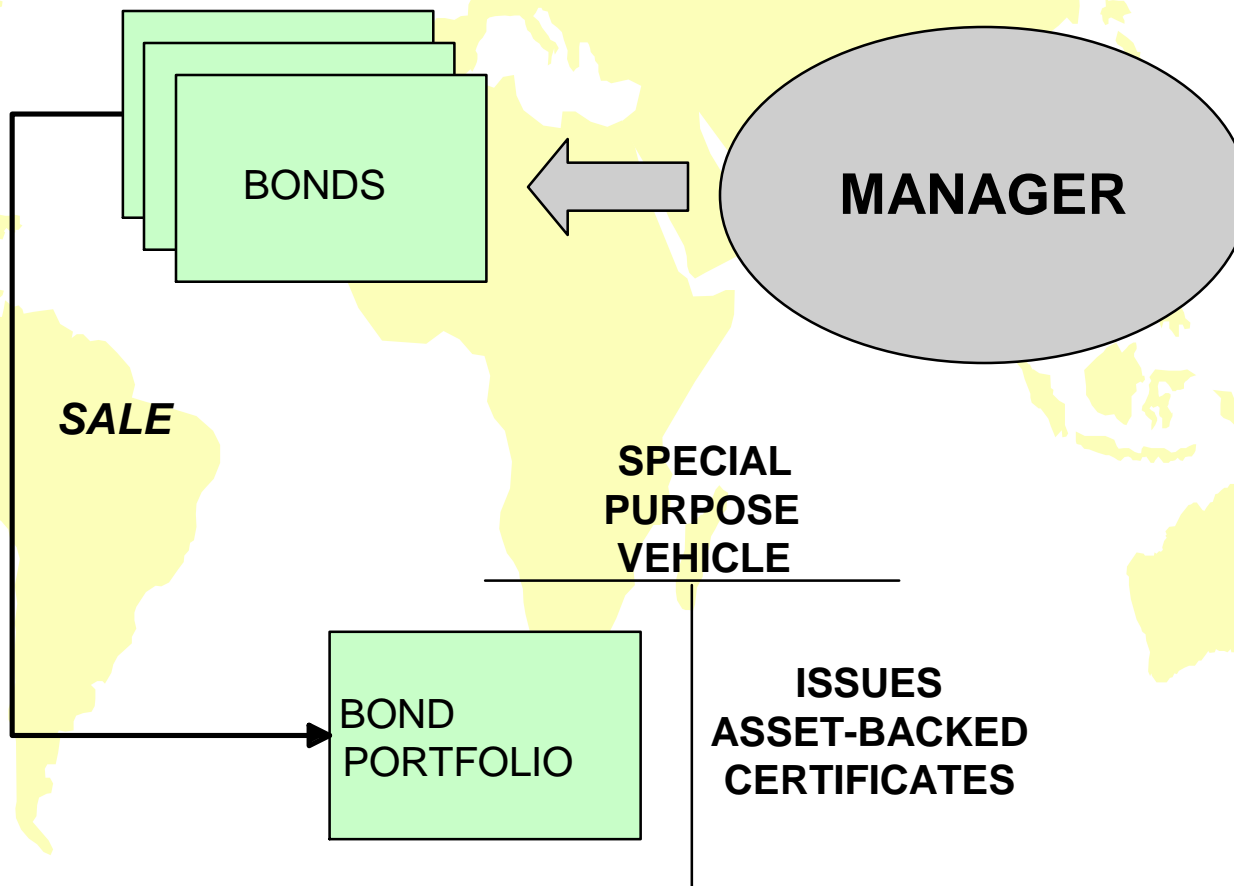
Cash Flow Backed CBOs



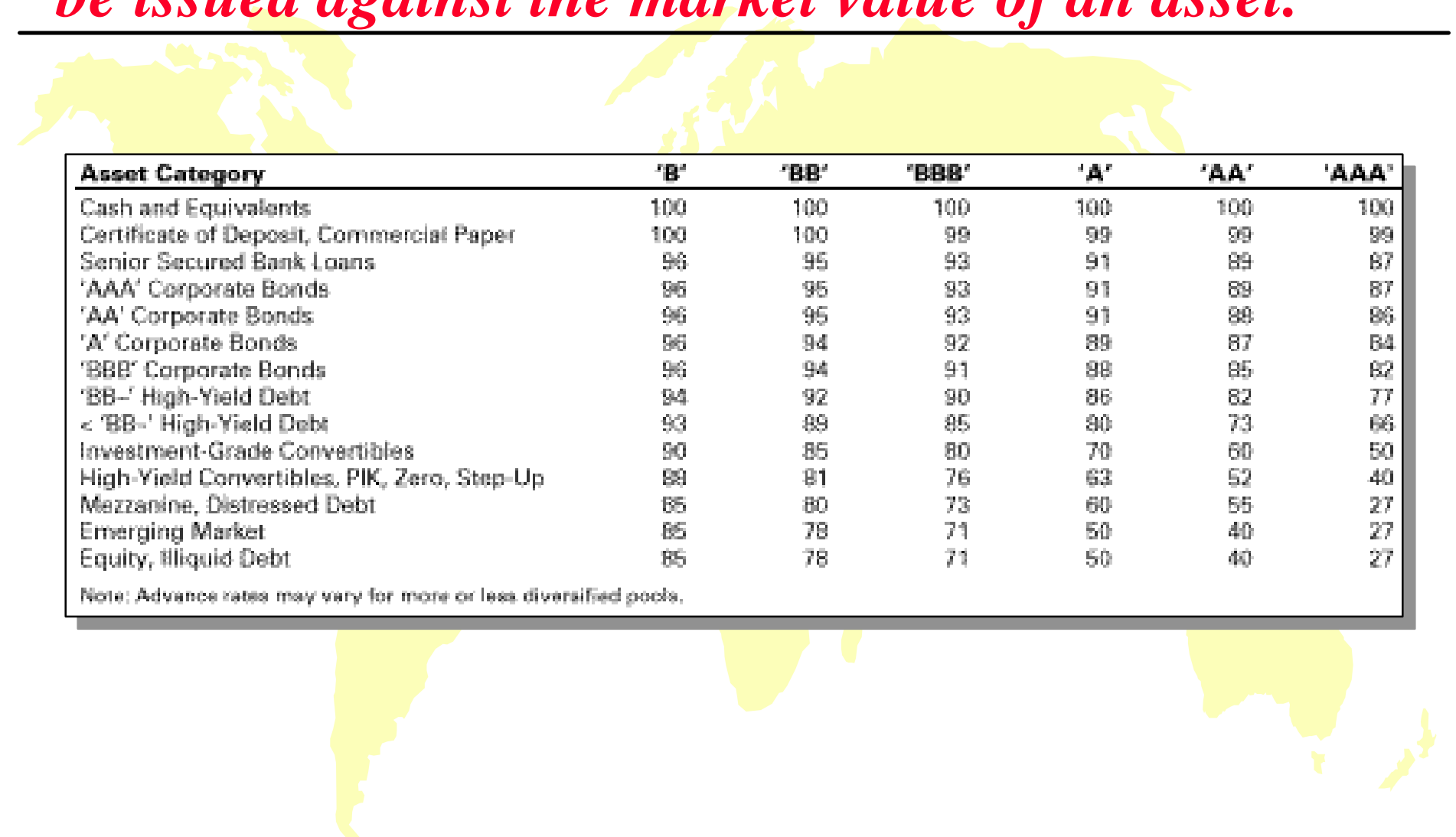
Market Value Backed CBOs

Motivation:

✍ Price arbitrage
(bonds are
underpriced,
and tradeable)



Advance rates determine how much rated debt can be issued against the market value of an asset.



Asset Category	'B'	'BB'	'BBB'	'A'	'AA'	'AAA'
Cash and Equivalents	100	100	100	100	100	100
Certificate of Deposit, Commercial Paper	100	100	99	99	99	99
Senior Secured Bank Loans	96	95	93	91	89	87
'AAA' Corporate Bonds	96	95	93	91	89	87
'AA' Corporate Bonds	96	95	93	91	88	86
'A' Corporate Bonds	96	94	92	89	87	84
'BBB' Corporate Bonds	96	94	91	88	85	82
'BB-' High-Yield Debt	94	92	90	86	82	77
< 'BB-' High-Yield Debt	93	89	85	80	73	66
Investment-Grade Convertibles	90	85	80	70	60	50
High-Yield Convertibles, PIK, Zero, Step-Up	89	81	76	63	52	40
Mezzanine, Distressed Debt	85	80	73	60	55	27
Emerging Market	85	78	71	50	40	27
Equity, Illiquid Debt	85	78	71	50	40	27

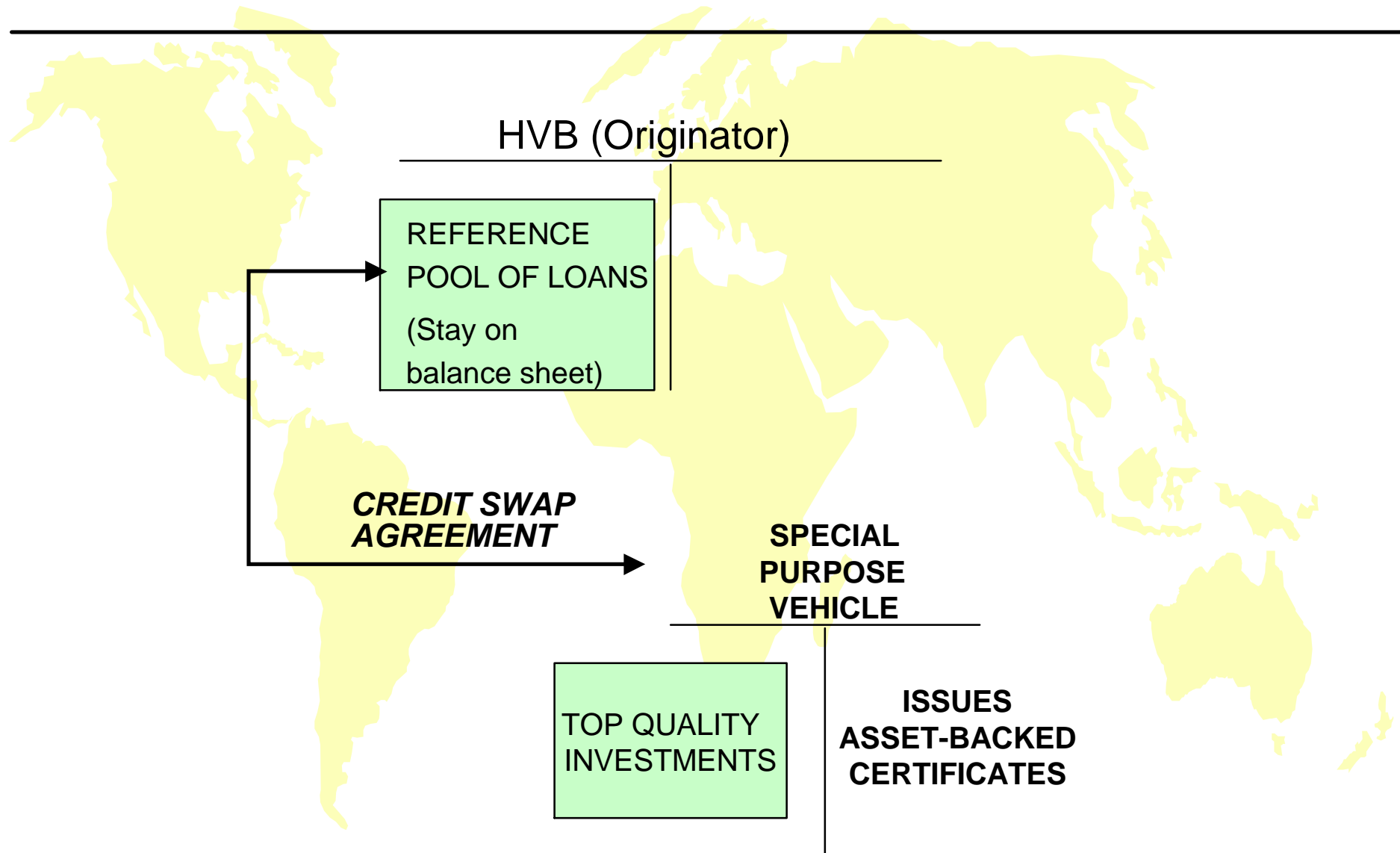
Note: Advance rates may vary for more or less diversified pools.

Example of Market Value CBO Asset Mix and Financing

Portfolio Assets	Market Value (\$ Mil.)	Advance Rate (%)	'A' Discounted Collateral Value (\$ Mil.)	Capitalization (\$ Mil.)	Rating	Required OC (\$ Mil.)	Additional OC (\$ Mil.)
Bank Loans	300	91	273	Revolving Notes*	500	'AA'	85
'BB' High-Yield Bonds	250	86	215	Senior Notes*	150	'AA'	85
'B' High-Yield Bonds	250	80	200	Senior-Subordinate Notes	65	'A'	73
Emerging Market Debt	50	50	25	Subordinate Notes	65	'BBB'	79
Private Equities	150	50	75	Junior Subordinate Notes	30	'BB'	84
Total	1,000	79	788	Participating Notes Equity	30	'B'	86
				Total	1,000	NR	

*Overcollateralization (OC) calculated for aggregate 'AA' rated debt. NR = Not rated.

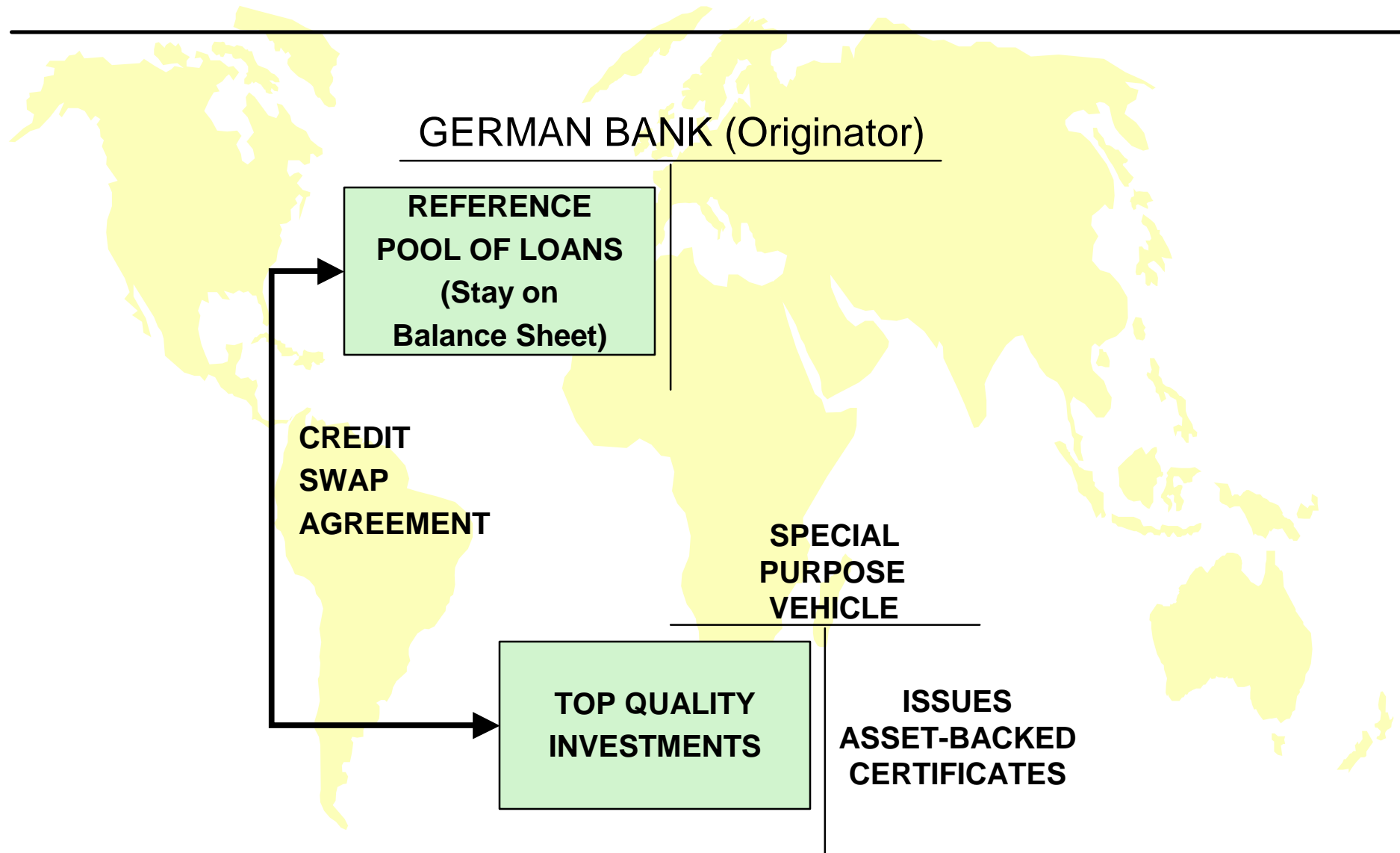
The Alternative: Synthetic ABS



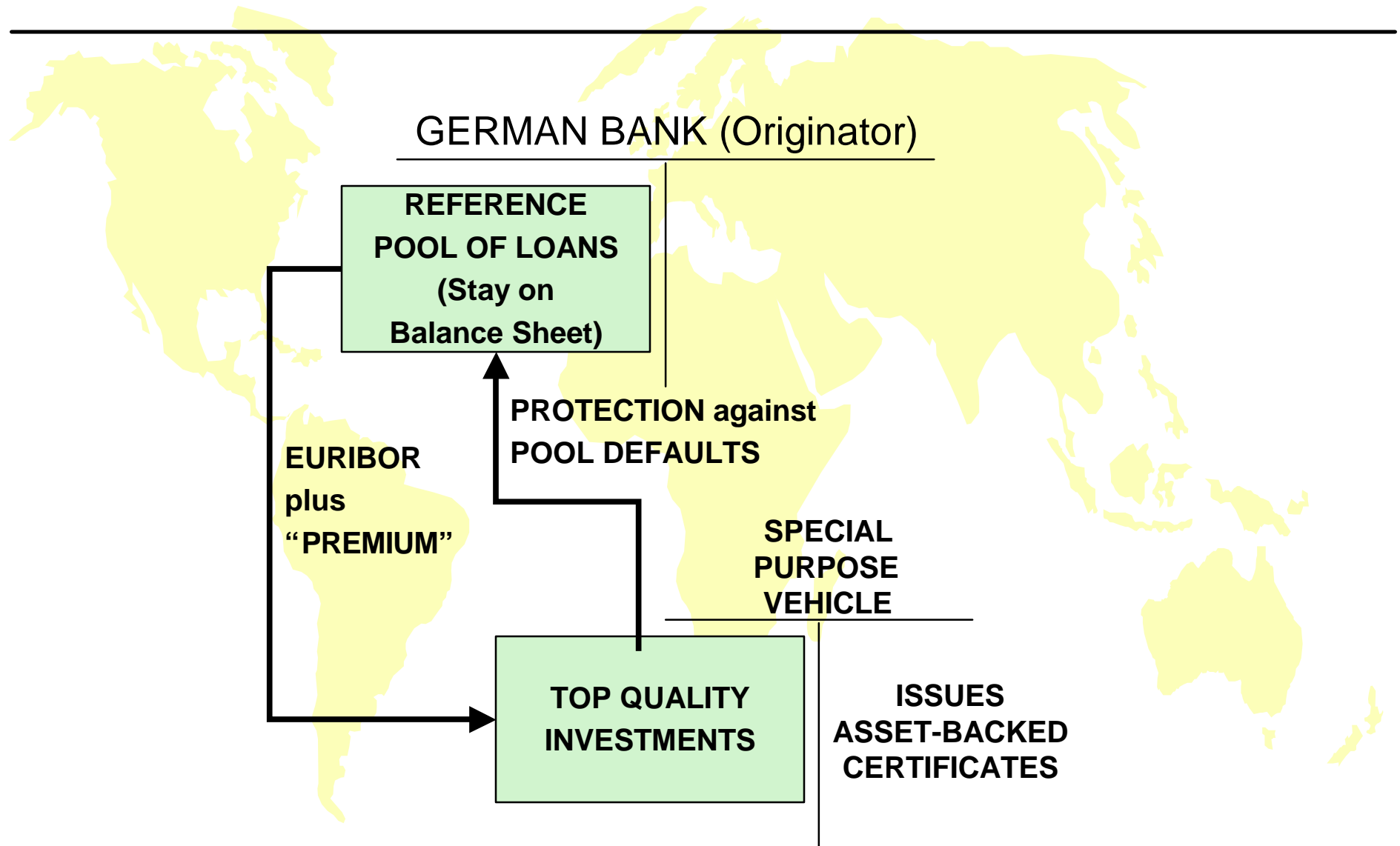
Synthetic ABS or Collateralized Loan Notes

- ✍ CLNs are SPV debt backed by the credit of the selling bank (or better)
- ✍ No loans are sold to the SPV
- ✍ But performance is based on the performance of a reference pool of loans
 - ✍ If the reference credits perform, full debt service is made on the CLN
 - ✍ If the reference credits default, the CLN is deemed “defaulted” and payment is halted.

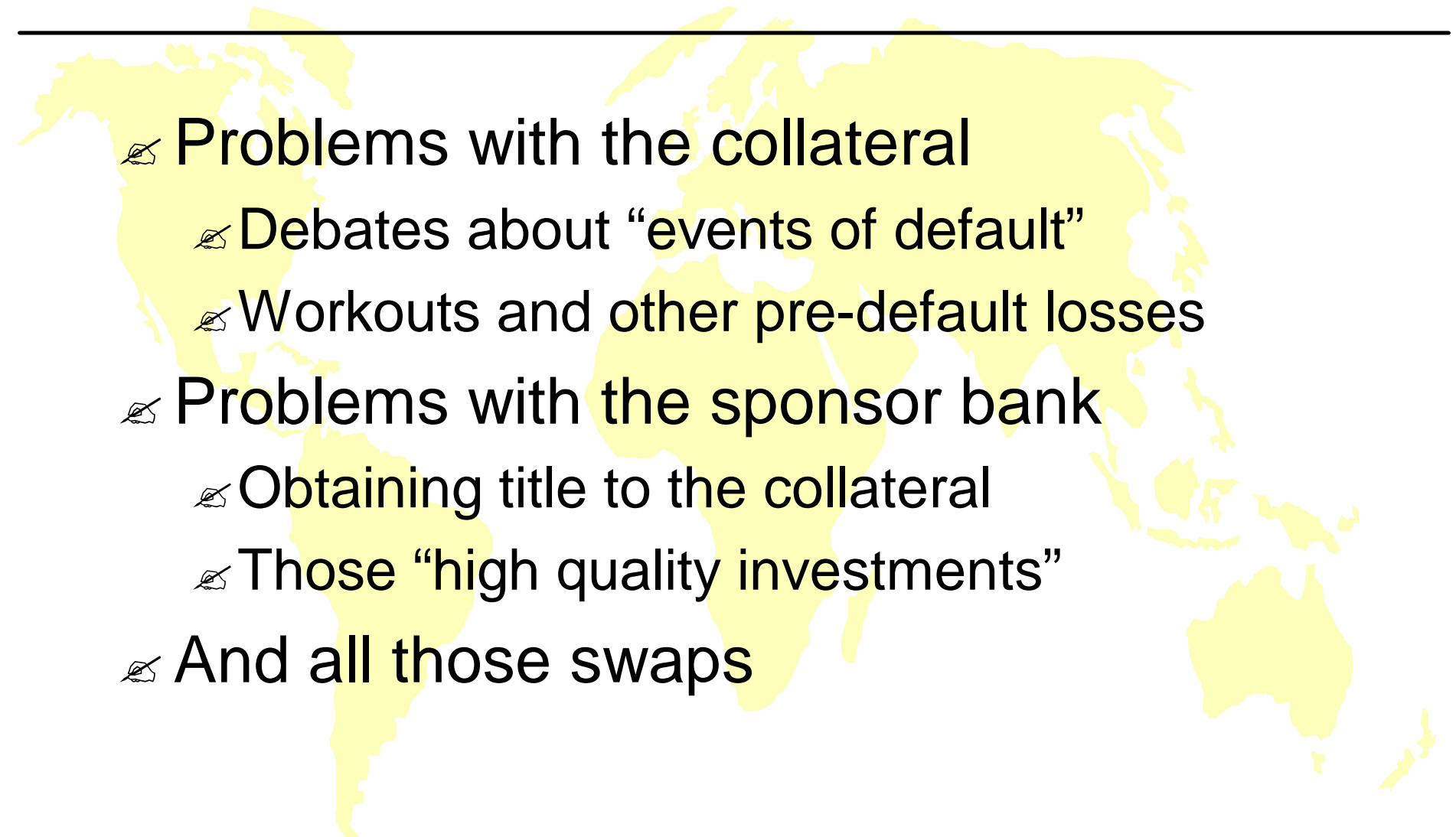
Synthetic ABS



Synthetic ABS



Credit Swaps in Synthetics: Doubts

- 
- ✍ Problems with the collateral
 - ✍ Debates about “events of default”
 - ✍ Workouts and other pre-default losses
 - ✍ Problems with the sponsor bank
 - ✍ Obtaining title to the collateral
 - ✍ Those “high quality investments”
 - ✍ And all those swaps

Asset-Backed Securities

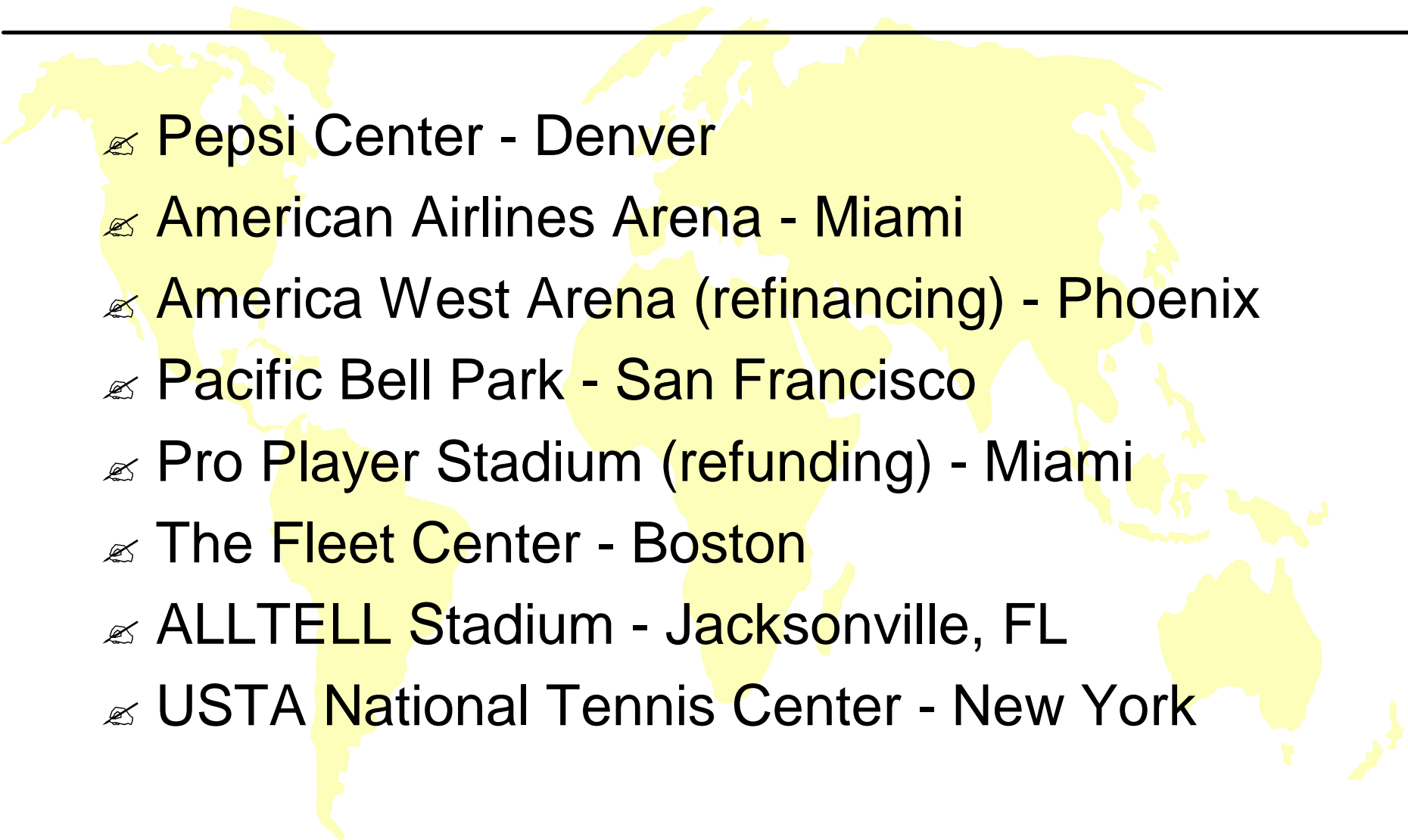
*Whole Business
Securitization*

Prof. Ian Giddy
Stern School of Business
New York University

Whole Business Securitization

- ✍ A securitization where the cash flows derive not from the repayment of debt or other pre-contracted cash flows or receivables, but from the entire range of operating revenues generated by a whole business (or a segregated part of a larger business).
- ✍ An attempt to improve the credit quality of corporate debt by tying the debt to specific elements of a stable business.

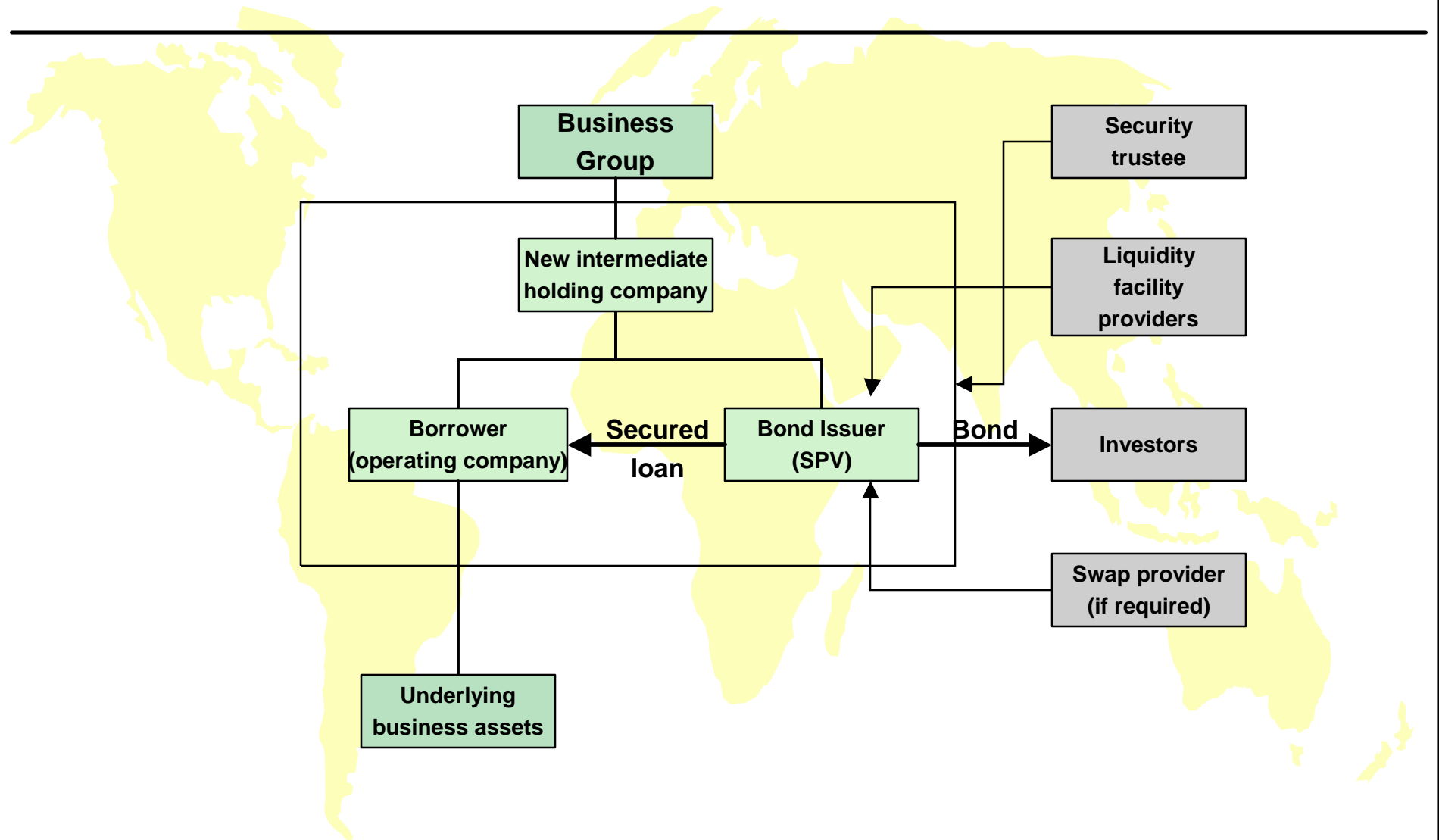
Sports Securitizations

- 
- ✍ Pepsi Center - Denver
 - ✍ American Airlines Arena - Miami
 - ✍ America West Arena (refinancing) - Phoenix
 - ✍ Pacific Bell Park - San Francisco
 - ✍ Pro Player Stadium (refunding) - Miami
 - ✍ The Fleet Center - Boston
 - ✍ ALLTELL Stadium - Jacksonville, FL
 - ✍ USTA National Tennis Center - New York

The Structure

- ✍ The issuer typically owns a loan to an operating company or companies. The loan is in turn secured by operating business assets in ongoing use.
- ✍ Both the SPV and the operating companies are owned by the corporate parent. The UK model offers legal assurance that the assets will not be sequestered if the parent enters bankruptcy protection.
- ✍ In the event of the insolvency of the corporate parent, the SPV and its trustees continue to run the business.

WBS “Secured Loan” Structure



WBS Alchemy?

TABLE 1

The advantages of securitisation

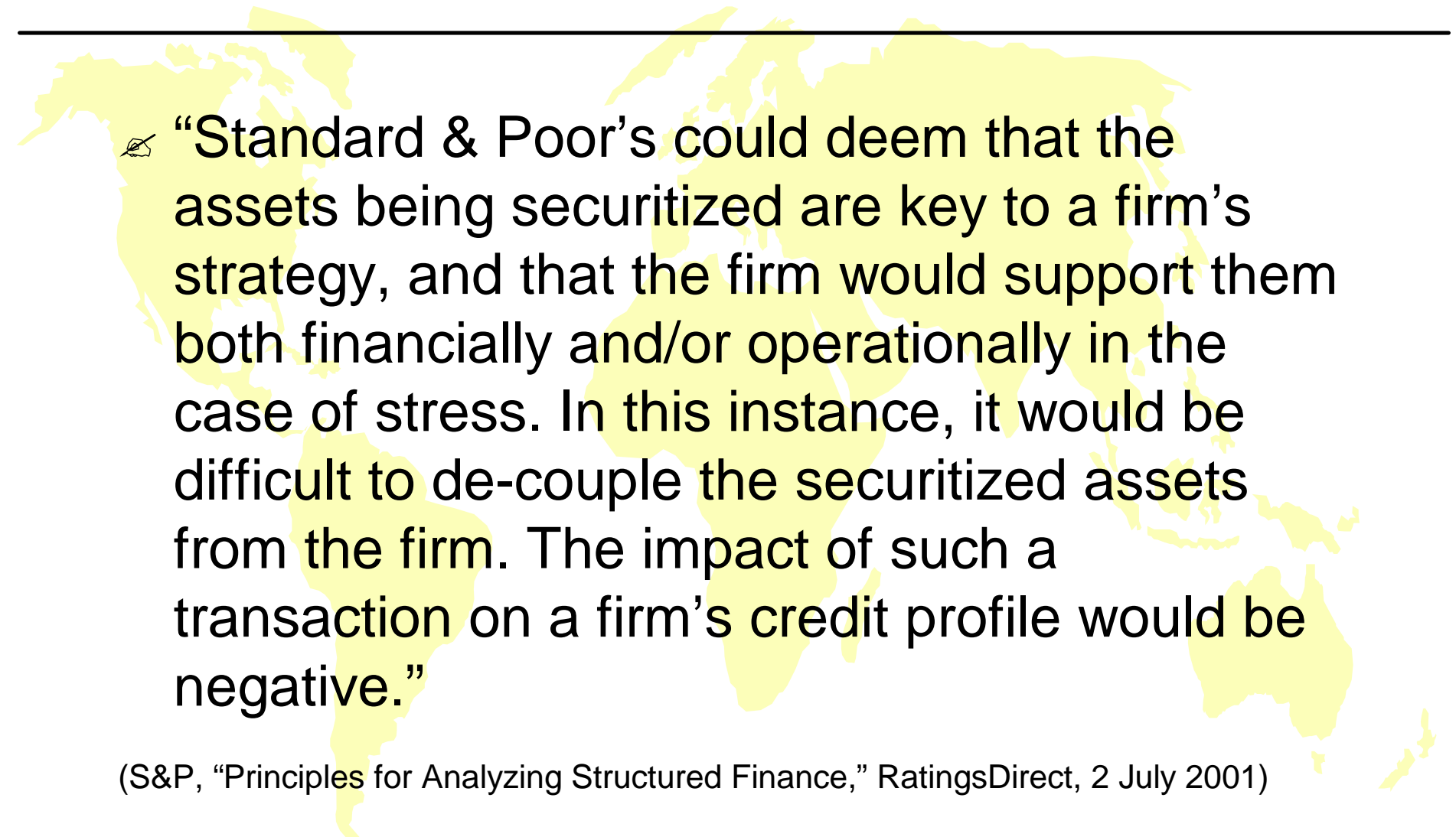
	Stand-alone	Leveraged loan	Securitisation
Debt/equity	50 : 50	65 : 35	90 : 10
Maturity of debt	15 years	10 years	25 years
Cost of debt	6.5 %	7.5 %	6.5 %
Expected return on equity	15%	25%	35%
Debt/EBITDA	3.8 times	5.0 times	7.0 times
EBITDA/interest	4.0 times	2.7 times	2.3 times
EBITDA/interest + principal	2.6 times	1.5 times	1.8 times
Weighted cost of capital	9.6 %	11.9 %	7.3 %

Source: Sebnem Erol, Deutsche Bank, in *The Treasurer*, July/Aug 1999

La Difference?

- ✍ The issuer typically owns a loan to an operating company or companies. The loan is in turn secured by operating business assets in ongoing use, *not self-liquidating financial assets like loans.*
- ✍ Both the SPV and the operating companies are owned by the corporate parent. *While the UK model offers legal assurance that the assets will not be sequestered if the parent enters bankruptcy protection, the independence of the SPV has yet to be tested, in the UK as well as elsewhere.*
- ✍ In the event of the insolvency of the corporate parent, the SPV and its *trustees must find managers to continue to run the business. The “purpose” of the vehicle looks less and less “special.”*

Not Completely Separate?



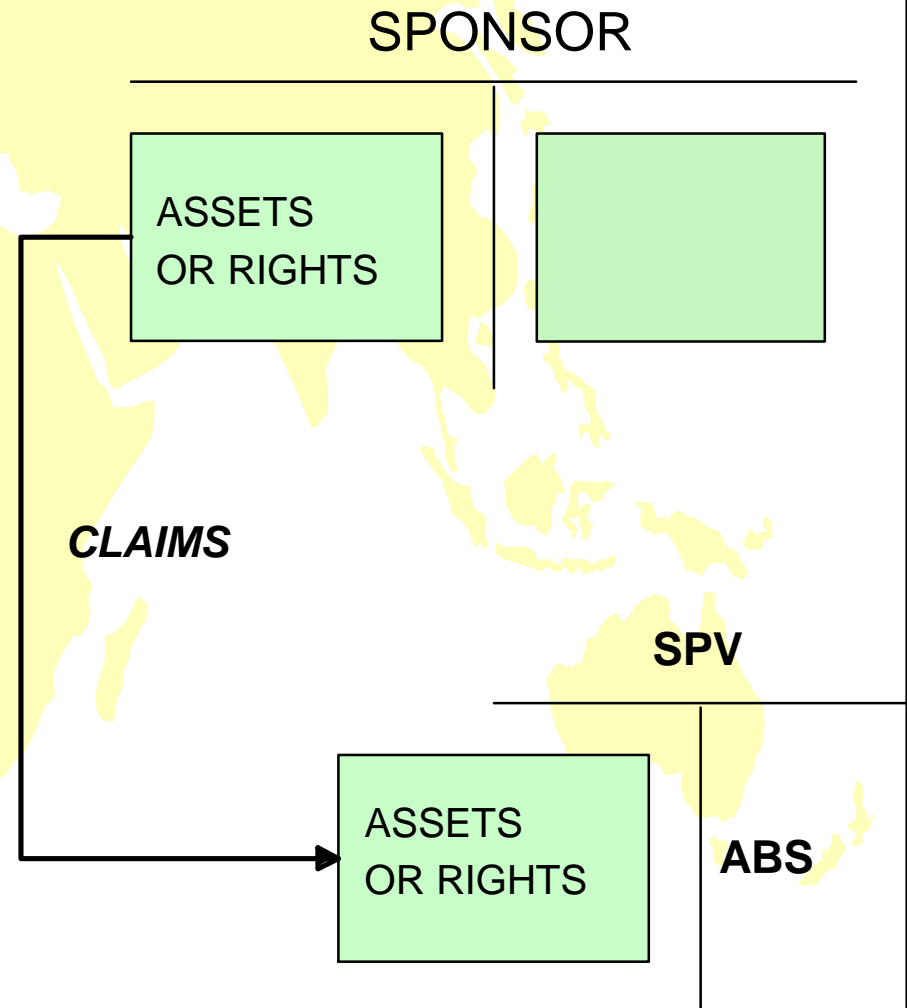
✍ “Standard & Poor’s could deem that the assets being securitized are key to a firm’s strategy, and that the firm would support them both financially and/or operationally in the case of stress. In this instance, it would be difficult to de-couple the securitized assets from the firm. The impact of such a transaction on a firm’s credit profile would be negative.”

(S&P, “Principles for Analyzing Structured Finance,” RatingsDirect, 2 July 2001)

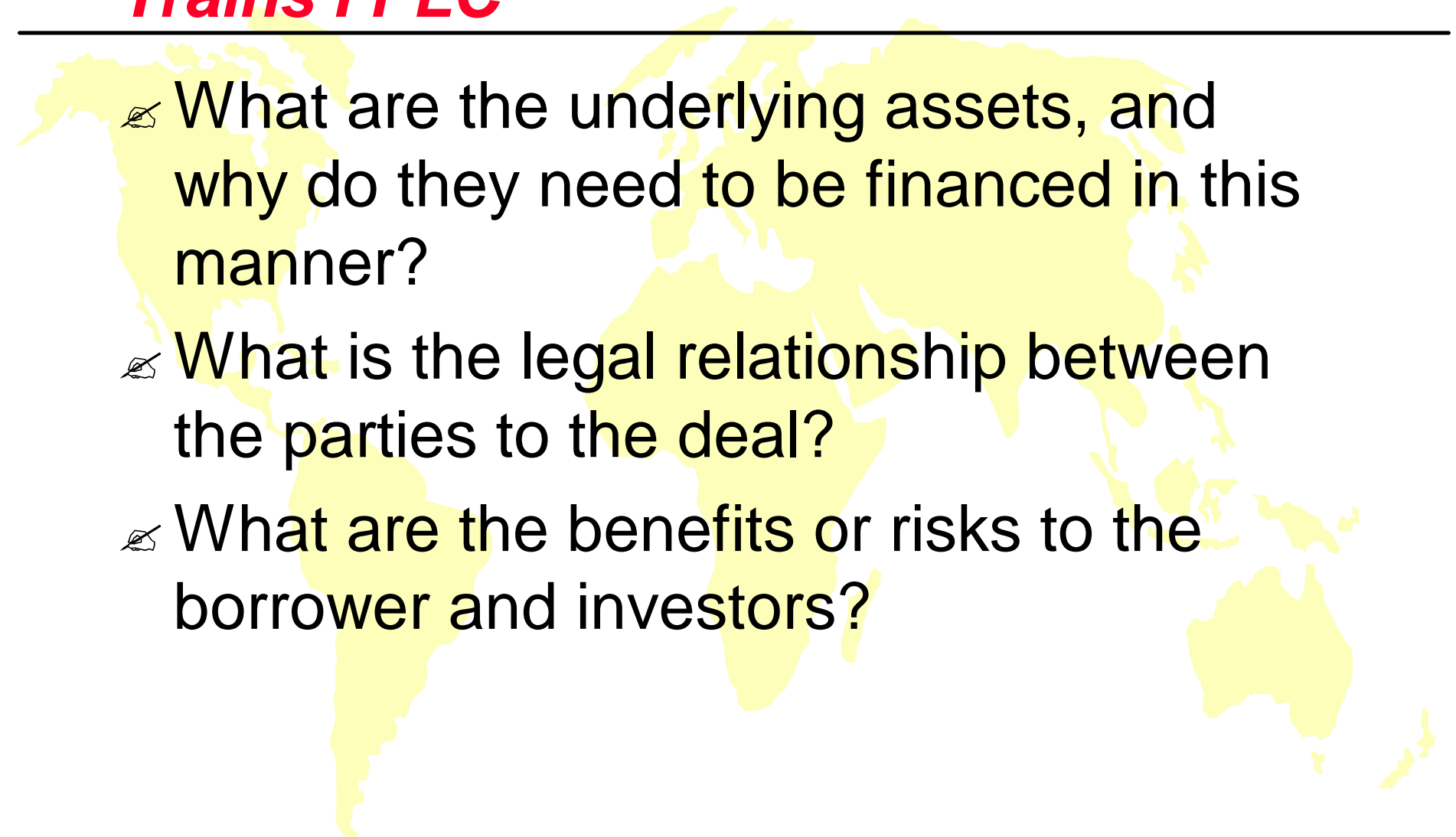
ABS or Corporate Debt?

KEY ISSUES:

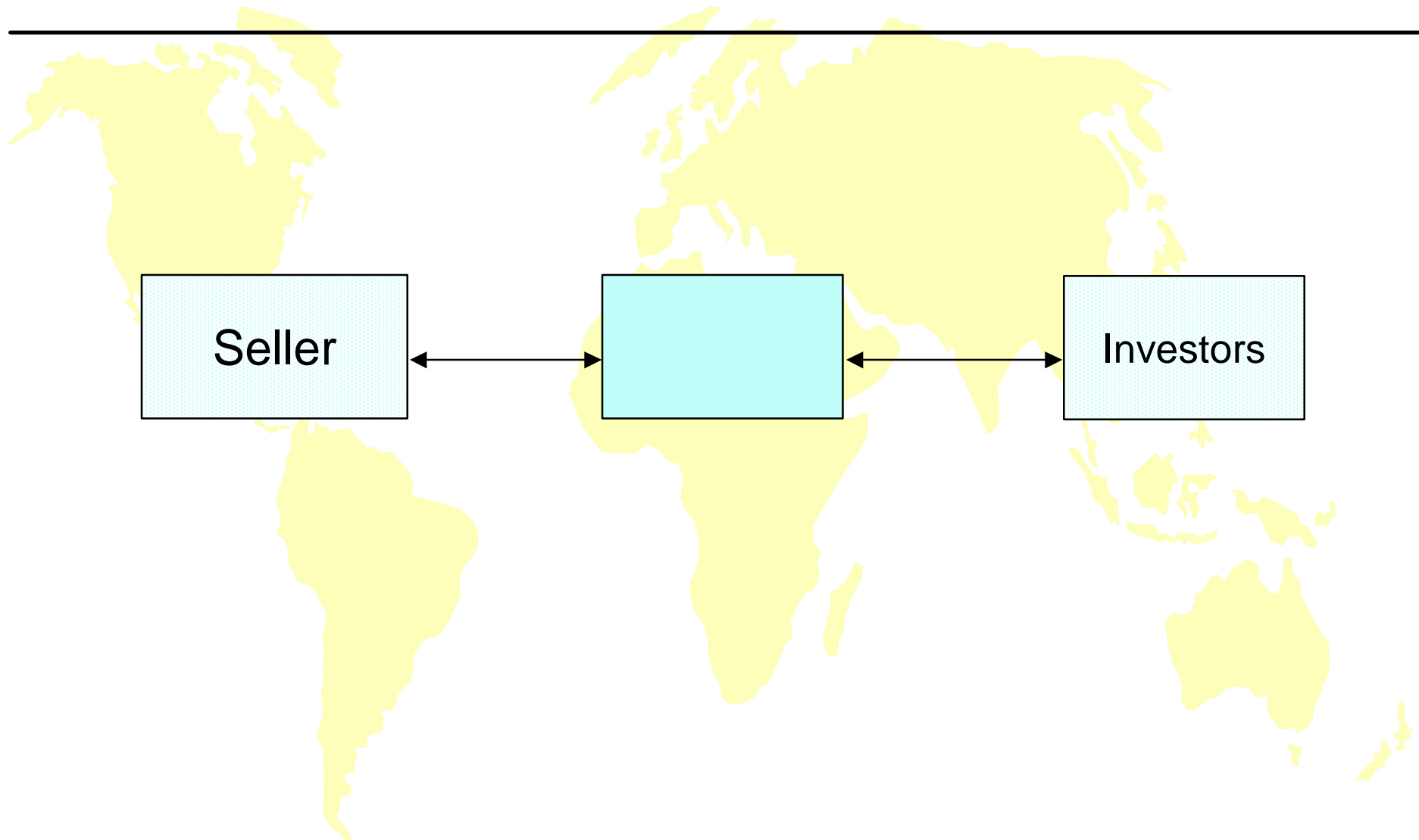
- ✍ **HOW ARE THE ASSETS TRANSFERRED?**
- ✍ **ARE THE ASSETS IDENTIFIABLE FINANCIAL CLAIMS ON SPECIFIC PARTIES?**
- ✍ **IS THE POOL AMENABLE TO STATISTICAL AND HISTORICAL ANALYSIS?**
- ✍ **IS ITS VALUE DEPENDENT ON THE SUCCESS OF THE SPONSOR'S BUSINESS?**
- ✍ **IS THE STRUCTURE IMMUNE FROM EVENT RISK?**



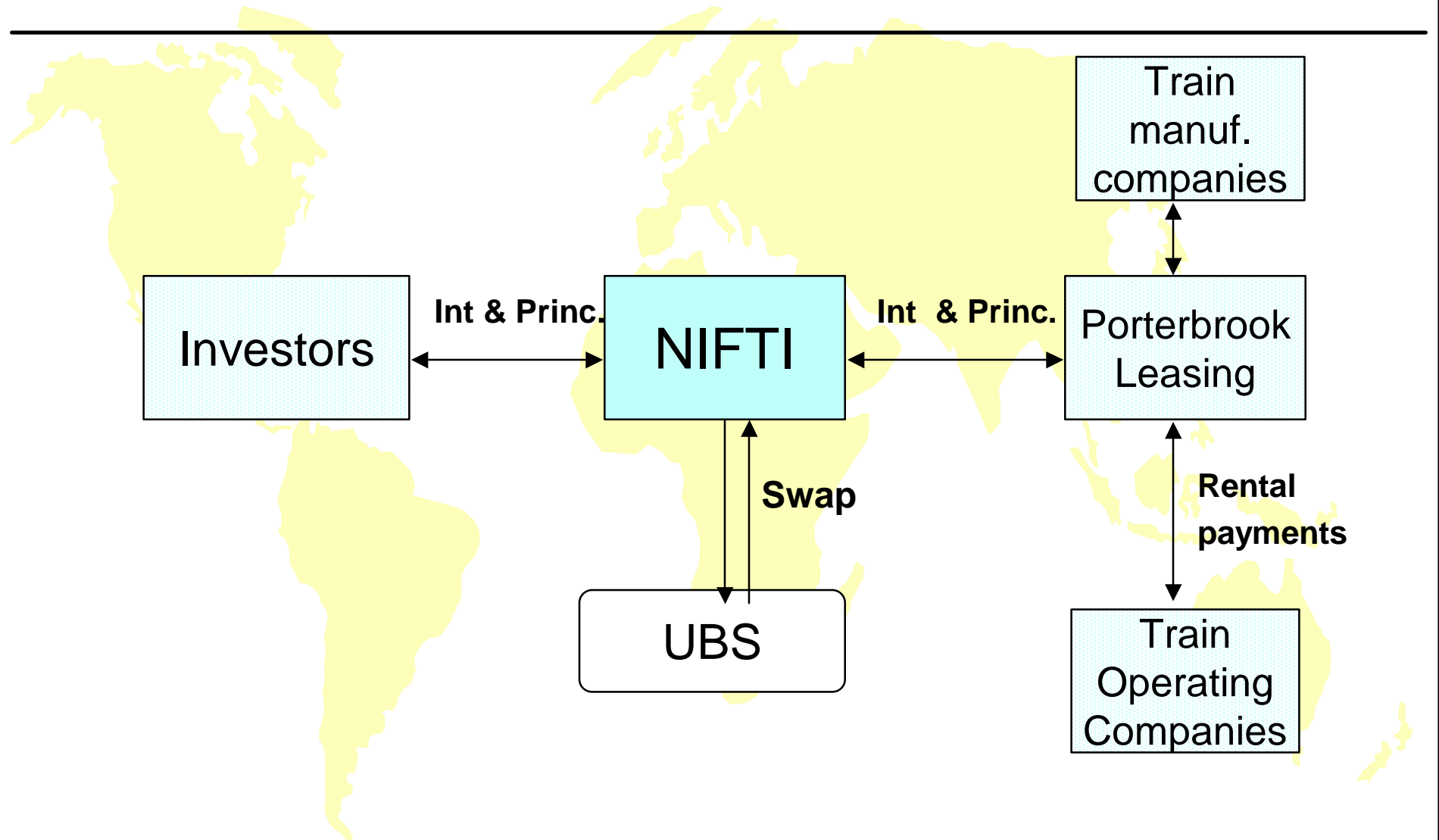
Case Study: Trains I PLC

- 
- ✍ What are the underlying assets, and why do they need to be financed in this manner?
 - ✍ What is the legal relationship between the parties to the deal?
 - ✍ What are the benefits or risks to the borrower and investors?

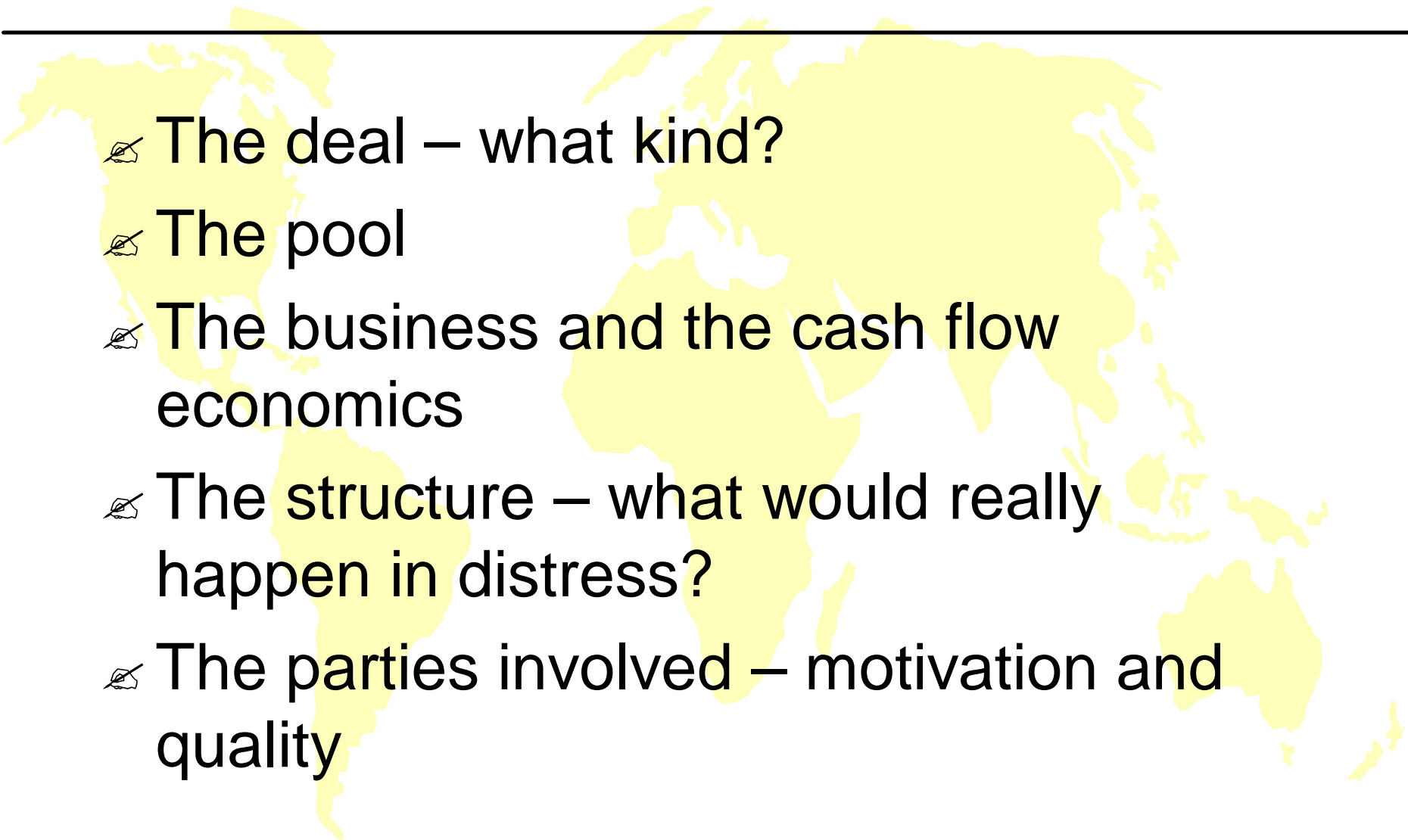
Trains?




Trains



A Guide

- 
- ✍ The deal – what kind?
 - ✍ The pool
 - ✍ The business and the cash flow economics
 - ✍ The structure – what would really happen in distress?
 - ✍ The parties involved – motivation and quality



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