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Off-the-Run Private ABS: A Rating Agency Perspective

Defining “Off-the-Run”

DBRS defines “off-the-run” or “esoteric” asset-backed securities as securitizations backed by assets lacking the critical mass, steady origination volume, or broad market acceptance and liquidity required for public issuance. This market is divided into two basic sub-sets: SEC-registered 144As and non-registered “true privates.” While 144A securities do not have to conform to SEC disclosure and accountability standards, many are relatively large transactions, often comparable to publicly issued securities. Thus, the ABS 144A market generally involves the securitization of assets that conform to some, if not most, public ABS standards. True privates, however, are characterized by their confidentiality, relatively small size, and non-standardized documentation.

Story Credits

Sometimes described as “story credits,” ABS privates generally entail labor-intensive new or modified asset class fundamental research, specialized modeling, and non-standard documentation review. These analytical requirements, along with the negotiated nature of the transactions, inevitably prolong an often challenging analytical process.

Originating, Servicing, and the Ongoing Concern

Operational and corporate credit risks are priority considerations for ABS privates. Originators/servicers are frequently not rated and therefore shadow ratings for these entities may be necessary for some transactions. While securitization theory necessitates the complete separation of asset risk from transferor risk, smaller and more specialized transactions are far more vulnerable to the originator’s/servicer’s credit condition (“event risk”). This is especially true for non-commoditized asset classes that require specialized servicing. Thus, many ABS privates are effectively classified as hybrid corporate transactions; bankruptcy remote legally, but not necessarily operationally.

The Rated, the Not Rated, and the Unratable

Most ABS privates are rated. The demand for ratings is driven by a combination of investor industry-specific regulatory requirements and a preference for potential liquidity. For example, insurance companies prefer rated investments, while hedge funds are more flexible. Some transactions, lacking required information, are effectively unratable.

Liquidity, Yield, and Protection

Typically, ABS privates are purchased by “buy and hold” investors. While lower liquidity, combined with extensive credit and operational analysis, pushes up yields, limited supply and strong investor demand for these instruments may moderate the all-in price. In the event of a credit-driven flight to quality, however, true privates would be harder to liquidate. Hence, portfolio insurance for these instruments may be difficult to secure.

Privacy, Transparency, and Accountability

True privates are, by definition, confidential transactions. Therefore, a rating agency will not disclose information to parties outside of the formal transaction process. However, DBRS will promptly provide actual and properly cleared prospective noteholders with transparent access to its analytical methodology.

Innovation vs. Conservative Standards

DBRS is committed to responding to private ABS transactions and sector innovations on a timely basis while also adhering to its conservative analytical standards.

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