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This is the fourth issue of the journal we have begun with articles on problems related to subprime mortgages and CDOs, and indeed there's more to come in the next and future issues. **Joseph Mason** begins this issue by discussing information problems such as the difficulty in valuing CDOs, accounting standards that are still catching up to complex structured instruments, and ratings that mean different things for different products. **Mark Adelson** and **David Jacob** focus on the unfortunate deterioration of the subprime mortgage market between 2005 and 2007. In the beginning subprime MBS were constrained by sophisticated investors and bond insurers, but later they were dominated by less selective and discriminating CDOs. **Ray DeGennaro** then gives us a primer on the two government-sponsored enterprises that originate mortgage-backed securities (MBS), Fannie Mae and Freddie Mac.

Next we hear from two of our editorial board members on both the traditional and the newer specialized structured asset classes. **Edward DeSear** gives us a detailed update on credit card securitization structures, including their self-correcting features and protections for investors. As we witness problems in the MBS market, bank credit card underwriting standards, by comparison, appear to be more seasoned over time and banks appear to have better policies for dealing with economic cycles and people with lower FICO scores and other credit qualifications. Also, Mr. DeSear notes, credit card assets are dynamic, in that banks can change the terms of credit card accounts to accommodate changed circumstances, whereas mortgage terms are locked in at the time a loan is originated. Furthermore, credit card structures have the effect of causing the securitizing banks to retain the risk of expected credit losses, including expected losses under various scenarios.

Paul Forrester then shows us two examples of the versatility of securitization technology to meet ongoing financial needs, insurance risk CDOs and "stranded cost" securitizations. CDOs have earned a bad reputation recently because so many of them in the past couple of years have been backed by subprime MBS, but this storm will pass and CDOs have many other applications. Mr. Forrester believes that CDOs are better regarded as a "technology" or a "process" than as a "product," because a product implies a static result and CDOs are anything but static. Over time, he notes, CDOs have reflected continual refinement and improvement of their structures and features and, with the continuing expansion of the universe of available CDO assets and the varied combinations thereof, CDOs are highly flexible, complex, and subtle transactions. The most compelling case for CDOs, in Mr. Forrester's opinion, is their specific application to a special asset or "problem." For example, collateralized loan obligations (CLOs)

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are portfolio management tools for banks, and also vehicles that provide investors with exposure to loan assets that would otherwise be inaccessible to them; trust preferred CDOs are efficient vehicles that provide capital to smaller banks and insurance companies that cannot easily access the capital markets directly; commercial real estate CDOs are efficient vehicles to provide mezzanine/subordinated capital for real estate. In hindsight, Mr. Forrester observes, there is not the same kind of premise for ABS CDOs. In his first article in our section on specialized asset classes, Mr. Forrester explains how insurance risk CDOs do have such a premise. Traditional insurance and reinsurance markets are capital-constrained and relatively opaque. There is little or no price transparency for the underlying risk transfer, and what little there is suggests that the traditional markets don't price "extreme" risk efficiently. He also notes that insurance risk CDOs allow an insurance company to adjust its risk portfolio more discretely and efficiently than it may be able to do in current markets.

With regard to his second article, Mr. Forrester comments that the use of stranded cost securitization for environmental compliance and storm recovery expenditures generates material efficiencies. He explains that the rating on the securitized exposures is generally higher than that of the related utility and is simpler from a regulatory capital viewpoint. Absent the securitization of such expenditures, a utility would fund those expenditures with a combination of debt and equity (usually around two or three to one) and, as a result, the cost thereof would likely be much higher. Furthermore, the

utility and its stockholders would be exposed to greater regulatory risk related to the affected utility's rate cases. They would also be exposed to greater market risk to the extent other market participants were not also incurring similar expenditures and financing them similarly, since the affected utilities most likely would not be able to "pass on" the related financing charges.

James Croke, Peter Manbeck, Sharad Samy, and Nik Mathews provide us with a detailed comparison of the three major credit rating agencies' published criteria for hedge transactions related to highly rated structured finance transactions. The authors point out that market participants are paying increasing attention to rating agency eligibility and collateralization requirements in their hedge documentation as a result of recent downgrades—and threatened downgrades—of financial institutions that often serve as swap counterparties to structured finance vehicles.

In our final section on project/infrastructure finance, **Tillmann Sachs, Christophe Bellinger, and Robert Tiong** apply their method for "quantifying qualitative information on risks" (QQIR), explained in the Winter 2008 issue of this journal, to a hypothetical case study of political risks related to a water project in Asia. **Rommel Gavieta** then explains lessons learned from a comparison of public-private partnerships and publicly administered projects in the development of mass transit systems in the Philippines and other Asian countries.

Henry A. Davis
Editor