www.ABAlert.com

Asset-Backed ALERT

THE WEEKLY UPDATE ON WORLDWIDE SECURITIZATION

More Banks Rearrange CDO Holdings

Citigroup, **Goldman Sachs**, **Lehman Brothers**, **National Penn** and **Zions Bancorp** have each shuffled around some of their investments in CDOs, in hopes of tempering the impact of losses on those holdings.

www.ABAlert.com

Asset-Backed ALERT

THE WEEKLY UPDATE ON WORLDWIDE SECURITIZATION

SEPTEMBER 19, 2008

THE GRAPEVINE

Treesdale Partners, an opportunistic investment shop led by former **RBS Greenwich** executive **Ron Weibye,** added four members to its staff this week. Three of the recruits came from RBS: mortgage-product traders **Bruce Gehrlein** and **Pat Macolino,** as well as deal-surveillance specialist **Erik Eggers. K.C. Anthony,** meanwhile, arrived from a hedge fund unit of **Citigroup** to head Treesdale's marketing efforts. The recruits report to Weibye, who left his post as RBS' head of non-agency mortgage-bond trading in April. New York-based Treesdale, which formed about three months ago, aims to invest in troubled home loans and mortgage bonds.

Hedge fund manager **D.E. Shaw** continues to recruit for an asset-backed securities investment team it just formed. A couple of weeks ago, the $39 billion firm hired **Richard McKinney,** who formerly headed U.S. securitized products at **Lehman Brothers,** to lead the new unit as a

See GRAPEVINE on Back Page

Stunned Investors Swarming Out of Market

Already-swollen spreads on structured-finance products ballooned even further this week, as the worst financial crisis in a generation grew even deeper.

Trading of asset- and mortgage-backed securities became petrified as investors withdrew from the market en masse, forcing sellers to pump up offered yields as they competed for the attention of the few buyers bold enough to remain active. Asset-backed commercial paper offered no safe haven, as funding costs in that sector shot through the roof due to fears that the credit market still hasn't seen its darkest period.

"Everything is wider, and it's wider offered without a bid," said **David Castillo,** who heads trading of fixed-income products at broker-dealer **Further Lane Securities** in San Francisco. "We're in the middle of history."

The catalysts in the structured-finance shakeup were the same as those roiling

See STUNNED on Page 10

Barclays to Integrate Lehman Mortgage Team

Barclays plans to retain a large chunk of **Lehman Brothers'** U.S. securitization team, instantly positioning the bank to become one of Wall Street's biggest structured-product underwriters.

Word of Barclays' staffing plans follows the London institution's announcement Tuesday that it would buy a large portion of Lehman's banking business for $1.75 billion, which in turn came just two days after Lehman said it would file for Chapter 11 bankruptcy protection.

It's too early to say just how Barclays will combine Lehman's U.S. securitization staff with its own, but the early word from industry headhunters is that the backbone of the team going forward will be a group of mortgage-bond traders from Lehman. That unit had been decimated by widespread layoffs as Lehman struggled under the weight of the ongoing credit-market crisis, but remained one of the largest of its kind in the States.

The business is a key one for Barclays, as the bank has long sought to build on what

See BARCLAYS on Page 12

Goldman, Morgan Stanley Eye Liquidations

Goldman Sachs and **Morgan Stanley** could soon seek to liquidate multi-billion-dollar portfolios of investments tied to troubled mortgages — holdings that are hampering efforts by the institutions to convey a sense of financial strength.

The clock is apparently ticking for both banks to unload the positions, as they face severe liquidity shortages brought on by concerns about their abilities to survive as Wall Street's last two independent investment banks. However, this week's historic financial-market upheaval will likely keep the operations from circulating new bid lists until conditions stabilize a bit.

Even then, Goldman and Morgan Stanley will have to contend with values that have fallen from already-dismal levels in the past few days (see article on this page). Both came clean on their mortgage exposures in earnings calls Tuesday.

Although Morgan Stanley has been selling some mortgage-related investments

See GOLDMAN on Page 14

Citi, Goldman and Lehman pulled the troubled securities out of the portfolios of hedge funds they run, placing them in special components of those vehicles known as side pockets. Meanwhile, National Penn and Zions shifted holdings out of "available-for-sale" investment books that must be marked to market, and into "hold-to-maturity" accounts that don't require such adjustments.

The moves follow a pattern in which an increasing number of financial-industry players have been moving around CDO investments since the credit crunch began last year, many in hopes of minimizing the balance-sheet effects of steep declines in those holdings' values. "We foresee a prolonged period of losses, both for banks and hedge funds, as they employ options, such as side pockets, to, among other things, delay the recognition of certain pending losses," said **Gene Phillips**, a director at CDO-valuation shop **PF2 Securities Evaluations.**

That said, there would be no balance-sheet benefit for a bank that moves CDO holdings from a hedge fund it operates into a side pocket. But such a shift could impact the fees an institution collects for managing the vehicles.

Hedge fund managers set up side pockets as a place to stash illiquid holdings, separating those investments from their main portfolios. The set-aside assets don't generate any fees, but they also don't drag down the returns of the broader fund — allowing the operators to generate more income from performance charges. Investors in the hedge funds, meanwhile, can't retrieve their full contributions until the side-pocket holdings are liquidated or assigned values.

As for banks that move investments from available-for-sale accounts to hold-to-maturity portfolios, those institutions can recognize gains with the initial transfers based on the values they assign to the positions. However, they stand to book losses later when the holdings mature or are sold. The hope among most shops employing the tactic is that the investments' values will recover in the meantime.

Zions recently moved $1.2 billion of CDO holdings into hold-to-maturity pools, while National Penn re-categorized up to $400 million in a similar manner. Those transfers, along with the moves by Citi, Goldman and Lehman, each likely took place since June — before Lehman succumbed to a liquidity shortage and eventually agreed to be bought by **Barclays.**

Securitization professionals said the banks probably won't be the last in the industry to reclassify CDO holdings in an effort to fortify their balance sheets, even if only temporarily. ❖