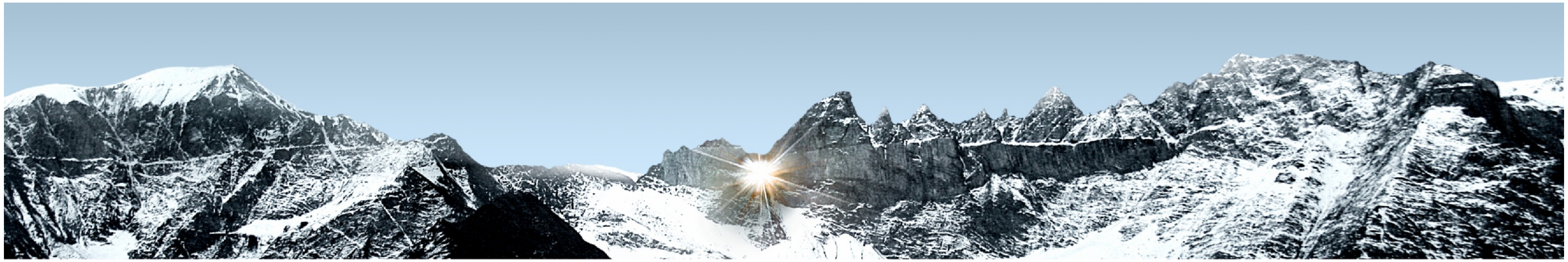

S • E • C • A

Subprime Crisis & Credit Crunch:

Daniel Riediker, Partner & CEO, Alegra Capital Ltd.

- The Tail of the “Unexpected” and the “Obvious”
- How well did Products Stand Up?
- Lessons to be Learned

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I. Securitization Basics

Types of Asset-Backed Securities

Asset-Backed Securities (ABS)

Mortgage-Backed Securities

Residential Mortgage-Backed Securities (RMBS)

Commercial Mortgage Backed Securities (CMBS)

etc.

Collateralised Debt Obligations

Collateralised Loan Obligations (CLO)

Collateralised Bond Obligations (CBO)

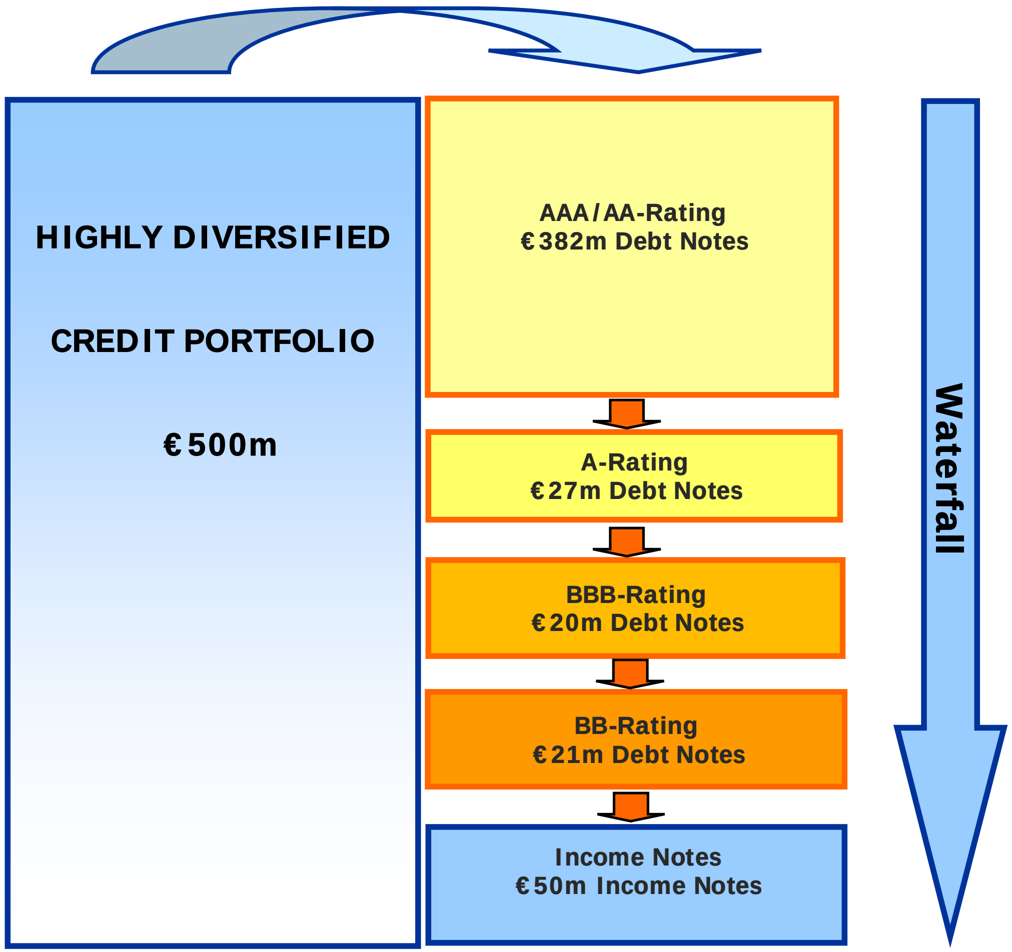
Collateralised Synthetic Obligations (CSO)

Other Forms

Consumer Loans
Leasing Receivables
Credit Card Receivables
Patent and Royalty Receivables

etc.

How Do Cash Flow Securitizations work? A compelling concept if done right



Closed ended structures with locked-in Liability Cost

Strictly follow the „Golden Rules of Financing":

- **Match maturity of liabilities and assets (no refinancing risk);**
- **Limit any currency or interest rate risk;**
- **Stick to rigid underwriting standards**

Ultimate outcome depends primarily on defaults and recoveries

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II. What went wrong: The 'Unexpected' and the 'Obvious'

Source: Elan Fleisher: Unpleasant Ways to Die

Split "The Unexpected" from "The Obvious"

The Obvious (right ?)		The Unexpected
• Ever increasing U.S. home prices & Home owners who could not afford the home in the first place; • Investment Banks massively pushing paper for fee generation • Short Term Leverage financing Long Term Assets creates problems in downmarkets • Market Value triggers create volatility and in bumpy markets come to haunt you	Toxic Combination!	• Risk control measures at Banks not really functioning • Investment Banks left with a lot more risk than anticipated • Rating agencies getting it plainly wrong • Snow ball effect as markets became entangled over time and widespread liquidity crunch • „Hedge Fund of the Year" imploding weeks after award

Significant Differences in Securitization Classes

➢ Example: Difference US-Subprime ABS to Leveraged Loan CLOs

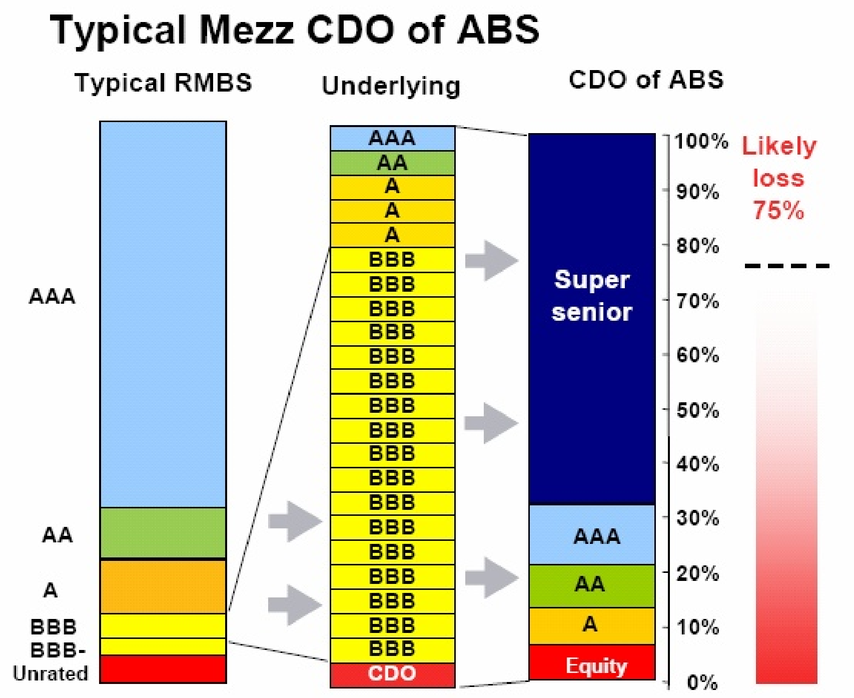
Subprime ABS		Leveraged Loan CLO
• „unknown “Borrower, no underwriting standards • Rating: „Law of large Numbers “ • Low Correlations and independent Regions • Lender securitizes 100 % of the Portfolio • Thin First Loss Tranches • If Rating Triggers are breached -> Liquidation	VERY DIFFERENT STRUCTURES	• Monitoring each Borrower • Rating: Credit Quality of actual Portfolio • High Correlations within Industries • Banks retain significant Portions of each loan • Income Notes have size of Tier I Capital of Banks • Defaults lead to Cash-Flow Diversions

☒ ~3 x historic „Delinquency Rates “= Total Loss on A and BBB

☑ ~3 x historic Default Rates= Return of Capital on Income Notes

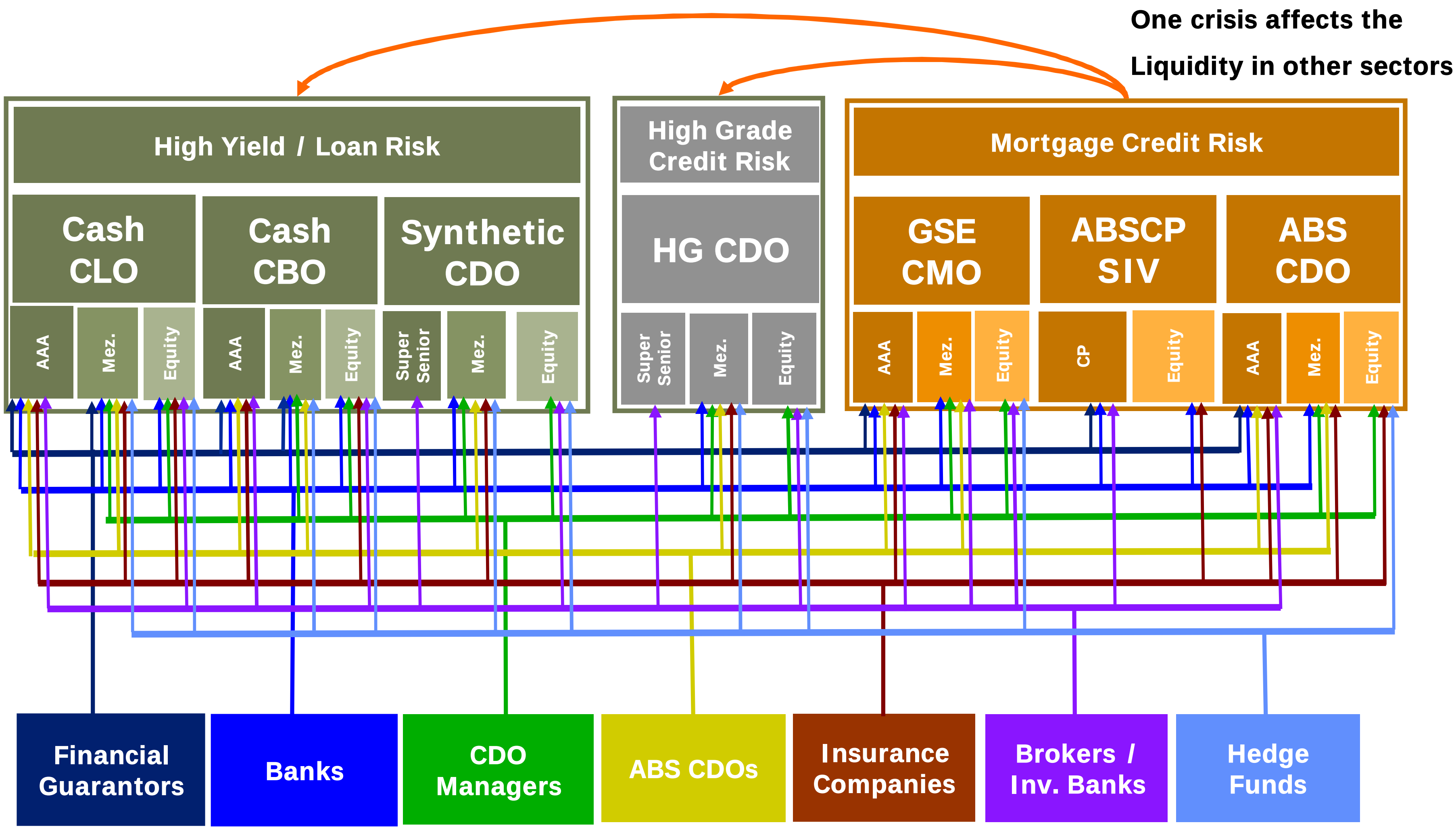
Double Layers of Leverage with Implications

- **Typical CDOs of ABS have double layers of leverage;**
- All the **risk is concentrated in one industry**;
- If one layer has a systematic problem then the loss to the CDO of ABS is multiplied. This has caused **CATASTROPHIC loss behavior**.



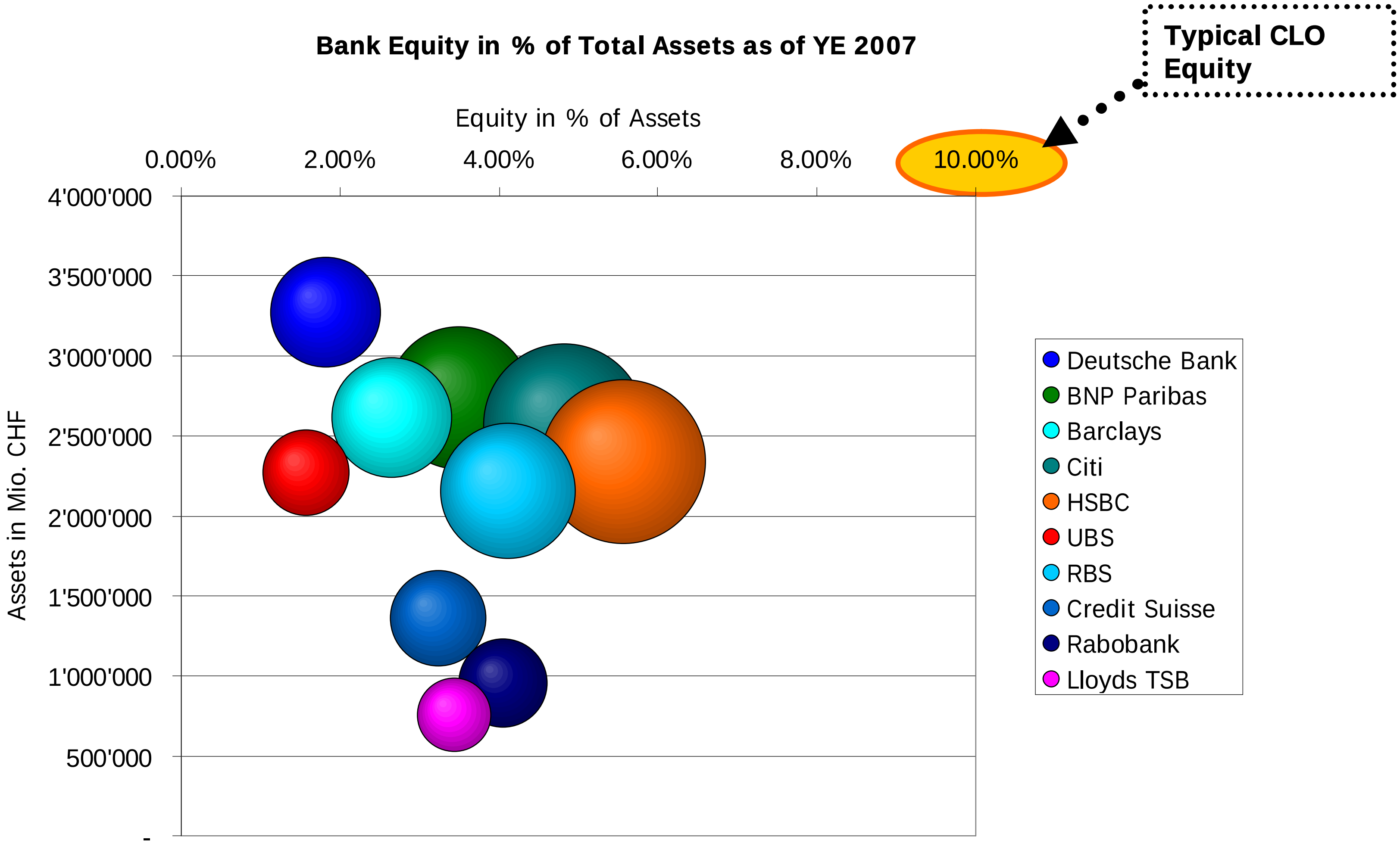
Source: Citi.

Global Spread of Risk (The Liquidity Problem)



Source: Lehman Brothers, Moody's, Alegra Capital

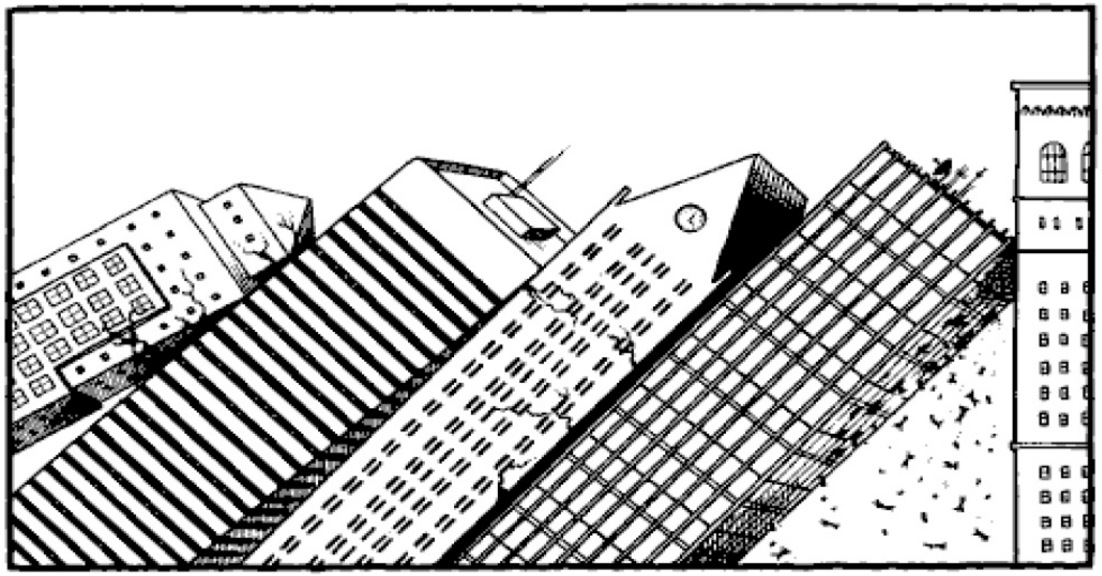
Forget Tier I Capital:
Significant Gross Bank Leverage adds to the Liquidity Problem



The size of the balloons represents the Bank's absolute equity;

Bank assets are gross reported assets, no risk-weightings applied

III. Stress Test: How did Products Hold Up?



Source: Elan Fleisher: Unpleasant Ways to Die

Long-Term Comparison of Selected ABS Products

Zone	Product	Downgrades p.a. 1984 - 2007	Intrinsic Value	Liquidity / Valuations
Dead Zone	ABS CDO	A lot more to come: 132bn Defaults now	Double layer of leverage and MV Triggers-> Catastrophic outcomes	•In crisis similarly illiquid •Depressed valuations across all segments regardless of intrinsic value
Dead Zone	MBS	Catastrophic: 35% downgrades*	Home defaults are rising, still significant future resets	
Counter-party Risk Zone	SIV	Low (Bank bail out) 1.75%	Intact for rescued vehicles only	
Counter-party Risk Zone	Synth. IG CDO	Massive: 12.18%	Static and High Leverage can harm	
Value Zone	Cash IG CLO	Low: 0.76%	Only a Depression could cause loss of capital but leverage is high	
Value Zone	Cash HY CLO	Lowest: 0.25%	Peak Defaults priced in, significant OC Cover allow stable cash flows	

Source: Standard & Poor's: Credit Quality Of Global CDOs Of ABS And SIVs Took A Hit In 2007, While CLOs Performed Well, Feb. 2008 / Alegra Reseach

* Estimate

Lessons for Investors in the ABS Universe

- **Analyse the underlying:** If the underlying assets are toxic, the best structure may not be able to protect!
- **Distinguish between ABS structures** (just like not all shares are the same); watch digital outcomes from double layers of risk!
- **Keep maturity matching profiles:** Leveraging long term assets with short term funding creates additional volatility and digital outcomes!
- **Watch out for „Market Value“ triggers:** Forced liquidations always yield the worst result. Focus on pure „Cash Flow Transactions“!

Lack of Liquidity has depressed Valuations in the whole market –

Intrinsic value of select ABS investments may be significant at this point-

Non-Depression outlook, „real money“ investors look at historic chances!

- **Invest on an educated basis:** Make your own assessment of investments or if you are not familiar with the product get advice from <u>independent</u> market participants!

About Alegra Capital

About Alegra Capital

- Alegra Capital is one of the leading managers of **CLO Equity** in Europe;

- Alegra Capital is a **totally independent** provider of Asset Management services in the Structured Credit area in Europe. Our „No ties with any Investment Bank "policy translates into a wide network of contacts with all major firms and ensures flexibility and freedom of choice for the right investments;

- Approx. **CHF 600 Mio.** under management in 5 CLO Equity and Mezzanine funds and a number of index certificates;

- Staff: 4 Partners, 1 Director Investments, 1 Portfolio Administrator, 1 Office Manager;

- Fitch considers the Risk Management System used by Alegra Capital as „Best in Class ".

Daniel Riediker

➢ **Daniel Riediker, Partner & CEO (41)**

Daniel Riediker co-founded Alegra Capital in 2003 as Partner and CEO. He was the former CEO of Centre Solutions Ltd., Zurich, and headed up Centre’s European CDO group. During his 8 years with the Centre Group, he collected a broad experience in the area of structured finance and alternative risk transfer. He acquired, structured and executed transactions in the areas of ABS (CDO), contingent equity and structured (re-)insurance. Mr. Riediker started his career with Zurich Financial Services, where he was responsible for strategic planning and business development of Zurich’s group reinsurance business. He received a magna cum laude degree in economics from the University of Zurich.

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