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THE WEEKLY UPDATE ON WORLDWIDE SECURITIZATION

Holders Steamed Over Lehman CDOs

Investors in 15 CDOs that **Lehman Brothers** issued in 2006 and 2007 are accusing the bank of misdirecting the deals' reserve funds.

The claim is that rather than parking the capital at its intended destination — ultra-safe cash equivalents — Lehman instead used the money to buy mortgage-backed bonds and other less-liquid instruments that fell outside its profile. The result has been heavy paper losses, and noteholders are thinking about suing the bankrupt institution.

At issue are almost $6.9 billion of CDOs that Lehman issued partly or completely as credit-default swaps: Airlie CDO 1; Aviv LCDO 2006-1, 2006-2 and 2006-3; Exum Ridge CBO 2006-1, 2006-2, 2006-3, 2006-4, 2006-5, 2007-1 and 2007-2; and Pebble Creek LCDO 2007-2, 2006-1, 2007-1 and 2007-3. The deals are backed by corporate debt instruments or swaps tied to those products.

Under terms of the transactions, Lehman was also supposed to create reserve funds by directing investor capital into U.S. Treasuries or other high-quality, short-term paper. The idea was to keep that money safe, while generating a small yield that could be used to pay interest to noteholders.

But instead, the bank allegedly set up the reserve funds to funnel cash into its Lehman Brothers ABS Enhanced Libor Fund, which in turn invested in a variety of structured products — about half mortgage bonds. While Lehman's goal was probably to generate added yield at a time when those instruments' performance appeared bulletproof, the move backfired when the debt market tanked last year.

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OCTOBER 24, 2008

THE GRAPEVINE

Kristofer Kraus has left his job as head of CDO banking and trading at **Barclays** in New York. It is unclear when Kraus departed, but industry players surmise that he might have split when the bank agreed to buy the investment-banking and trading arms of bankrupt **Lehman Brothers** last month. Barclays plans to cut an estimated 3,000 staffers as it completes the takeover. The layoffs are likely to come in areas where the companies overlap, including fixed income. Kraus joined Barclays from **Credit Suisse** in May 2005.

Industry players attending **Information Management Network's** annual "ABS East" conference in Hollywood, Fla., this week pegged the number of people in attendance at roughly 600. That would confirm expectations that many of the 1,300 individuals who registered wouldn't show up — and fits in with talk that attendance would be well off last year's

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Card Squeeze Creating Liquidation Buzz

Rising defaults among private-label credit-card accounts are prompting some lenders to think about unwinding securitizations backed by those assets.

Companies rumored to be mulling such moves include clothing retailer **Charming Shoppes** and **Sterling Jewelers,** the operator of the **Kay Jewelers** and **Jared** chains.

At issue is a jump in the number of accounts that retailers are deeming uncollectable. According to **Fitch,** securitized pools of private-label credit cards saw their charge-off rates climb to nearly 9.4% last month, from 8% in March and 6.4% last September.

In some cases, those losses are large enough to make it uneconomical for lenders to continue operating trusts that were used to securitize the cashflows. Now the preferred strategy among those shops appears to be to liquidate the underlying receivables, including defaulted accounts, and use the proceeds to

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ABN Amro's Haley Preparing for Departure

Longtime market player **Bill Haley** is serving his last days as **ABN Amro's** securitization chief.

Haley plans to exit the post at the end of this month, ending a tenure in which he presided over term-securitization underwriting, commercial-paper conduit activities, debt capital markets and private placements in New York.

He hasn't lined up a new job yet, and isn't likely to do so until 2009. But he intends to remain active in the market going forward, perhaps as a senior relationship manager. He would also be interested in a high-ranking position related to the **U.S. Treasury Department's** $700 billion Troubled Asset Relief Program (TARP) — something he sees as an opportunity to "give back" to the battered securitization business.

Haley's departure comes nearly a year after **Royal Bank of Scotland** bought Amsterdam-based ABN's wholesale-banking unit. RBS then began moving in April

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Covered-Bond Players Grind Out Progress

A firmer timeline is developing for banks to start issuing covered bonds in the U.S.

As Europe's better-established market for covered bonds went into a slump last month, industry players began to question earlier predictions that U.S. activity would kick in by yearend. They've since reached a consensus: Don't expect issuers in the States to float any of the mortgage-related debt issues until the first quarter of 2009, if not later.

But work on the deals continues to progress, as banks seek an alternative to issuing traditional mortgage-backed securities amid doubts about whether that market will ever revive. For example, **SIFMA** is putting together a U.S. covered-bond council whose mission would include bringing together investors, issuers, dealers and other players to figure out how the sector should take shape. It expects the group to form within the next six weeks, encompassing an existing

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Indeed, sources familiar with the transactions say that liquidating the reserve funds would lead to substantial losses. **Gene Phillips,** a director at CDO-valuation shop **PF2 Securities Evaluations,** noted that the reserve funds were reported to have lost an estimated 20% of their value.

In the worst case, for fully funded deals, that could be enough to wipe out the double-A-rated tranches of the issues even if the rest of the collateral performed perfectly. It is unclear whether the losses would be due to mark-to-market adjustments or realized losses among the underlying bonds.

It could be a while before there are any answers. While the transactions each experienced events of default after Lehman filed for Chapter 11 bankruptcy on Sept. 15, the bank isn't likely to liquidate them. That's because the institution holds the most-senior pieces of most of the issues, and therefore has final say over whether or not to unwind them. It has already said it wouldn't liquidate the reserve funds.

Still, bondholders are feeling the consequences of Lehman's gamble. The lowest tranches of the deals have already stopped receiving payments, due to diminished cashflows from the GICs. Recoveries may be difficult as well, given Lehman's bankrupt status and expectations that other parties will seek claims against the company — some involving other CDOs and swaps. ❖

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