

**GCIB Capital Markets Approval Committee*****Coventree Capital – Liquidity Put Option***

<b>SPONSORING BUSINESS UNIT:</b>	NA Credit Derivatives
<b>LOCATION:</b>	New York
<b>PRESENTERS:</b>	Sumit Roy, Doug Warren, Rick Caplan, Jonathan Koerner, Rafi Khan
<b>CMAC DATE:</b>	December 17, 2002

***Background:***

Coventree is the sponsor of several multi-asset multi-seller securitization conduits, which issue commercial paper (CP) to fund securitization transactions. To satisfy rating agency considerations, this CP must be backed by some form of acceptable liquidity backstop. Unlike US ABCP liquidity facilities, where the facility usually covers for both market disruption and credit risk, the Canadian liquidity facilities cover only for market disruption. The liquidity support provider is not required to fund the CP if there is any asset deterioration that results in downgrade of the CP.

As of November 2002, out of a total amount of CAD \$2.9 billion of CP issued by Coventree sponsored conduits, approximately CAD \$1.6 billion (55%) was issued as Extendible CP, CAD \$1.2 billion (41%) as liquidity backed CP and CAD \$0.1 billion (4%) as Forward Rate Notes (FRNs). The Extendible CP gives Coventree the ability to extend the maturity of the CP from a typical 30 day duration to as long as 1 year in the event of a market disruption. While the use of ECP has been successful for Coventree, their conduit's ECP has become a large percentage of the total ECP market in Canada (44% as of Q1 2002 and higher now, see Appendix A).

Coventree's conduits are set up such that the pool of assets purchased by the conduit are financed by a series issuance of CP that is secured by the underlying pool of assets. This setup has the effect of creating "silos" within the conduit, where each series of CP issued is linked to a particular pool of assets.

***Client Objectives:***

As Coventree has a significant pipeline of securitization deals, they wish to reduce reliance on ECP as liquidity backstop and develop other sources of liquidity. Coventree is therefore seeking an alternate backstop facility that is efficient in cost and size. Coventree also seeks to set the facility in a substantial deal size so that it avoids the complications, cost and time to approach various liquidity providers.

In order to achieve its objectives, Coventree is seeking to structure the liquidity put as a program ("Program") with a notional amount of CAD \$ [1] billion. Any new asset added

to the Program will be subject to Citibank's due diligence. Citibank will have the right to reject the asset if it is not satisfied with asset quality or subordination levels.

**Transaction Summary:**

Generally, each individual transaction in the Program will be structured as follows:

- 1) A newly set up special purpose trust ("New Trust") purchases an asset rated AAA by Dominion Bond Rating Services (DBRS), the Canadian rating agency.
- 2) New Trust funds its purchase by issuing two notes – Junior and Senior notes. Junior notes are subordinate to Senior notes in payment priority and liquidation. The level of subordination is determined on an asset-by-asset basis in order to achieve "Super AAA" level for Senior notes. Both Senior and Junior notes are rated AAA by DBRS.
- 3) One of Coventree's conduit (Conduit) purchases Series Y and Z notes and in turn funds these assets by issuing CP Notes (Series A) and Extendible CP (Series E) notes. The Series A and E notes are securitized by Series Y and Z notes respectively.
- 4) The Series E notes are extendible if the Trust is unable to issue new Series E notes for a one-month term at an offering price of at least 110 bps higher than the one-month bankers acceptance (BA) rate.
- 5) Citibank writes an option to Conduit that is exercisable by the Conduit if Series A notes cannot be issued at BA + 50 bps. In that case, Conduit will issue a new series - Series C notes to Citibank. The seniority and terms of Series C notes will be identical to Series A notes. The put is exercisable only if DBRS affirms the rating of the Senior notes on the day of the funding to be R-1 (high), which is DBRS's highest short term rating. The put is therefore designed to cover for market disruptions and liquidity events, and does not cover for credit risk of the underlying assets. *because if it is not R-1 (high) rating, it would be lost*
- 6) The term of the option will depend upon the underlying pool of assets, but will not be in excess of [5] years.
- 7) Citibank is not obligated to fund if there is an event of default that has occurred and is continuing on the date of the funding under the Trust Indenture. The event of default includes failure of the Trust to make any payment due and payable or if the Trust defaults in any material respect in observing or performing any material covenant or condition.
- 8) In the event the put is exercised, Coventree must attempt to issue CP in the market at a spread of less than 50 bps every day that our put facility is drawn in an attempt to redeem our paper.
- 9) Citibank will have a security interest in the underlying collateral if the put is exercised.

*This is a  
Spread  
option*

**Risk Considerations:**

## 1) Super-senior position

Citibank risk position is super-senior in payment priority and liquidation of the collateral ([30%] AAA subordination). Additionally, Citibank's position will be reduced as the underlying asset amortizes through potential prepayments.

## 2) Historical spreads

The R-1 (high) rated CP has never traded at 50 bps spread since Coventree conduits started issuing CP since April 2000 (see Appendix B). Even the spreads for R-1 (mid) rated CP have been higher than 50 bps on only 4 one-day periods (in 1992) since 1990 (see Appendix C). The average spread on R-1 (high) rated CP issuance since April 2000 has been 2.6 bps over one-month BA. The current spread of R-1 (high) rated CP over one-month BA is about 3-4 bps.

## 3) Collateral

The underlying collateral is AAA rated CMBS of a US securitization. The AAA tranche has about 37% subordination. Citibank's CMBS group has reviewed the collateral for quality and subordination.

**Risks/Mitigants:**

1. Deterioration of credit quality of collateral prior to option exercise
  - DBRS must affirm R-1 (high) rating on the day of the exercise. To the extent the Series A note is not rated R-1 (high), the put cannot be exercised
2. Deterioration of credit quality of collateral subsequent to option exercise
  - Citibank assumes this risk, but the likelihood of the put getting exercised is remote. Also, once exercised, the Trust must attempt to issue paper in the market every subsequent day and is obligated to redeem Citibank if it can fund at less than BA + 50 bps.

**Operations:**

The writer of the put will be the Canadian branch of Citibank, N.A.

**Accounting:**

Accounting Policy has reviewed the transaction and determined that New Trust and Conduit should not be consolidated with Citibank. The risk position will be marked to market consistent with the established firm guidelines.

***Funding:***

Upon exercise of the put, Citibank needs to fund the Series C notes on the same day. In order to facilitate same day funding, the Conduit would need to notify Citibank by 10:00 am. Additionally, the amount that is funded on the same day would be limited to CAD\$ equivalent of USD [150] MM.

***Tax:***

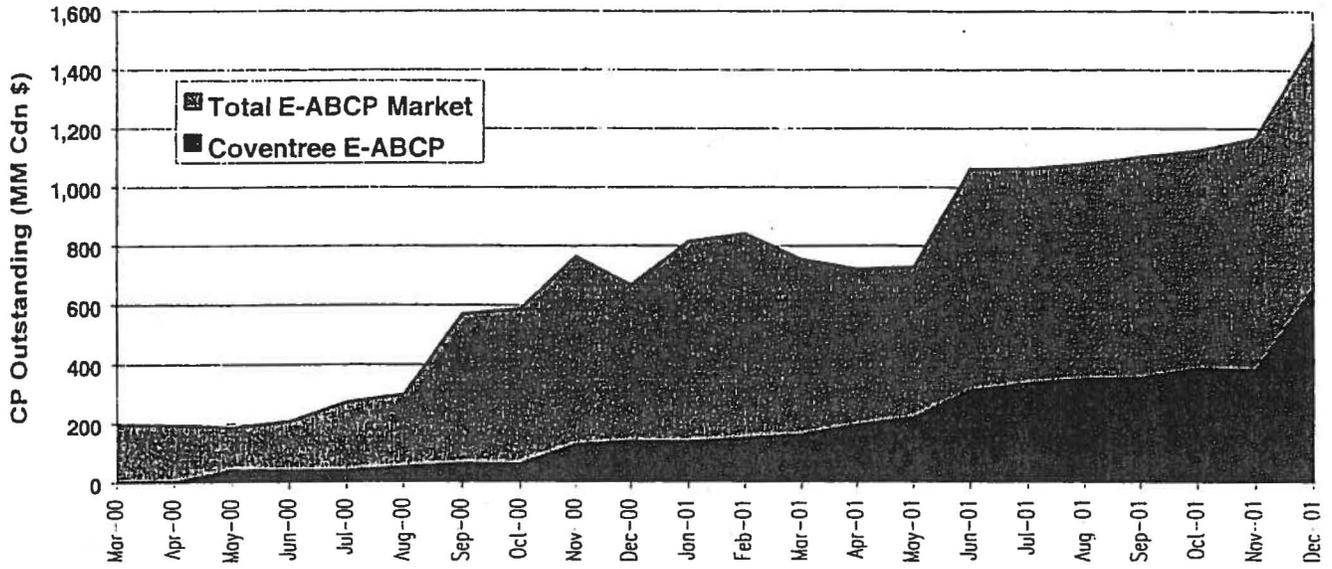
Since the writer of the put option will be a Canadian resident entity (Canadian branch of Citibank, N.A.), there will be no Canadian withholding tax on premium payments to Citibank.



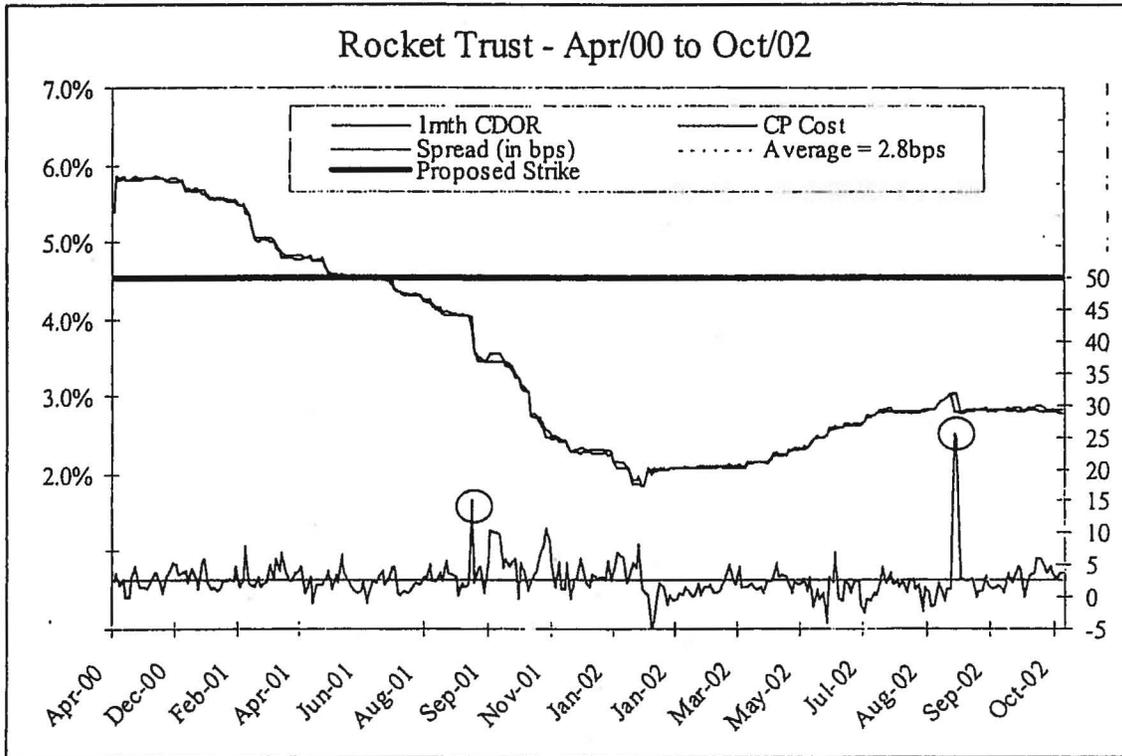
***Regulatory Capital:***

The position will be managed as a super senior risk exposure in our trading book on a VaR basis.

APPENDIX A



APPENDIX B



**Notes:** September 12, 2001 – 15.2bps (30% of proposed strike). Spread on next trade – 2.3bps

September 4, 2002 – 25bps, but this is misleading. That morning, market participants were expecting the Bank of Canada to raise rates 25bps, and CP pricing reflected this. The BoC did not raise rates and at 10AM BA's set down 23.5bps from the day before. If you compare the CP yield to the BA setting the day before, the spread is actually 1.5bps.

APPENDIX C

