

SECURITIZATION OF FINANCIAL ASSETS

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GENERAL BACKGROUND

Mortgage backed (**MBS**) and asset backed (**ABS**) securitizations, or more generally, the securitization of financial assets (for purposes of this outline, **Securitized Assets**), is a form of structured finance initially developed in the early 1980's in MBS format. It matured in the late 1980's in both MBS and ABS formats and is now a U.S. \$2+ trillion industry in the U.S. alone. In recent years, it has spread to Europe (the largest market outside the U.S.), Latin America and Southeast Asia (primarily Japan), and the worldwide market is estimated to be in excess of U.S.\$4 trillion.

Virtually all forms of debt obligations and receivables (**Receivables**) have been securitized in the U.S.: residential mortgages; home equity loans; commercial loans; manufactured housing loans; timeshare loans; auto, truck, RV, aircraft and boat loans and leases; credit card receivables; trade receivables (just about any type, i.e., airline tickets, telecommunications receivables, toll road receipts); equipment loans and leases; small business loans; student loans; lottery winnings; legal fees from tobacco litigation; and record album receivables (David Bowie and Pavarotti). Although the basic concepts, many based upon tax and accounting effects and desired results, are essentially the same, each asset class presents unique structuring considerations, and the players are constantly looking for ways to improve structures to achieve higher ratings (and thus lower costs) and reduced expenses. Securitizations outside the U.S. have been more limited because of certain impediments (discussed below). In Latin America and the Caribbean the principal asset classes securitized have been home mortgage loans and trade receivables (primarily the "future flow" from trade receivables, discussed in more detail below).

BASIC STRUCTURE

In its simplest form a Securitization involves (1) the sale of a large pool of Receivables by an entity (**Originator**) that creates such Receivables (or purchases the Receivables from entities that create them) in the course of its business to a "bankruptcy remote," special purpose entity (**SPE**) in a manner that qualifies as a "true sale" (vs. a secured loan) and is intended to achieve certain results for accounting purposes, as well as protecting the Receivables from the claims of creditors of the Originator, and (2) the issuance and sale by the SPE (**Issuer**), in either a private placement or public offering, of debt securities (**Securities**) that are subsequently satisfied from the proceeds of and secured by the Receivables. When the Securitization is "closed," funds flow from the purchasers of the Securities (**Investors** - usually banks, insurance companies and pension funds) to the Issuer and from the Issuer to the Originator. All of these transactions occur virtually simultaneously.

In the United States, the Issuer in the basic structure is normally a trust (grantor, owner or business, depending upon the Originator's objectives and the structure), which issues Securities consisting of notes or other forms of commercial paper (**Notes**) or certificates evidencing an undivided ownership in the Issuer (**Certificates**), or both. Frequently, there is also created a

residual interest in the Issuer that entitles the holder (usually the Originator) to funds remaining after all obligations to the holders of the Notes and Certificates (**Securityholders**) have been satisfied. During the term of the Securitization, payments on the Receivables are collected by a servicing entity, usually the Originator (**Servicer**), deposited and invested (in “eligible securities”) in various accounts under the control of a trustee (**Trustee**), and disbursed by the Trustee to the Securityholders in payment of the Securities.

In most instances a “two step” structure is used whereby the Receivables are first transferred by the Originator to an intermediate SPE (**Intermediate SPE**) that is a wholly owned subsidiary of the Originator, but which is only permitted to engage in the business of acquiring, owning and selling the Receivables, has at least one independent director or member and is restricted in various ways from entering into voluntary bankruptcy and other prohibited acts. Frequently, this transfer is, at least in part, a contribution of capital by the Originator to the Intermediate SPE. In the second of the “two steps,” the Intermediate SPE sells the Receivables to the Issuer. This structure is intended to enhance the “true sale” and “bankruptcy remote” characteristics of the transaction. That is, the transaction is structured to insure that the sale of Receivables to the Intermediate SPE is a “true sale” rather than a financing device, which is necessary for the Originator to get the Receivables off its balance sheet and book a profit or loss for accounting purposes and, combined with the second transfer by the Intermediate SPE to the Issuer, an essential part of the required protection from the claims of creditors, including by avoiding consolidation of the Receivables with the assets of the Originator in the event of the bankruptcy of the Originator. Beginning in 1997, a change in accounting rules in the U.S. pursuant to FAS 140¹ has virtually mandated the use of the two step structure to obtain an “isolation of assets” and, therefore, a “true sale,” whenever the Originator retains an interest in the Securities issued by the Issuer (usually for credit enhancement purposes, as discussed below). However, it should be noted that in some cases the Originator does not want a true sale to occur (and book a gain or loss) and deliberately structures the transaction as a secured loan or under provisions of the IRC that will result in a taxable transaction.

The above description of the Securitization structure is very basic. Actual structures involve many more elements and participants.² The classes of assets also result in different and, in many cases, more complex structures. For example, in securitizing motor vehicle leases, to avoid the very high costs of multiple transfers of titles to the vehicles, a new structure was developed several years ago (in which the author of this outline participated) where the vehicles are initially titled in and the leases made through an “origination” or “titling” trust and the trust then issues, in a series of complex transfers to other trusts, limited partnerships and limited liability companies (**LLCs**), units and sub-units of beneficial interest in the trust which are actually the “receivables” that are securitized, the Securityholders having no interest, beneficial or otherwise, in the underlying vehicles or leases.

¹ Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, issued by the Financial Accounting Standard Board of the Financial Accounting Standards Foundation (issued originally June, 1996 as FAS 125 and effective after December 31, 1996).

² Further, as of the date of this Article the FASB is considering new interpretations of FAS 140 that would require changes in the structure of some securitizations. Such matters are beyond the scope of this Article.

ADVANTAGES

The Securitization structure is intended to provide significant advantages to Originators, such as:

1. The Receivables are moved “off balance sheet” and replaced by a cash equivalent (less expenses of the Securitization), thus improving the Originator’s balance sheet and resulting in gain or loss, which itself is usually an intended, beneficial consequence.³

2. The Originator does not have to wait until it receives payment of the receivables (or, in a “future flow” securitization, until it even generates them) to obtain funds to continue its business and generate new Receivables. In many cases this is essential, and a role otherwise filled by more traditional methods of financing, including factoring (in some ways Securitization is a very sophisticated form of factoring). This is more significant when the Receivables are relatively long term, such as with real property mortgages, auto loans, student loans, etc., and not as significant with short term Receivables, such as trade and credit card Receivables.

3. The Securities issued in the Securitization are more highly rated by participating rating agencies (because of the isolation of the Receivables in a “bankruptcy remote” entity), thus reducing the cost of funds to the Originator when compared to traditional forms of financing. In instances where the Receivables bear interest, there is usually a significant spread between the interest paid on the Securities and the interest earned on the Receivables. Ultimately, the Originator receives the benefit of the spread. In addition, the Originator usually acts as Servicer and receives a fee for its services.

4. In non-revolving structures, and those with fixed interest rate Receivables, assets and related liabilities can be matched, eliminating the need for hedges (although in most transactions, hedges are required).

5. Because the Originator usually acts as Servicer and there is normally no need to give notice to the obligors under the Receivables, the transaction is transparent to the Originator’s customers and other persons with whom it does business. This is frequently not the case in foreign securitizations.

These advantages are tempered by the fact that the Securitization structure results in higher costs than traditional forms of financing, but this is more than offset by the advantages. However, these higher costs mean that the value of a pool of Receivables must be significant to justify Securitization. Most Securitization offerings are in excess of U.S.\$100,000,000, a number greater than U.S.\$1 billion, and some in the several billions of dollars. In fact, many Securitizations at the low end are not structured by the Originators, but use “**conduit**” Issuers maintained by banks and investment bankers. In these securitizations, Originators sell Receivables to conduits that aggregate Receivables from multiple Originators (even different forms of Receivables) to create large pools to support the Securities issued by the Issuer-conduit. Because the operators of the conduits keep a bigger share of the “pie,” an Originator is

³ The concept of “off balance sheet” refers to the intended result that after the securitization of the Receivables they will not be consolidated for financial accounting purposes on the balance sheet of the Originator. Making that determination has become more complex since the Financial Accounting Standard Board issued *Interpretation No. 46* in early 2003. Such considerations are beyond the scope of this Article.

frequently better off structuring a Securitization that uses its own Issuer in a “term” Securitization when its pool of Receivables is sufficiently large. This doesn’t always follow, however, particularly when there is a steady need for cash and a series of more frequent, smaller conduit securitizations may meet that need better than less frequent, larger term securitizations.

It has also become fairly common for Originators to use conduits as “warehouse” facilities. That is, Receivables are sold to a conduit for all of the reasons described above and are later repurchased and included in a pool of Receivables for a term securitization. In this manner, an Originator can accumulate Receivables for inclusion in a substantial term securitization while still moving the Receivables off balance sheet (if desired) and obtaining funds for its business. Of course, as the conduit has a fiduciary duty to its investors, the Receivables must be repurchased at fair market value, and to protect the “true sale” there is no option or other right to repurchase.

The Securitization structure described herein and in the “Anatomy of a Securitization,” attached as **Appendix A**, is for a term securitization. In a conduit Securitization, the structure stops as far as the Originator is concerned when the ISPE sells the Receivables to the conduit (rather than to an Issuer), although in most cases the Originator acts as Servicer, as described below. Further, there is no PPM, Offering Circular or Prospectus (as described in the Anatomy of a Securitization).

There has also developed a form of securitized lending that is briefly described in attached **Appendix B**. This structure has been found useful for smaller pools of Receivables where the cost of a term or even conduit structure is prohibitive, and can even provide better cost/benefit results with a very substantial pool of Receivables depending on the nature of the Receivables and the needs of the Originator. This is a structure that should be considered by most Originators when they do their preliminary analysis.

MAJOR PLAYERS

The major “players”⁴ in the securitization game, all of whom require legal representation to some degree, are as follows (this terminology is typical, but different terms are used; for example the “originator” is often referred to as the “issuer” or “seller”):

Originator - the entity that either generates Receivables in the ordinary course of its business, or purchases and assembles portfolios of Receivables (in that sense, not a true “originator”). Its counsel works closely with counsel to the Underwriter/Placement Agent and the Rating Agencies in structuring the transaction and preparing documents and usually gives the most significant opinions. It also retains and coordinates local counsel in the event that it is not admitted in the jurisdiction where the Originator’s principal office is located, and in situations where significant Receivables are generated and the security interests that secure the Receivables are governed by local law rather than the law of the state where the Originator is located.

Issuer - the special purpose entity, usually an owner trust (but can be a grantor, business or even common law trust, or a corporation, partnership or fund), created pursuant to a

⁴ In describing the players, it is necessary to refer to certain documents and structural elements that are not fully described herein. These are described in greater detail in the attached “Anatomy of a Securitization.”

Trust Agreement or Pooling and Servicing Agreement between the Originator (or in a two step structure, the Intermediate SPE) and the Trustee, that issues the Securities and avoids taxation at the entity level. This can create a problem in foreign Securitizations in civil law countries where the trust concept does not exist (see discussion below under “Foreign Securitizations”).

Trustees - usually a bank or other entity authorized to act in such capacity. The Trustee, appointed pursuant to a Trust Agreement or Pooling and Servicing Agreement, holds the Receivables, receives payments on the Receivables and makes payments to the Securityholders. In many structures there are two Trustees. For example, in an Owner Trust structure, which is most common, the Notes, which are pure debt instruments, are issued pursuant to an Indenture between the Trust and an Indenture Trustee, and the Certificates, representing undivided interests in the Trust (although structured and treated as debt obligations), are issued by the Owner Trustee. The Issuer (the Trust) owns the Receivables and grants a security interest in the Receivables to the Indenture Trustee to secure payment of the Notes. Counsel to the Trustee provides the usual opinions on the Trust as an entity, the capacity of the Trustee, etc.

Investors - the ultimate purchasers of the Securities. Usually banks, insurance companies, retirement funds and other “qualified investors.” In some cases, the Securities are purchased directly from the Issuer, but more commonly the Securities are issued to the Originator or Intermediate SPE as payment for the Receivables and then sold to the Investors, or in the case of an underwriting, to the Underwriters.

Underwriters/Placement Agents - the brokers, investment banks or banks that sell or place the Securities in a public offering or private placement, frequently retaining portions for their own account. The Underwriters/Placement Agents usually play the principal role in structuring the transaction, frequently seeking out Originators for Securitizations, and their counsel (or counsel for the lead Underwriter/Placement Agent) is usually, but not always, the primary document preparer, generating the offering documents (private placement memorandum or offering circular in a private placement; registration statement and prospectus in a public offering), purchase agreements, trust agreement, custodial agreement, etc. Such counsel also frequently opines on securities and tax matters.

Custodian - an entity, usually a bank, that actually holds the Receivables as agent and bailee for the Trustee or Trustees.

Rating Agencies - Moody’s, S&P and Fitch. In Securitizations, the Rating Agencies frequently are active players that enter the game early and assist in structuring the transaction. In many instances they require structural changes, dictate some of the required opinions and mandate changes in servicing procedures.

Servicer - the entity that actually deals with the Receivables on a day to day basis, collecting the Receivables and transferring funds to accounts controlled by the Trustees. In most transactions the Originator acts as Servicer.

Backup Servicer - the entity (usually in the business of acting in such capacity, as well as a primary Servicer when the Originator does not fill that function) that takes over the event that something happens to the Servicer. Depending upon the quality of the Originator/Servicer, the need and significance of the Backup Servicer may be important. In some cases the Trustee retains the Backup Servicer to perform certain monitoring functions on a continuing basis.

CREDIT ENHANCEMENT

Credit enhancements are required in every Securitization. The nature and amount depends on the risks of the Securitization as determined by the Rating Agencies, Underwriters/Placement Agents and Investors. They are intended to reduce the risks to the Investors and thereby increase the rating of the Securities and lower the costs to the Originator. Typical forms of credit enhancement are:

1. Over-collateralization - transferring to the Issuer, Receivables in amounts greater than required to pay the Securities if the proceeds of the Receivables were received as anticipated). The amount of over-collateralization (usually 5% to 10%) is determined by the Rating Agencies and the Underwriters/Placement Agents, and this in turn will depend upon the quality of the Receivables, other credit enhancement that may be available, the risk of the structure (such as the possible bankruptcy of the Originator/Servicer), the nature and condition of the industry in which the Receivables are generated, general economic conditions and, in the case of foreign-based Securitizations, the "Sovereign risk" (see discussion below under "Foreign Securitizations"). If all goes well, it is repurchased at the end of the transaction (see the attached Appendix entitled "Anatomy of a Securitization") or returned as part of the residual interest. This form of credit enhancement is required in virtually all Securitizations.

2. Senior/subordinated structure - issuance of subordinated or secondary classes of Securities, which are lower-rated (and bear higher interest rates) and sold to other Investors or held by the Originator. In the event of problems, the higher rated (senior) Securities receive payments prior to the lower rated (subordinated) Securities. It is not uncommon for there to be a number of classes of Securities that are each subordinated to the more highly rated, resulting in a complex "waterfall" of payments of principal and interest. In the common structure described above, senior and subordinated classes of Notes would be paid, in order of priority, prior to classes of Certificates, and Certificates prior to any residual interest in the Issuer, and subordinated Securities may be retained by the Originator and pledged for the benefit of the Trust (and, therefore, the Investors). This form of credit enhancement has become routine, but cannot be used in a grantor trust structure, which is why the owner trust has become most common.

3. Early amortization - if certain negative events occur, all payments from Receivables are applied to the more senior securities until paid. This is very common.

4. Cash collateral account or reserve fund - the Originator deposits funds at closing, or funds are taken from excess spread and deposited until the agreed amount is reached, in an account with Trustee to be used if proceeds from Receivables are not sufficient. Adjustable depending upon events. May be in the form of a demand "loan" by the Originator to the account.

5. Security bond - guarantee (or wrap) of payments due on the Securities. Issued by AAA-rated monoline insurance companies (if available).

6. Liquidity provider - in effect, a guarantee by the Originator (or its parent) or another entity of all or a portion of payments due on the Securities.

7. Letter of credit (for portion of amounts due on Securities) - not used much any more because of costs. These were common in the late 1980's when issued by Japanese banks at low rates.

LEGAL OPINIONS

Legal opinions are very important documents in every Securitization and result in considerable negotiations among counsel for the Originator, Underwriter/Placement Agent and Rating Agencies. The opinions given by the Originator's counsel are the most extensive, frequently running 50 or more pages because of the need for reasoned opinions, as courts have not ruled upon many of the underpinnings of the Securitization structure. In addition to the usual opinions regarding due organization, good standing, corporate power, litigation, etc, others deal with the validity and priority of security interests, true sale vs. secured loan, substantive consolidation in bankruptcy, fraudulent transfer, tax consequences and compliance with securities laws and ERISA. Opinions are also given by counsel for the Trustees and frequently by counsel to the Originator or Underwriter/Placement Agent in regard to tax and securities matters. As indicated above, local counsel opinions may be required as well.

For reasons of structuring and such opinions, in addition to attorneys who are experienced in Securitizations, expertise is required in the areas of securities law, tax law, bankruptcy and the UCC. Expertise is also required in many instances in the substantive laws relating the business of the Originator and the nature of the Receivables.

FOREIGN SECURITIZATIONS

This Securitization structure has presented problems in civil law-based countries, where the concepts of trust law have traditionally not existed. In addition, in many countries there are concerns about government intervention in the international flow of funds and other aspects of Securitizations, the ability of the Servicer and Trustee to enforce the collection of Receivables in a commercially reasonable manner, additional tax burdens, the unpredictable nature of courts and government instability. These are known as the "sovereign risk" and have either completely blocked in-country Securitizations or have resulted in ratings of the Securities no higher than the rating of the country. As a result, many Securitizations, particularly those involving Latin American originated Receivables, have used a structure where the Receivables are transferred to offshore entities ("offshore" may be in the U.S.) and the entire transaction takes place outside the country of origin.

This situation continues to prevail in a number of countries, but many have adopted legislation to permit the limited use of trusts or the creation of special purpose corporations to serve the same purpose. However, even where such legislation has been adopted, sovereign risk issues may prevent a Securitization that is able to take advantage of international money markets, particularly outside of Western Europe. Further, such legislation has often been incomplete or flawed.

Nevertheless, economic and financial market conditions in many countries have provided strong incentives for Originators and the non-US market is growing every year, although the Asian and South American markets are very difficult at this time. Moreover, because of a lack of experienced underwriters, trustees and attorneys in most countries, many such service providers have expanded into Europe and Latin America.

In Latin America, one of the most common asset classes is "future flow" receivables. In this type of Securitization, involving trade receivables of short duration, only a relatively small amount of existing Receivables are transferred to the Issuer and the Investors purchase Securities with a much higher face value based upon the subsequent transfer by the Originator

to the Issuer of a “future flow” of Receivables to be generated by the Originator with the proceeds of the Securitization. In effect, the Originator receives payment for Receivables that do not exist, and will only come into existence through the future conduct of the Originator’s business. Obviously, this can only be accomplished by Originators with strong track records and engaged in businesses with a high likelihood of continuing at profitable levels. In addition, it usually involves foreign Receivables that can readily be transferred and collected offshore.

Appendix A

ANATOMY OF A SECURITIZATION

All terms herein have the same meanings used above in “Securitization of Financial Assets”. It should be noted, however, that while the nomenclature used herein is common, different terms are also used and some terms may be used with different meanings. For example, the “Originator” is often referred to as the “Issuer” or “Seller,” and is in fact deemed to be the “Issuer” by the SEC for registration purposes.

PLAYERS

- Originator -** the owner of the Receivables prior to the Securitization; either the entity that originated the Receivables or that acquired them from originators.
- ISPE -** the intermediate SPE, a wholly owned corporate or limited liability company subsidiary of the Originator, to which the Originator initially sells or contributes the Receivables in a two-step “true sale” transaction, such as described in FAS 140; if U.S. based it is typically formed in the State of Delaware, it must be qualified in the jurisdictions where it will conduct business.
- Issuer -** the SPE, usually a trust (grantor, owner or business), that purchases the Receivables to hold during the Securitization and issues the Securities, directly or indirectly; a pass-through tax entity.
- Trustee -** the entity that acts as Trustee of the Issuer – in a typical owner trust structure, called the “Owner” Trustee.
- Indenture Trustee -** in an owner trust structure, the Trustee appointed under the Indenture created pursuant to the Issuer Trust Agreement.
- Custodian -** the entity that holds the Receivables as agent for the Trustee and, in an owner trust structure, a security interest in the Receivables for the Owner Trustee.
- Servicer -** the entity that services the Receivables on behalf of the Issuer and the Trustee (and Indenture Trustee, if there is one); usually the Originator.
- Backup Servicer -** the entity that assumes the duties of the Servicer in the event that the Servicer is removed or otherwise cannot act; may also provide services on behalf of the Issuer and the Trustee (and Indenture Trustee, if there is one) prior to such assumption. May not be required, depending on strength and past performance of the Servicer.
- Investors -** the ultimate purchasers of the **Offered Securities** (as opposed to the Securities retained by the ISPE and/or Originator as credit enhancement).

- Underwriters/ Placement Agents** - the brokers, investment banks or banks that sell or place the Offered Securities in a private placement or public offering (the Securitization described herein is a private placement).
- Rating Agencies** - Moody's, S&P and Fitch; usually two rate the Offered Securities.
- DTC** - The Depository Trust Company; as the Securities are usually book-entry only (unless certain events occur), the DTC holds global Notes, through its nominee, Cede & Co., and communicates information to and receives payments on behalf of the beneficial owners of the Securities. Not used in private placements.

SUMMARY OF TRANSACTIONS AND DOCUMENTS

Bear in mind that everything happens essentially simultaneously. Most of the principal documents are dated as of the same date, usually the first day of the month in which the Securitization closes. This simplifies references and avoids conflicts with intermediate acts, such as the creation of the Issuer. Documents relating to various elements of the structure are indicated in **bold**. Nomenclature in actual structure and documents may change; terms are those used in typical Securitizations.

1. The Underwriters/Placement Agents and Rating Agencies conduct due diligence of the Originator, the Receivables and the servicing procedures of the Originator. Frequently, counsel to these parties participate. If counsel to the Originator has not represented the Originator to any extensive degree, it may also have to conduct due diligence.
2. The Underwriter/Placement Agent and the Originator (and their counsel) structure the Securitization (in many cases the Rating Agencies will participate).
3. Counsel to the Originator and Underwriters/Placement Agents prepare drafts of the transaction documents. Usually, counsel to the Underwriters/Placement Agents is the primary drafter, and counsel to the Originator reviews and comments, although in some cases counsel to the Originator assumes the primary role. In addition, counsel to the Custodian, Rating Agencies and Backup Servicer usually draft the principal documents to be signed by their clients. It is typical that these documents are worked on right up to the closing, but they should be in essentially final substantive form prior to the issuance of the Preliminary **Private Placement Memorandum** (or **PPM**) or **Offering Circular** (recently, the latter has become the term preferred by the Underwriters/Placement Agents) in a private placement, or a **Prospectus** in a public offering.
4. ISPE is formed. Its **Certificate of Incorporation** and **Bylaws** (or if a limited liability company, its **Certificate of Formation** and **Limited Liability Company Agreement**) are specialized and must contain certain provisions to insure its bankruptcy remote character. Part of this is the appointment of at least one independent director (or member in an LLC) with no relationship to the Originator. There are professional independent directors that are typically retained.
5. The Originator and ISPE enter into **Underwriting** or **Private Placement Agreements** with the Underwriters/Placement Agents, and **Rating Agency Agreements** with the Rating Agencies.

6. Based upon information provided by the Originator and its accountants, and its own due diligence, counsel to Underwriters/Placement Agents or the Originator, as the case may be, with the Underwriters/Placement Agents and the Originator, prepares the Preliminary Private Placement Memorandum or Offering Circular for distribution to potential investors, and in some cases a separate **Term Sheet** is used as well. The final Private Placement Memorandum or Offering Circular, or the Prospectus is issued just prior to the closing.
7. The Issuer is formed pursuant to a **Trust Agreement** or **Pooling and Servicing Agreement** between ISPE and the [Owner] Trustee and, if a business trust, the filing of an appropriate **Certificate of Trust** with the Secretary of State of the state of formation (usually Delaware). The Issuer is given a name, such as “[Originator] [Receivables] Owner Trust 2005-1.”
8. If Notes (see 14, below) are to be sold, an **Indenture** is created between the Issuer and the Indenture Trustee. Pursuant to the Indenture, the Trust will grant a security interest in the Receivables to the Indenture Trustee.
9. The Originator sells the Receivables to ISPE pursuant to a **[Receivables] Purchase Agreement**. The Originator will make comprehensive representations and warranties to and limited repurchase agreements with ISPE and its successors and assigns. However, to insure a true sale, the Originator's only obligations in regard to the Receivables are to repurchase or replace Receivables that do not meet the representations and warranties; it does not warrant the performance of the Receivables or guarantee payment of the Securities. But see the limited right of the Originator/Servicer to repurchase the Receivables, below. Because there is very little judicial authority as to Securitization true sale transactions, the Originator also grants a “backup” security interest in the Receivables to ISPE in the event a court should hold that the transaction is in fact a secured loan.
10. ISPE sells the Receivables to the Issuer pursuant to the **Sale [Transfer] and Servicing Agreement** (or **Pooling and Servicing Agreement**, if creates the trust) among the ISPE, the Issuer, the Servicer and the [Owner] Trustee. The Servicer will agree to service the Receivables pursuant to the Sale [Pooling] and Servicing Agreement and, assuming the Originator is also the Servicer, make representations and warranties as to the Receivables substantially the same as in the [Receivables] Purchase Agreement. In addition, if the Backup Servicer is significant to the transactions, it may also be a party to the Sale and Servicing Agreement, or there may a separate **Back-Up Servicing Agreement**. The ISPE also grants a backup security interest in the Receivables to the Issuer. The Originator/Servicer usually has the right (and is expected) to purchase the remaining Receivables when the face amount remaining is equal to or less than 10% of their original face amount (5% as to some asset classes). The Sale and Servicing Agreement and the Offering Circular are the most complex and important transaction documents. Both describe the Securities and the “waterfall” of payments in detail.
11. Pursuant to the **Custodian Agreement** among the Custodian, the Servicer, ISPE and the Indenture Trustee, the Receivables will be delivered by the Originator, on behalf of ISPE, to the Custodian to hold on behalf of the Indenture Trustee.

12. There will frequently be, if the structure provides for multiple trustees, an **Administration Agreement** between the Servicer or an affiliate, as Administrator, and the Owner Trustee, for the purpose of performing most of the obligations of the Owner Trustee.
13. The Offered Securities will be rated and priced by the Rating Agencies.
14. The Indenture Trustee will issue to the ISPE in partial consideration for the Receivables, pursuant to the Indenture, Notes or several tranches of **Notes**, with different degrees of priority of payment and other attributes. The most subordinated may be retained by the ISPE or the Originator as a credit enhancement. Actually, global Notes (and Certificates as described in the next paragraph) are issued and delivered to DTC to be distributed by DTC to and to hold on behalf of the beneficial owners pursuant to the **Letter of Representations** among DTC, the Issuer, the Owner Trustee and the Indenture Trustee.
15. The Issuer may also issue **Certificates**, representing undivided ownership interests in the Issuer, to the Investors, and the residual interest in the Issuer to the ISPE in payment of the balance of the consideration for the Receivables, all subordinated to the Notes. If a series, the Certificates will also have different degrees of payment and priority, and may also be retained by ISPE or the Originator as a credit enhancement. In some transactions only Certificates are issued, and in that case there is no Indenture or Indenture Trustee and Notes are not issued.
16. The ISPE will sell the Offered Securities (the Notes and Certificates not retained by ISPE or the Originator) to the Underwriters for resale to Investors, or directly to Investors in a private placement by the Placement Agents pursuant to **Note** and **Certificate Purchase Agreements**.
17. Payments on the Receivables will be received by the Servicer and, after the deduction of permitted servicing fees and expenses of the Servicer, paid into a Collection Account controlled by the Indenture Trustee and invested in eligible securities. When payments on the Securities are due, the necessary funds may be paid directly from the Collection Account or be transferred into Note and Certificate Distribution Accounts for such purpose. A Lock Box Account may also be required. These accounts must be created with appropriate depositories, typically with the Owner Trustee. Such payments are distributed in the order of priority pursuant to a "waterfall." Upon the occurrence of specific "trigger" events, such as insufficient funds to pay the primary waterfall, the available funds are distributed pursuant to an alternative waterfall with a different order of priority, designed to first protect the fees and expenses of trustees and other necessary costs to maintain the structure and then the amounts due on the Securities in their order of priority.
18. Other documents:
 - Directors resolutions**, as appropriate.
 - UCC Financing Statements** evidencing the sales and grants of security interests.
 - Opinions** of counsel for the Originator/Servicer and ISPE, the Issuer, the [Owner] Trustee, the Indenture Trustee (if any) and the Backup Servicer (if any), covering,

among other things (depending upon the party), organization, good standing, authorization, non-breach, no litigation, enforceability, true sale, security interests in the Receivables, tax consequences to holders of the Offered Securities, compliance with securities laws and ERISA, accuracy of the Private Placement Memorandum/Offering Circular, non-consolidation, treatment of the Notes and Certificates as debt, etc.

Officer's Certificates as to Articles, Bylaws, incumbency and other matters required by the agreements.

Officer's Certificates to support assumptions in legal opinions.

Various **certifications; designations; receipts as to Receivables and related files, and funds; wiring instructions; authentications of the Notes and Certificates, etc.**

Appendix B

Securitized Loan Structure

This is essentially hypothecation financing, but where the Receivables pledged as security are isolated in an SPE, which in turn becomes the borrower. In its most basic form, the Originator (or multiple, affiliated Originators) transfers the Receivables to its wholly-owned SPE in a “true” sale, and the SPE then uses the Receivables as collateral for a loan from a bank-related lender and participating liquidity banks (the bank itself usually acting as agent for all the lenders). In turn, the lenders may, and usually do, securitize the loan, sell participations to investors, etc. in order to obtain the funds for the loan, but in most cases the Originator is not directly involved in such transactions. The structure of the securitized loan, required legal opinions and the like, however, are dictated by the structure and requirements of the ultimate securitization facility.

The loan can be for a fixed amount, which would be typical for long term Receivables, or on a revolving basis for short term Receivables, with the Originator transferring new Receivables to the SPE-borrower as existing Receivables are paid and the outstanding balance of the loan fluctuating with the amount of the unpaid Receivables owned by the SPE-borrower.

The loan proceeds are used to pay the Originator the purchase price for the Receivables or are distributed to the Originator, depending on whether the Receivables are sold or contributed as capital by the Originator to the SPE-borrower. LLCs are commonly used for SPEs as they facilitate this process. As in a securitization, the Originator typically acts as Servicer, including after the loan itself is securitized by the lender. Among the issues that need to be addressed are the ratio of the loan or revolving advances to the face amount of the Receivables, and other forms of credit enhancement, such as a reserve fund.

The revolving facility structures are typically for terms of one year and renewable annually. They may be amended in the interim or upon renewal to, among other things, adjust the maximum amount of the loan and add other affiliates of the initial Originators as additional Originators.

This is usually a simpler and less-expensive structure than a term or conduit securitization in terms of legal and other structuring fees, but perhaps not in net cost. The front end of the structure is basically identical to the first stage of a term securitization, and thus isolates the receivables for bankruptcy purposes, which is why the funding costs are lower than in traditional warehouse or factoring transactions.