

Banks' Use of Off Balance Sheet Facilities, Structured Finance Fed Day 2009

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THE FEDERAL RESERVE BANK OF RICHMOND

RICHMOND ■ BALTIMORE ■ CHARLOTTE



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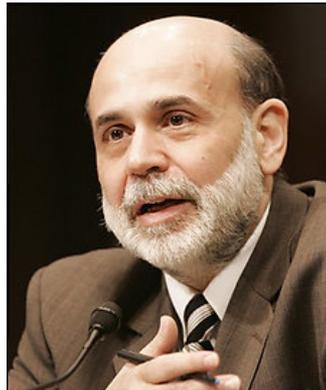


And do not necessarily reflect those of the Federal Reserve Bank of Richmond



Chris Klepnis - Bloomberg

or the Federal Reserve System.



Susan Walsh - AP Wire Service





Securitization

- All of portion of Credit risk is transferred to third parties
- At least 2 tranches reflecting different levels of seniority
- Performance depends on underlying exposures
- Underlying exposures are financial assets





Securitization

- Tranching of credit risk is the structuring of cash flows and credit exposure - share of the credit losses differs from the pro rata interest in the underlying pool of exposures
- “Investor” includes any party, including the originating institution, holding an interest in a securitization transaction – must have a 3rd party
- Through securitization, obligation for payment shifts from the originating entity to the performance of the underlying pool of exposures

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Securitization

Support may be offered to the transaction in various ways
(beyond simple performance of the asset pool)

- Senior/subordinated structure
- Liquidity and credit enhancement
- Overcollateralization
- Cash collateral and spread accounts
- Insurance
- other





Motivations

- Interest rate risk management
- Funding
- Customer accommodation
- Allow to focus on fee revenue and deal structuring
- Allow to focus on underwriting expertise
- Credit risk management
- Capital relief





Securitization

Retail asset classes securitized

- Residential mortgages (1st, 2nds, HELs, and HELOCs)
- Credit cards
- Auto
- Student loans
- Other

Other assets securitized

- Commercial mortgages
- Other



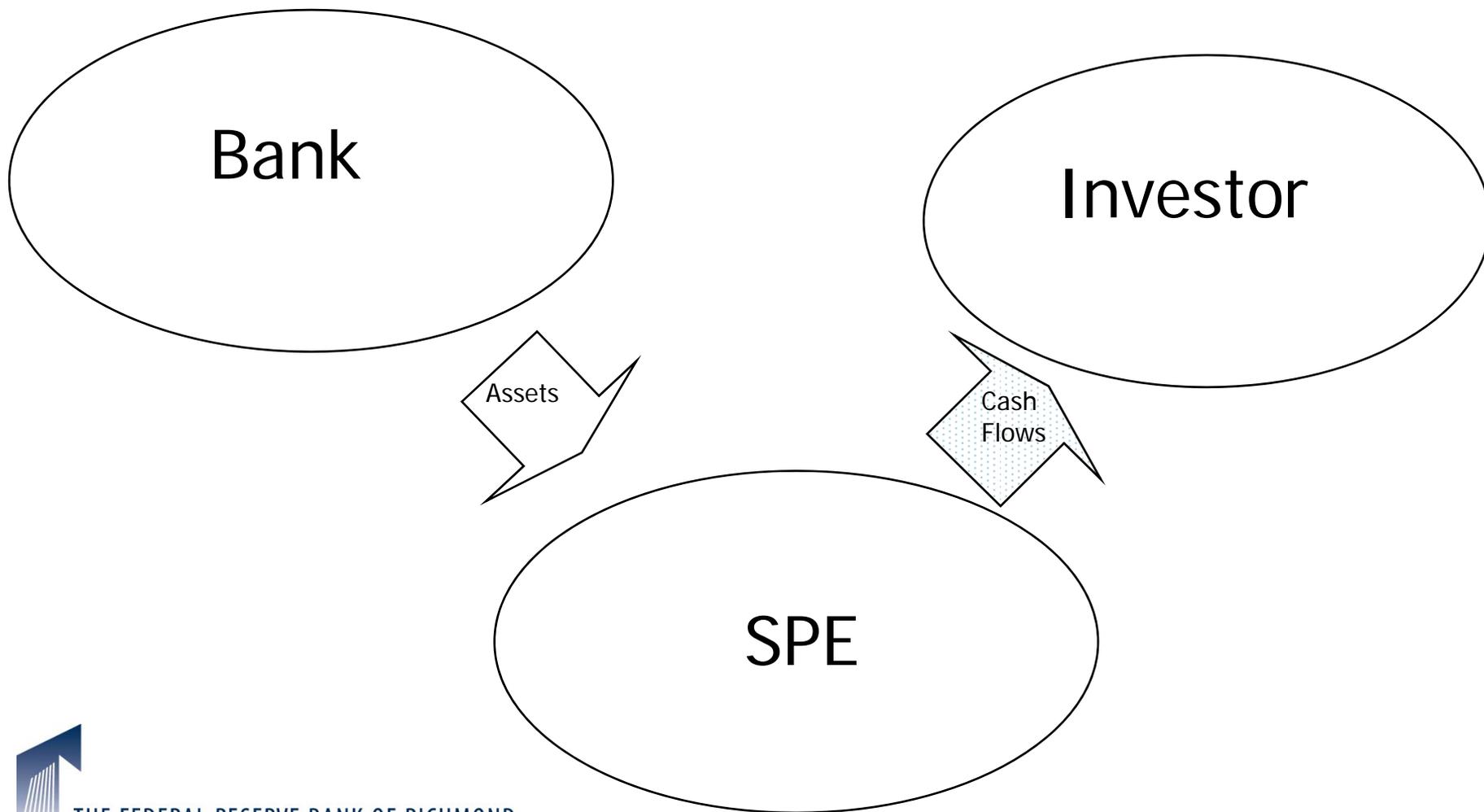


An Example Transaction

- An institution pools together a group of assets, usually originated in-house, but sometimes purchased
- Assets tend to be similar –
 - Maturity
 - Underwriting standards
 - Rates, etc.
- Creates a special purpose entity (SPE) to “own” the assets and trustee arrangements to manage cash flows
- Structures/negotiates a deal in-line with rating agency criteria

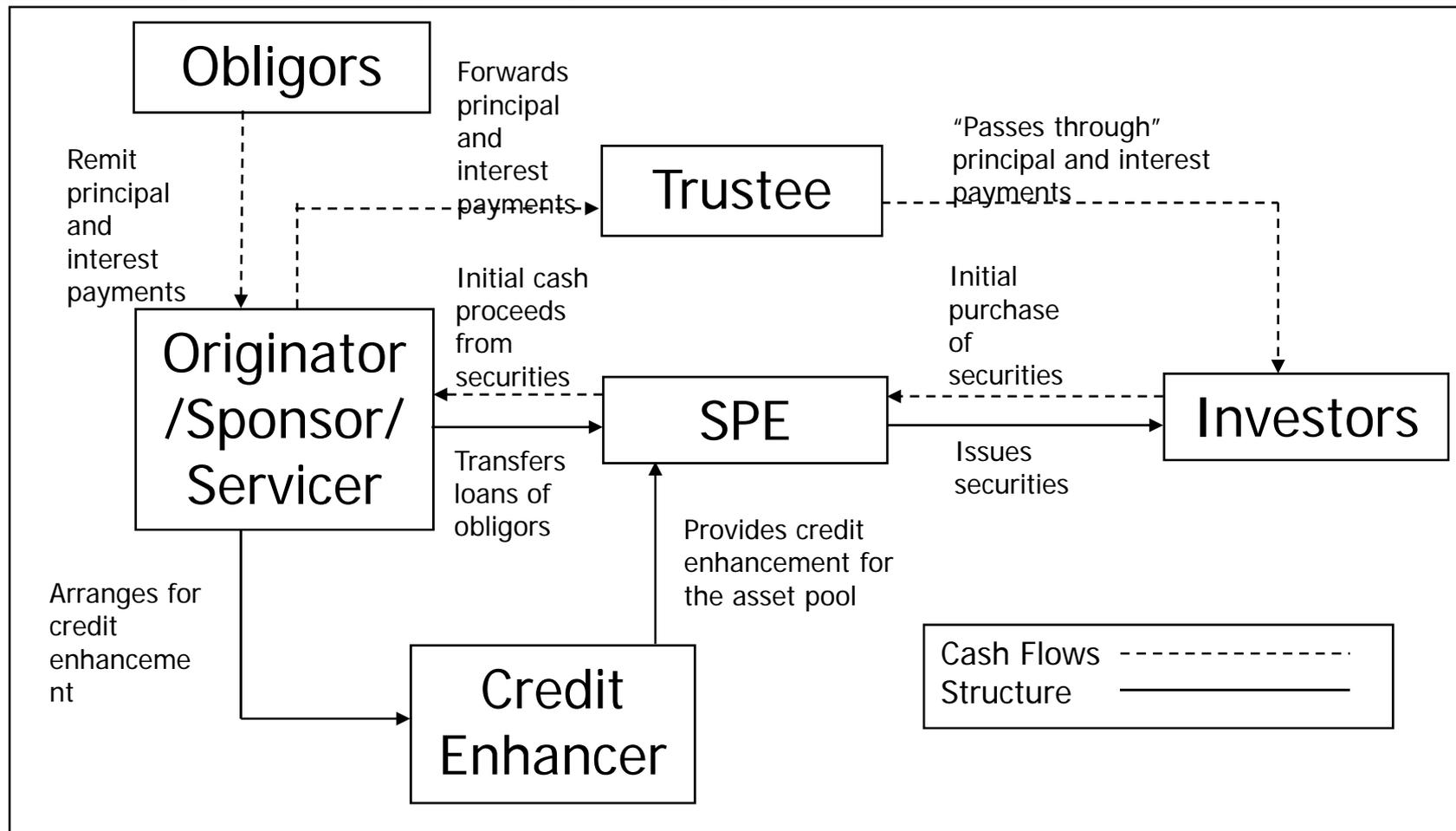


Example Transaction



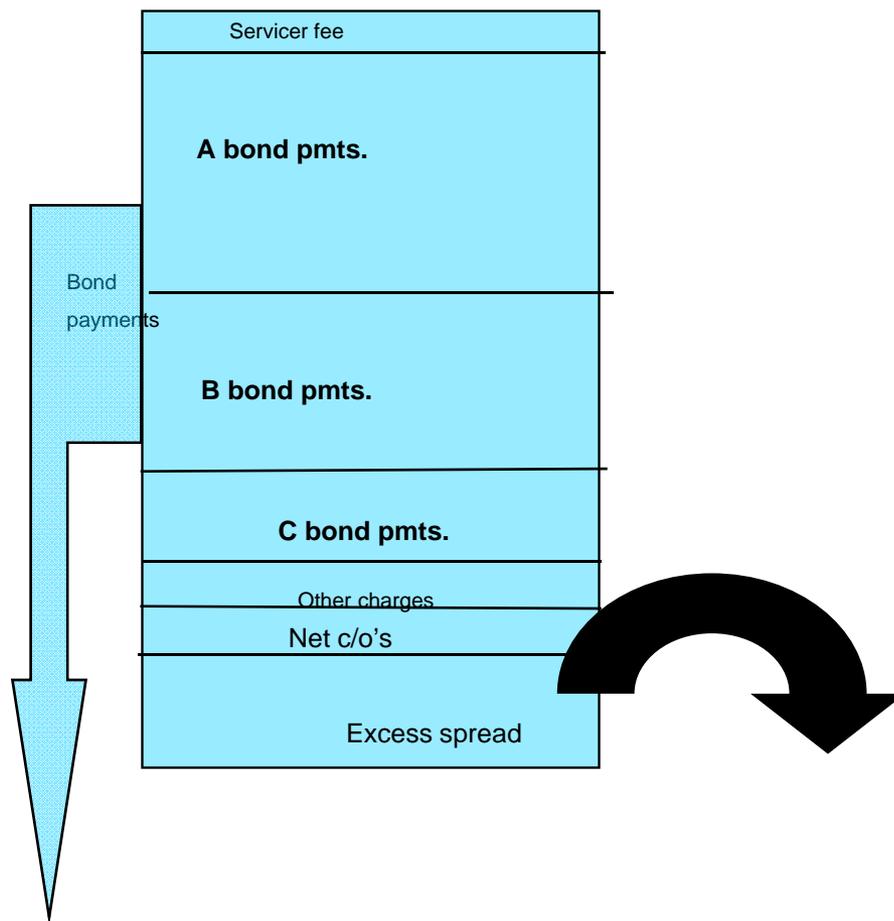


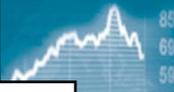
Cash flows with external credit enhancer



From "Fundamentals of Securitization", Brad D. Shinn, OSFI, 10/25/06

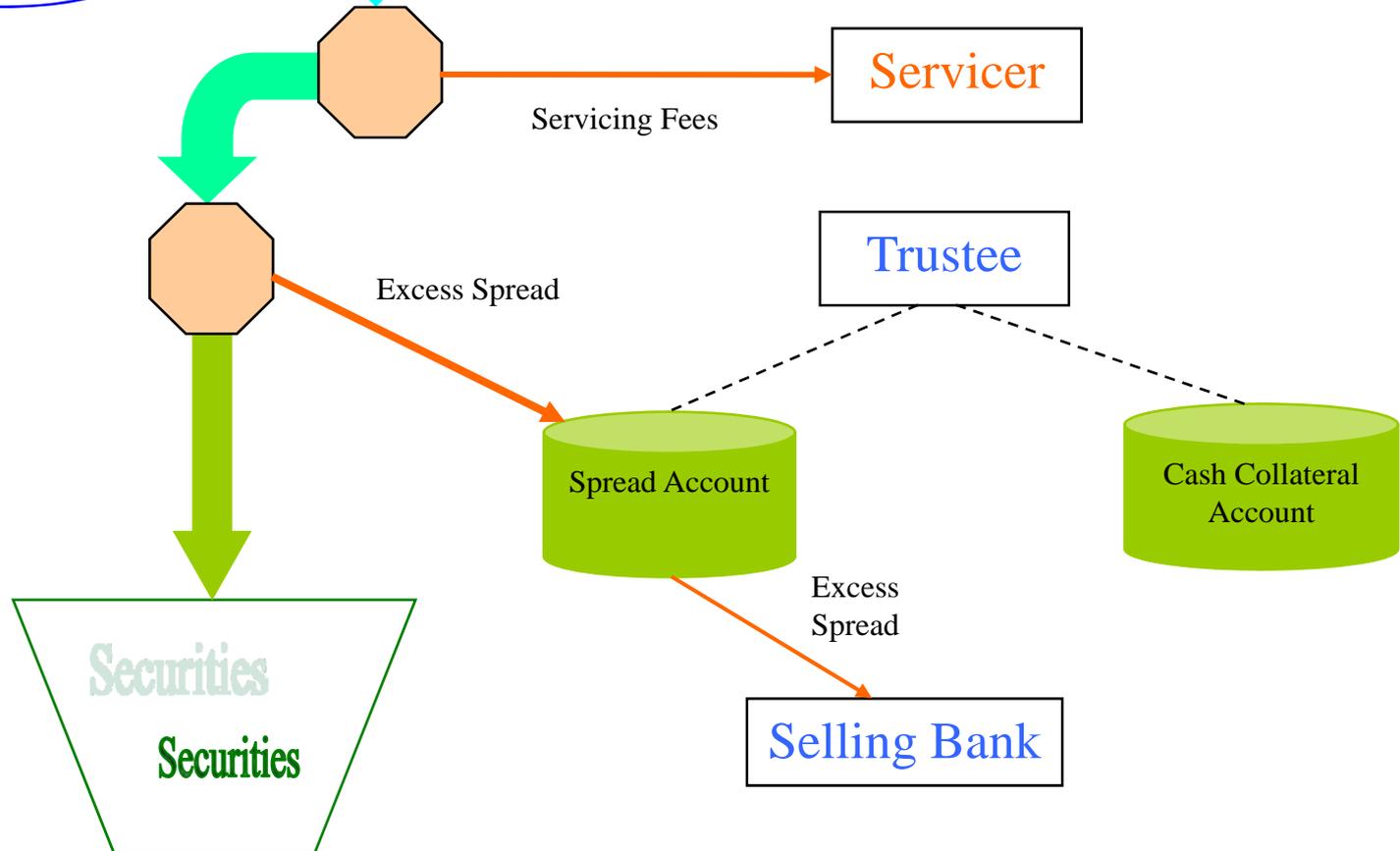
Waterfall of Cash Flows





Asset Pool

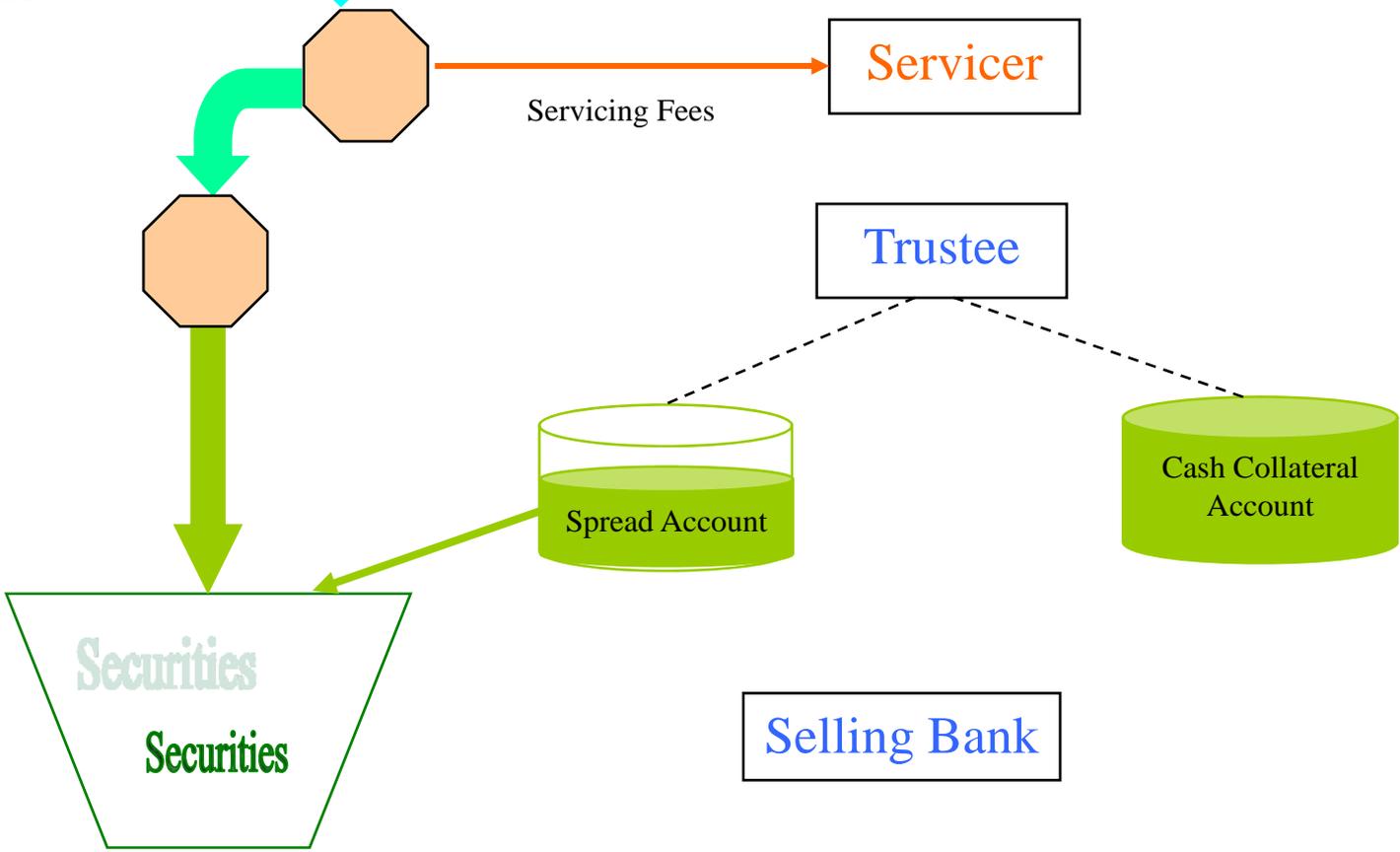
When losses are low





Asset Pool

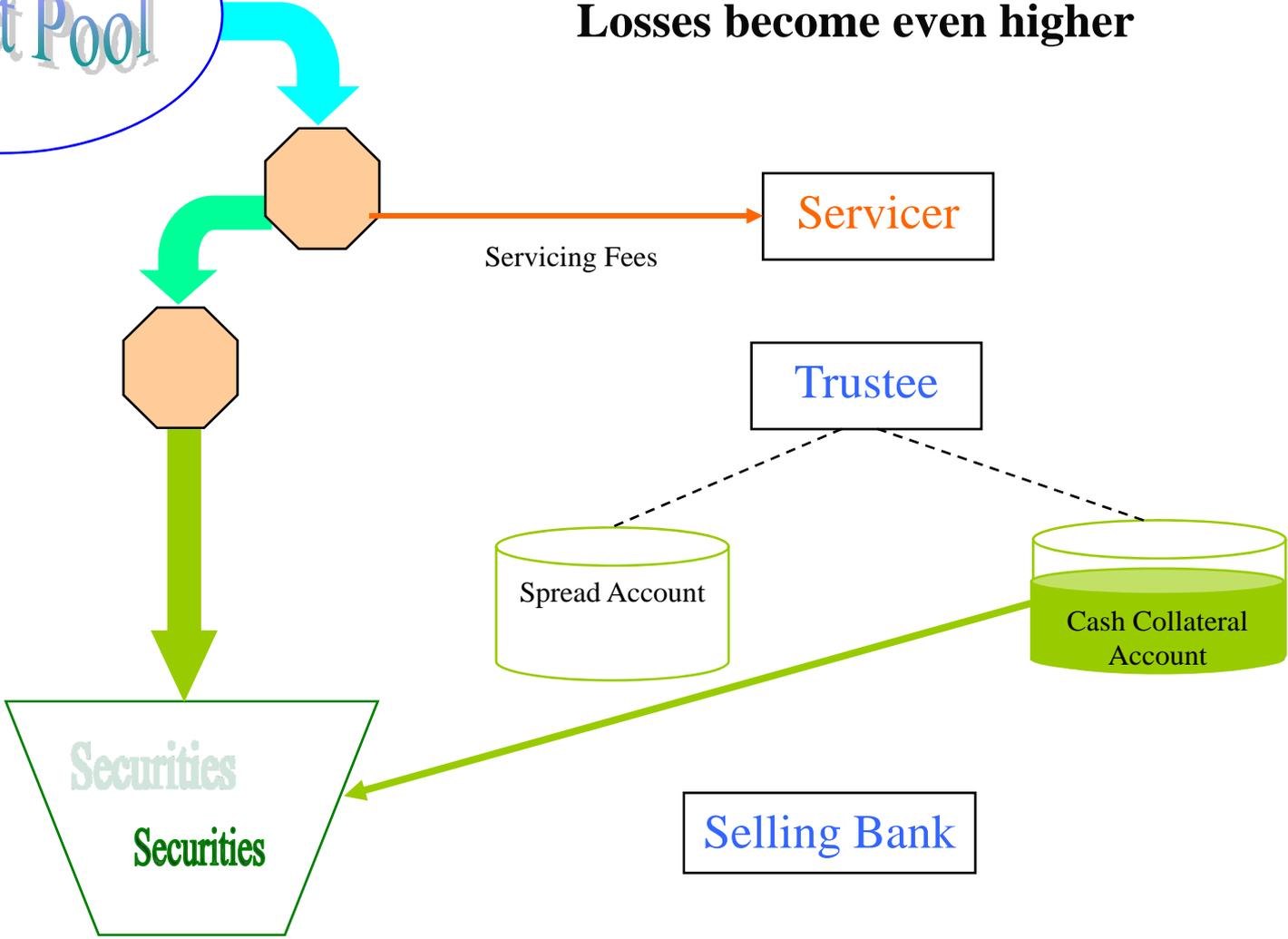
Losses become high



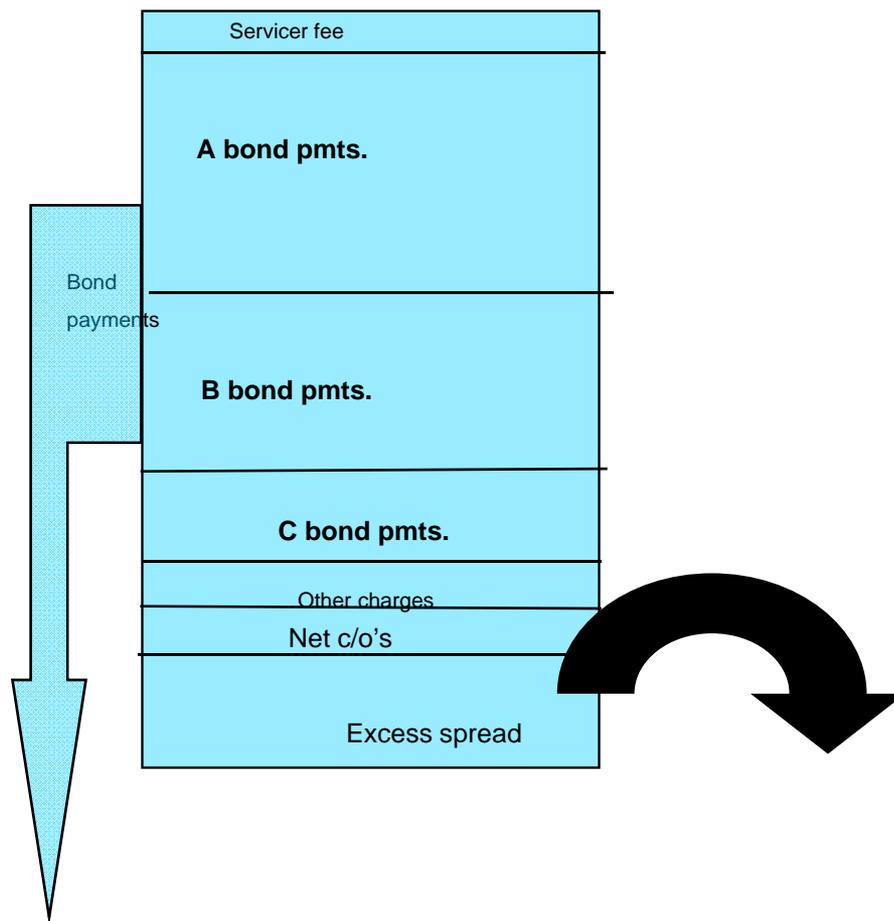


Asset Pool

Losses become even higher



Waterfall





Key Components for Success

- Underwriting of underlying assets
- Well structured deals
- Ratings
- Market liquidity and structure

Questions?

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