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A BRIEF INTRODUCTION TO STRUCTURED INVESTMENT VEHICLES

Structured Investment Vehicles, or "SIVs", are market value based companies that incorporate many of the characteristics of traditional asset-backed vehicles, but at the same time have much of the flexibility of operating companies.

SIVs typically purchase highly rated medium and long-term assets and fund the purchase of such assets through the issuance of highly rated commercial paper and medium-term notes (the "Senior Notes") and one or more classes of subordinated notes (the "Capital Notes"), in order to generate a spread between the yield on the SIV's portfolio and its cost of funds.

As contrasted with collateral debt obligations ("CDOs"), SIVs have no preset investment period and can generally continue to issue Senior Notes and Capital Notes (collectively, the "Notes") and to acquire assets, effectively for an indefinite period of time. In addition, the program documentation for SIVs generally allows for considerable flexibility (subject to rating agency approval) to (i) issue multiple series of Capital Notes and to introduce additional types of Senior Notes, such as extendible notes, (ii) increase the total outstandings, (iii) change the SIV's eligibility criteria and portfolio parameters, and (iv) engage in other activities not expressly contemplated by the program documents on the original closing date.

As a result of the flexible nature of the SIV structures, SIVs have proven to be highly resilient during periods of market volatility.

PURPOSE

A Sponsor's principal motivations for establishing SIVs are the creation of a net spread to provide stable returns to the holders of the Capital Notes and the creation of management fee income. In addition, certain sponsors are motivated to provide attractive investment opportunities to their customers through the issuance of Capital Notes utilizing an off-balance sheet vehicle.

STRUCTURE

SIVs are established as bankruptcy remote limited-purpose vehicles in jurisdictions, such as the Cayman Islands and Jersey, that afford beneficial tax treatment. The majority of SIVs issue the Senior Notes in both the U.S. and Euro markets in order to take advantage of pricing differences in these markets so as to reduce the SIV's cost of funds.

A United States wholly owned subsidiary of the SIV is routinely established to co-issue the Senior Notes in the U.S. market. A U.S. co-issuer is utilized in order to permit purchases of Senior Notes by those investors who are limited to purchasing U.S. securities. In certain transactions, the U.S. subsidiary directly issues the U.S. Senior Notes, the repayment of which is guaranteed by the SIV.

The SIV appoints a manager (the "Manager"), an entity that is typically the sponsor or an affiliate of the sponsor, pursuant to a management agreement (the "Management Agreement"). The Manager provides investment advice and funding and operational support to the SIV and establishes the monitoring systems of the SIV. In a number of SIV transactions, the management functions are divided among multiple entities. The Management Agreement and the compliance manual, which is prepared by the Manager (the "Compliance Manual"), sets forth the portfolio parameters, compliance tests, operating restrictions and reporting requirements for the SIV, as well as the back-up and disaster recovery arrangements that are required to be maintained. Although the offering materials utilized for the offer and sale of the SIV's Notes will describe in varying detail certain of the information set forth in the Compliance Manual and the simulation models used to ascertain a SIV's compliance with the compliance tests described below, such materials are proprietary in nature, and typically only the SIV, the Manager and the rating agencies have access to such materials. Generally, the Compliance Manual and the simulation models can be amended periodically without the consent of the holders of the Notes upon consultation with the rating agencies.

The flexibility inherent in the SIV structure is in part due to the latitude the Manager of a SIV has with respect to the operation and modification of the SIV. The Manager has considerable discretion to determine the composition of the assets which comprise the SIV's portfolio, to dispose of assets and to conduct the operations of the SIV. The Manager can also, subject to confirmation from the rating agencies, modify the portfolio parameters and simulation models on behalf of the SIV to reflect changes in market conditions as well as technological innovations. For these reasons, the capabilities, experience and resources of the Manager are of critical importance to the ratings of the SIV.

Traditionally, SIVs were documented utilizing a U.K. trust structure pursuant to which the core program documents were governed by English law and a charge in the SIV's portfolio is granted to a U.K. "Security Trustee" for the benefit of the holders of the Notes and the other secured parties pursuant to a security trust deed. The core documents of the majority of the more recent SIV transactions are governed by U.S. law and the portfolio of the SIV pledged to a U.S. "Collateral Agent" for the benefit of the holders of the Notes and the other secured parties pursuant to a U.S. law governed security agreement. The structure selected will affect the manner in which the SIV's portfolio is liquidated and the roles certain relevant parties to the program documents will play in such liquidation.

ASSET PORTFOLIO

Generally, the portfolio of the SIV is marked to market on a daily basis by the Manager in accordance with a pricing methodology which has been reviewed by the rating agencies and set forth in the Compliance Manual. The central issue to the rating agencies' rating approach in respect of SIV transactions is to ascertain whether, following the wind-down of the SIV, the Senior Notes will retain their rating levels until the last Senior Note has been repaid in full.

The individual asset criteria for each asset in the SIV's portfolio are set forth in the SIV's Management Agreement and/or Compliance Manual and, among other things, typically require that the assets predominantly have an investment grade rating on the date of purchase by the SIV. However, the portfolio of one of the more recent SIV transactions in the market is comprised of a diversified portfolio of primarily non-investment grade senior bank loans.

SIVs are also subject to a variety of portfolio parameters agreed upon with the rating agencies. While the portfolio parameters and individual eligibility criteria for each SIV program vary, these limits generally seek to ensure that the credit quality, diversity and liquidity of the SIV's portfolio are sufficient to support the ratings of the Senior Notes. Typically, the breach of the SIV's portfolio parameter either will impact the "Capital Adequacy Test" described below or will result in the SIV entering into a more restrictive operating mode with the severity of the impact being dictated by the nature and extent of the breach. As more fully described below, depending upon the severity of the breach, the SIV could be required to wind-down.

The SIV will also be required to hedge its currency and interest rate exposure within very stringent parameters. Since the counterparties to such hedging arrangements are not supporting the ratings of the SIV's Notes, such counterparties are only required to have an investment grade rating. However, the exposure to each such counterparty is treated as an asset for purposes of the Capital Adequacy Test.

COMPLIANCE TESTS

On each business day, the Manager will perform in accordance with the SIV's investment guidelines and operating parameters, a series of financial tests to determine the SIV's exposure to liquidity, interest rate, market and leverage risks. These tests (the "Compliance Tests") customarily consist of the following:

- Capital Adequacy Test. The Manager will conduct a test to determine if the market value of the SIV's portfolio reduced by capital charges in respect of the assets of the portfolio is sufficient to cover the payments required to be made on the Senior Notes and other senior liabilities of the SIV. Certain older SIV transactions utilized a matrix approach to ascertain the capital charges of the SIV's portfolio, where each asset in the portfolio was subject to a predetermined "hair cut". The more recent SIVs utilize a fully modeled simulation approach of asset, hedge counterparty, credit and market value risk.

- Liquidity Adequacy Test. In order to manage and reduce the risk relating to funding longer-term assets with short or medium-term liabilities, the Manager will monitor the SIV's forward schedule of payments and anticipated receipts on each business day and perform various tests on these schedules. Although the specifics vary among the SIV transactions in the market, typically the "Liquidity Adequacy Test" will require that the SIV has liquidity in the form of eligible liquidity backstops and/or highly liquid assets sufficient to cover the worst 1, 5, 10 and 15 day cumulative net outflows. Generally this test requires that the SIV maintain liquidity backstops in an amount equal to between 5% and 10% of the outstanding principal amount of the Senior Notes and other senior indebtedness of the SIV.

- Interest Rate F/X Sensitivity Test. The Manager must also monitor the SIV's total portfolio with respect to changes in interest rates and foreign exchange rates. The Manager runs a test, on a daily basis, to determine if the resulting changes in the value of the SIV's portfolio are within the predetermined parameters.

- Leverage Compliance Test. The Manager will also typically run a test to determine if the capital of the SIV is leveraged within pre-established limits.

Many SIVs have differing thresholds for each Compliance Test in order to measure the severity of the noncompliance, and depending upon the severity of such non-compliance, the SIV could be required to limit its operations or to wind-down.

MODES OF OPERATION

The Management Agreement and the Compliance Manual will often describe a number of operating modes for the SIV which are triggered by certain events. The nature and severity of the triggers, as well as the number of operating modes, vary among SIV transactions. Generally, these triggers include non-compliance with Compliance Tests, ratings downgrades, and breaches of certain of the SIV's portfolio parameters.

The more recently established SIV transactions in the market is to have multiple modes of operation, such as a "Normal Operations Mode", a "Limited Operations Mode", a "Defeasance Mode" and an "Enforcement Mode", so as to establish multi-level early warning systems giving the Manager ample time to return the SIV to full compliance.

As its name implies, a SIV is in "Normal Operations Mode" when it is in compliance with the portfolio parameters and Compliance Test and no trigger event has occurred. When the SIV is in Normal Operations Mode, it can purchase assets in accordance with its investment guidelines and issue Notes up to the maximum outstanding amount.

The Limited Operations Mode is, in effect, an early warning for the Manager to bring the SIV back to Normal Operations Mode. Usually, when a SIV enters into the Limited Operations Mode, it is only permitted to issue Senior Notes for the purpose of refinancing its existing liabilities and is not permitted to purchase any additional assets (other than cash equivalents), unless such purchase would assist in bringing the portfolio back into the Normal Operations Mode. The Manager will focus on bringing the SIV back into the Normal Operations Mode usually by de-leveraging the portfolio, reducing the risk of the portfolio and/or attracting additional investors in Capital Notes.

The Defeasance Mode will trigger the orderly liquidation of the portfolio by the Manager, but will not trigger the enforcement of the security interest in the portfolio by the Security Trustee or Collateral Agent. As a result, it is still possible for the SIV to return to the Normal Operations Mode.

If the SIV enters the Enforcement Mode, it can not return to the Normal Operations Mode and the Collateral Agent or the Security Trustee will enforce the holders of the Notes and the other secured parties' security interest by liquidating the portfolio in accordance with the SIV's established "enforcement guidelines". The SIV's enforcement guidelines will reflect the assumptions upon which its capital model has been based. For instance, the capital model for certain SIVs assumes that all Senior Notes and other senior liabilities will be paid in full within one year after the commencement of the Enforcement Mode while the capital model for other SIVs assumes that assets in the SIV's portfolio will be sold only as the liabilities of the SIV come due.

DEVELOPMENTS

Since the first SIV transaction was established in 1988, SIV structures have evolved substantially. Early SIVs utilized a static matrix or "hair cut" approach to determine if the capital cushion that protects the holders of the Senior Notes was sufficient to maintain the ratings of such Notes. All of the more recently established SIVs use some form of dynamic simulation model based on risk factors that affect the SIV's performance, such as the tenor of the Senior Notes, the derivatives exposure, the asset maturity, liquidity, the ratings of the assets and the exposure of the portfolio to obligor, geographic industry and other concentration limits. The current state-of-the-art approach is to utilize a "Monte Carlo" simulation approach. Moody's has developed a capital model for application to SIVs based upon the Monte Carlo simulation, a description of which is available on its web site.

SIVs have also added additional modes of operation so as to mitigate the possibility that the SIV will enter into the Enforcement Mode, and have increased the number of series of Capital Notes (standard, mezzanine and enhanced Capital Notes) and the types of Senior Notes (extendible commercial paper) being issued. The permitted activities of the SIVs have also broadened greatly to include securities lending activities and the selling of credit default swaps.

The portfolios of SIVs have also expanded well beyond the traditional portfolios of investment grade debt securities. Seward & Kissel has acted as transaction counsel for a number of very innovative SIV transactions, including transactions in which the SIV portfolios are predominantly composed of non-investment grade senior bank loans.

The program documents for certain of the more recent SIVs have incorporated the ability of the manager to allocate the assets of the SIV into multiple separate portfolios on its books and records. This structural innovation is designed to permit one or more additional investment managers to be appointed to effectively manage separate investment portfolios within the SIV.

In addition, 2006 has seen the emergence of a new variation of the traditional SIV structures, referred to by the industry as "SIV lites", which utilize significantly higher equity leverage and have portfolios comprised of assets with higher spreads than traditional SIVs.

As the portfolios of SIVs and CDOs increasingly overlap, CDOs with market value structures and commercial paper tranches become more prevalent, the line between SIVs and CDOs is becoming increasingly blurred. The past year has seen an unprecedented number of SIV transactions hit the market place, and from all indications, 2007 promises to be another exceptional year, both in terms of new issuances and innovations adopted by new programs.

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