Presentation to 2008 ABS East
October 19, 2008
Richard Field, Managing Director TYI, LLC

Good afternoon. It is hard to think about a future for structured finance given the recent turmoil in the financial markets. Over the last 14 months we have been in a downward spiral. This spiral started as a structured finance market buyer's strike driven by the inability to value these securities. It then spread into a full blown credit crisis and finally morphed into a crisis of confidence.

Against this backdrop, I would like to describe for you what I believe to be the future of the structured finance industry.

> First, I am going to focus on the theoretical benefits of structured finance to show why it is vital to restart the structured finance market. I feel that I need to do so because there are many prominent individuals who would have you believe that our modern economy can work well without structured finance.
>
> Second, I am going to talk about what is wrong with the current implementation of structured finance – there must be something terribly wrong… just look at the markets.

Third, I am going to show you what the industry needs to do to regain the trust and confidence of investors so that it can re-emerge on a sound and stable basis.

The structured finance industry has $15 trillion of securities outstanding worldwide today. These securities include asset backed commercial paper, ABS, RMBS, CMBS, Exotic and covered bonds, just to mention a few.

Slide: Is Structured Finance Worth Saving?

Why is Structured Finance Necessary?

In theory, structured finance serves a useful purpose. Implemented properly, it enhances the safety and soundness of the banking system. That the actual implementation did not achieve this ultimate result does not mean that the idea behind structured finance is flawed. As I will discuss in a few moments, it was the implementation that went wrong.

As you know, banks in a modern economy perform two essential economic functions.

First, banks allow market participants to store wealth and subsequently pay for the goods and services the participants acquire.

Second, banks profit from bringing together borrowers and savers. In an ideal world, they charge enough on the loans they make to cover their costs and deliver a positive risk-adjusted return to their equity holders.

Regulators worldwide seek to protect their banks' ability to perform these economic functions.

It is the lending function that introduces two major risks to the banking system.

- The first is credit risk. Borrowers sometimes don't repay their loans. This fact has been demonstrated repeatedly over the last forty years. Examples of this include the well-known histories of Latin American debt and commercial real estate lending in the United States.
- The second is interest rate risk. In a rising rate environment, as shown by the U.S. Savings and Loan industry in the 1980's, holding a portfolio of 30-year fixed-rate mortgages and relying on shorter-term funding is a sure fire way to lose money.

Structured finance transfers these lending related risks from the banks to investors while retaining a profitable relationship for the banks from bringing borrowers and savers together. It transfers the risks by using the idea that the cash flow from a diversified pool of loans can be divided and that there are investors with different risk / return profiles who will acquire each tranche of the cash flow. It retains a profitable relationship by making the banks responsible for servicing the transaction.

By design, structured finance enhances the safety and soundness of the banking system and this is the reason there is an essential role for structured finance going forward.

Slide: What Went Wrong?

What Went Wrong with the Implementation?

To answer this question, I need your help. I have here a brown paper bag with a question mark on it that represents the lowest risk piece of a structured finance security. Each of you is a potential buyer of this security.

On September 1, 2008, when I put this security together, it had $100 of collateral in it and I had an offer to buy it at $100. In the interest of full disclosure and because I don’t have time to circulate a prospectus with its convoluted legal text for you to read, let me summarize the key risk factor. The key risk is that you don’t know how the collateral has performed over the last month and a half. Now, please raise your hand if you would be willing to buy it from me today for $95? Nobody? The fact that no one would buy the security tells me three things.

- First, it tells me that *with no current data about the performance of the security's collateral, there is no market for the security*. You will remain on a buyer's strike until you find out this information.
- Second, it tells me that you learned that careful attention must be paid to the representations and warranties made about the assets backing a security. *For many of you, this lesson sank in as you began to reread some of the prospectuses for sub-prime mortgage deals and discovered that Issuers were allowed to load up the security with the worst assets from their balance sheet.*
- Third, it tells me that what someone else was willing to pay or paid for a security doesn't tell you what the current value of the security is.

Since you would like to know what is inside the bag, let me share with you last month's remittance report. The reason for showing you this remittance report is that *this is the data currently available* to market participants when they want to see what is going on with the collateral backing any structured finance security. According to the end of month remittance report which was just released on Friday, as of September 30, 2008, the cash paid out during the previous 30 days was $25 and the estimated value of the remaining collateral was $75. I must remind everyone that today is October 19, 2008 or 19 days after the date on the remittance report. Since then, there has been no information on the performance of the collateral. Please raise your hand if you would buy the security from me today for $70? Anybody? How about $10? Anyone at this distressed price. The fact that no one else would buy the security tells me that I *still haven't provided you with the data you want to value the security and therefore there is still no market or at best a distressed market for the security.* This also confirms the results of a June 2008 JP Morgan survey of institutional investors who said they needed more information than the currently available price quotes, prospectuses, Regulation AB and Remittance Reports. You would like to know what is in the bag this instant because it could be substantially different than what an out of date, end of month, remittance report shows.

Since you would like to know what is inside the bag this instant, let me show you what I believe the future of structured finance will look like. (Pull out the plastic bag from inside of the paper bag.) As everyone can see, the plastic bag has $50 in it which is the current value of the collateral. Keeping in mind that you could come up and examine the contents of the plastic bag to verify that it is a real $50 bill before any money changes hands, please raise your hand if you would be willing to buy the contents of the plastic bag for $45? I notice that almost everyone in the room would be happy to buy the contents of the plastic bag for $45 and make a $5 profit if they can verify that the plastic bag contains a real $50 bill.

Why have I been able to go from a buyer's strike to a deep liquid market? I provided real time collateral level transparency in the context of the security to all market participants. Each market participant was able to use the analytic and pricing model of their choice to independently value the collateral. Each market participant was then able to compare this value to the price the security was offered at to make a buy/hold/sell decision.

All investors understand that transparency is the cornerstone of deep, liquid markets. It removes the opacity that scares investors. As you just experienced, real time collateral level transparency restores trust, confidence and the willingness to invest capital in the credit markets. And it does it RIGHT NOW. (Hold up plastic bag)

What went wrong with the implementation of structured finance before today? It was implemented worldwide without real time collateral level transparency. It had the veneer of liquidity but without the real time collateral level transparency infrastructure to support it. Therefore, it lacked the foundation for being a deep, liquid market. As we have just demonstrated, going forward, real time collateral level transparency must be a basic feature of all structured finance deals since it makes it possible to *monitor, value and trade these securities*.

Before we leave the topic of what went wrong, I want to talk about some of the many major problems caused by opacity that real time collateral level transparency cures.

(Slide: Market Discipline)

First, real time collateral level transparency solves the problem of how to stop issuers from selling poorly underwritten collateral, like sub-prime loans or undocumented loans, at premium prices.

Here is another plastic bag with $50 of play money in it. As buyers, you know immediately it isn't worth a real $50 like this plastic bag. As a result, you aren't going to offer anything close to the same price.

The beauty of adding transparency is that combined with representations and warranties *it enforces market discipline on issuers*. If an issuer originates quality loans, it can anticipate receiving a high price for the securities backed by these loans. If an issuer originates low quality loans, it can anticipate receiving a lower price for the securities backed by these loans.

(Slide: Greater Fool Pricing)

Second, real time collateral level transparency solves an important problem with any TRACE type price reporting system. As you know by now, price data by itself doesn't tell you the value of a security. There could be a number of factors influencing the reported sale price that have nothing to do with the actual value of the security. These include that the last price shown may have belonged to the greatest fool. In order to make a buy/sell/hold decision, Investors need to be able to *independently value* the security and *then compare* this valuation with the price shown by Wall Street. Real time collateral level transparency creates an efficient market where price reflects value. Price transparency without real time collateral level transparency is just market participants bidding blindly.

(Slide: Valuations)

Third, real time collateral level transparency eliminates the need to try to value structured finance securities using proxies like the ABX index. This particular index looks at the prices of credit default swaps on 20 structured finance securities. It reflects the price for insurance on these securities, which is what an index based on credit default swap prices measures. The index does a great job of measuring fear. As fear and uncertainty about the future increases, the price for insurance goes up.

With real time collateral level transparency there is no need to use a *fear based* index as a central driver in valuing a security. *With real time collateral level transparency* a security can be valued based on how the collateral backing a security is actually performing.

The actual performance can be compared with the expected performance in the payment or loss curves used in the discounted cash flow pricing model. Adjustments to these curves are anchored by this actual performance and as a result, the range of prices generated by the model narrows. As valuation differences narrow, it is easier for buyers and sellers to find common ground for making a transaction.

(Slide: Trust but Verify)

Fourth, real time collateral level transparency makes it possible for market participants to "Trust, but Verify" what is going on with structured finance securities. Last fall, Moody's and S&P testified before Congress that the lack of current information caused their ratings to lag behind actual performance. With real time collateral level transparency, the Rating Services will have the information they need to make timely adjustments to their ratings.

(Slide: Third Party Pricing)

Fifth, real time collateral level transparency will help to support the growth of independent valuation firms. Market participants will no longer have to rely on Wall Street's proprietary pricing models. This eliminates a long standing conflict of interest where Wall Street used its proprietary models to value the very same securities they also bought and sold. As a result, the market for structured finance securities will become much deeper and more liquid as it is driven by information based trading that reflects competing views of the future.

(Slide: Level Playing Field)

Sixth, real time collateral level transparency means that everyone has the same information at the same time and no one can benefit from having information before other market participants. That firms took advantage of the information gap caused by the delayed reporting of remittance data was made clear in the November 9, 2007 Wall Street Journal's Heard on the Street column. The column discussed the impact of this information gap as it applied to Saxon Capital Inc. (a sub-prime originator and servicer Morgan Stanley had acquired) and Morgan Stanley's bearish subprime wager. The column quotes a Morgan Stanley official saying about the wager that "it might have been informed by market data that Morgan Stanley was getting from Saxon's activities." I highlighted Morgan Stanley because the article was about them, but there were a number of other Wall Street firms that had access to real time collateral performance data that were also both shorting the market and underwriting new securities. Real time collateral level transparency eliminates any conflict of interest between these activities.

(Slide: Risk Management Made Easy)

Seventh, real time collateral level transparency improves the ability of regulators and financial institutions worldwide to monitor the market, to eliminate regulatory arbitrage and to take corrective action.

- Regulators could at all times know with certainty both the market value and exactly what is happening to the collateral that underlies the portfolio of securities a financial institution owns. With this information, regulators could realize the European Union's recommendation of coordinating all the regulators who monitor the 30 largest financial institutions in the world.
- Rather than operate in the absence of information caused by opacity, any country's regulator could look at the portfolio no matter where in the world the financial institution holds the securities and identify areas of concern. Since the financial institutions would also know what is happening with their portfolios, they could work with regulators to proactively address any problem areas.

In summary, real time collateral level transparency significantly enhances regulatory and risk management across the entire financial system.

(Slide: Return of Active Market)

Eighth, real time collateral level transparency would help governments determine how much capital each bank needs to raise, either from the markets or from governments to cover the losses in their portfolios. It helps because it supports the return of active trading which in turn generates real market prices for marking the portfolios to market.

(Slide: What Do We Do Now?)

What Does the Industry Need to do to Regain Investor Confidence?

As the cashier says at the checkout line at the grocery store… Paper or Plastic? (Hold up both bags and set paper bag down) Real time collateral level transparency is far better than any regulation or bailout program, but you already knew that because you were willing to buy the plastic bag.

My first recommendation is to define real time collateral level transparency.

- First, it is individual loan level data where the privacy of the borrower should comply with HIPAA standards, the strictest privacy standards enforced in the U.S. today. HIPAA standards should be sufficient for compliance with EU bank privacy laws, an important consideration as we have a global problem in restarting securitization, not just one confined to the United States.

    - The individual loans (like mortgages, autos and credit cards) will be tracked, but are not traceable to identifiable individual borrowers.
- Second, as a practical matter, because of the cash settlement process between banks, the best real time loan level data is data as of the *close of business yesterday* which can be *disseminated today* in compliance with Sarbanes-Oxley so that every market participant can get the data at the same time before the credit markets open.
- Third, the data itself will include all the relevant information that end users need. It will include as many of the data fields recommended by the American and European Securitization Forums as possible.
- Fourth, this individual loan level data will be delivered to each market participant's desktop in the context of the unique structure of the deal it is supporting. Such as the deal's over-collateralization. The *data isn't useful if market participants can't easily access it or understand it*.

Finally, please note that Regulation AB and other disclosure rules are minimum requirements which leave us with the paper bag. There are no laws that prevent the higher standard of disclosure we are discussing today that was highlighted by the plastic bag.

Since late last year, the U.S. Treasury Secretary has been asking for an industry solution to end the buyer's strike in structured finance. On April 14, 2008 *Total Securitization* published my solution in a “Learning Curve” article on implementing transparency. My second recommendation, which repeats this solution, is the establishment of a utility, owned by an industry consortium, to collect, compile, verify, standardize, analyze and make available for dissemination the daily collateral performance data in the context of each deal’s structure. The daily performance data will flow from the audited or auditable billing and collection systems used to manage the individual loans to this independent third party and then out to the market participants. This lowers the industry’s cost of providing transparency to each market participant’s desktop while maintaining the highest possible quality standards for the data. In addition, this maximizes the flexibility of the transparency transmission mechanism so that it can meet the evolving needs for transparency to support new products into the future.

Ultimately, the transparency data is useless if the market participants don’t trust it. By definition, the third party must focus only on the activities involved in collecting and disseminating the data to market participants. This focus eliminates the competitive conflicts of interest that would be present if it were *controlled* by a single data distributor, an analytic and pricing model vendor, a rating agency, a servicer/trustee or any other information vendor who is currently supporting the structured finance industry.

The industry owned utility will make the data freely available. All market participants should use this data to enhance the value of *their* offerings. If the industry is ever to regain the Investors' trust, it needs to choose to avoid any potential conflicts of interest wherever possible. To avoid the remotest appearance of a conflict of interest with this data, the current industry participants just should not be in the business of compiling and maintaining the integrity of this data.

My third and most important recommendation is that we begin the process of implementing and not just talking about real time collateral level transparency right now. Around the world, Issuers should pay for and make the data available. Why should Issuers pay? In the structured finance markets, they benefit most from the economic value of trust.

In addition, Governments should make implementing real time collateral level transparency a basic condition of receiving an injection of funds from the Governments, whatever form those funds take. This is particularly true for all RMBS related securities that the Governments acquire. The US Government intends to modify many of the loans underlying these securities. It is critical that the market participants have the daily data to monitor these modifications and properly revalue the securities. Otherwise, when the Governments try to resell the securities, it will be just like this paper bag with no one knowing the value of the contents and no one willing to buy.

We have the technology and know-how to implement this type of transparency. Since I am a U.S. taxpayer and would like to minimize the bailout's cost, I would recommend, since they are already getting funds from the U.S. Government, starting with Fannie Mae and Freddie Mac. They should be leading examples of industry-wide best practices. Best practices include real time collateral level transparency. We could fully implement real time collateral level transparency for their securities in 6 to 8 months from today. We could also fully implement real time collateral level transparency on the bulk of the rest of the $15 trillion structured finance market within 12 to 18 months from today.

Finally, in the spirit of transparency, I need to make a disclosure. My firm is sponsoring the formation of *this industry owned utility* and will provide it the information technology and personnel to implement real time collateral level transparency. Let me make three points about this disclosure:

> First, several of the largest financial institutions in the world are pursuing the opportunity to become an investor. Each of these institutions will also become a client. By embracing the utility they are telling the world that they believe they have nothing to hide. This is a critical first step in re-

establishing trust between banks and restoring investor confidence.

Second, the origins of my firm's intellectual property dates back to the 90's when I set about solving the problem of eliminating fraud from medical receivable backed structured finance deals. I received a patent for this groundbreaking work. Since then, I have developed, enhanced and adapted the technical basis for this solution to bring transparency to all the different asset types backing structured finance deals.

Third, the individuals who have indicated their desire to run this utility and who would actually implement transparency from an IT perspective have spent most of their careers as senior executives in the business offices of one of the ten largest financial institutions in the world.

- They have significant experience integrating computer systems using a small army of consultants and managing databases similar in size to what the utility will have.
- They have assured me that the technical solution I have proposed is straight forward in its implementation and that it will provide transparency for even complex CDO's.
- They provided the 6-8 month time frame for executing transparency across Fannie Mae

and Freddie Mac and the 12-18 month time frame for most of the rest of the Industry.

In conclusion, the structured finance industry has talked about the need for transparency for over one year. Now is the time to stop talking and start doing by implementing real time collateral level transparency. (Holding up clear plastic bag) Are you in?

Thank you for listening. At this time, I would like to answer any questions that you may have.

Slide: Questions and Answers