

Innovation Series
GLOBAL CORPORATE TRUST

Three's Not a Crowd

Why the third party is the key to achieving greater efficiency in whole loan tri-party transactions



THE BANK OF NEW YORK MELLON.



Experienced trustees and custodians are reevaluating the entire tri-party reverse repo life cycle. How will their changing perspective affect originators, issuers, and investors?

As a low-risk, high-yield, and extremely liquid investment vehicle, tri-party repo is a well-established business, embraced in the U.S. for more than 20 years and in Europe for more than 10 years.

During the past decade, the tri-party repo market experienced tremendous growth, both in the United States and Europe. The Federal Reserve Bank estimates approximately 40% of overnight repo in the U.S. is conducted via tri-party, while the European Repo Council (ERC) estimates that approximately 11% of repos outstanding in December 2005 were settled via tri-party. In 2006, the European repo market grew 14%, according to the International Capital Market Association's 12th semiannual survey. The survey yielded results from 74 offices from 66 financial groups in 15 European countries, North America, and Japan.

Over the years, third-party custodial service providers have helped to facilitate growth of the whole-loan tri-party marketplace.

Mortgage Whole Loans

Individual mortgage loans, also known as mortgage whole loans, represent an asset type used as collateral in a repo transaction. These whole loans typically are purchased by investment banks or other financial intermediaries after origination and held until a loan securitization package can be created. In the interim, the loans are used as collateral to secure cash financing through warehouse lending arrangements, commercial paper issuance, or a bilateral or tri-party repurchase agreement, in which the seller agrees to sell and then repurchase the loans at an agreed-upon price and time.

In a generic tri-party repo transaction, a custodian bank acts as a third-party service provider to the two principals in the trade, ensuring that each party receives cash or securities for the transaction. The custodian maintains cash and securities accounts for both parties, verifies collateral eligibility, establishes the mark to market value of securities pledged as collateral, processes income, and provides daily reporting to both parties.

Over the years, third-party custodial service providers have helped to facilitate growth in the whole-loan tri-party marketplace by providing transactions that:

OFFER A SOLUTION FOR THE PERPETUAL DILEMMA OF WHERE TO
ALLOCATE SHORT-TERM CASH

PRESENT A WAY TO OPTIMIZE LARGE INFLUXES OF CASH WITHOUT A
LONG-TERM COMMITMENT

DO NOT REQUIRE INVESTORS TO INCUR ANY SPECIAL INFRASTRUCTURE OR
TRANSACTIONAL COSTS

Role of the Third-Party Service Provider

When a whole loan is originated, there is a long list of third-party services that may be required to support a custodial file as it moves from origination to securitization. These services generally fall into the following areas:

Document Custodian - Review, certification, document custody, and reporting

Collateral Agent - Asset control, allocation, and reporting

Trustee (post-securitization) - Trustee, paying agent, analytics, and master servicer reporting

Document Custodian

When a whole loan is originated, a document custodian is typically charged with holding a physical collateral file that contains the mortgage note, the mortgage itself, the title policy, the deed of trust (depending on the state of origination), the assignment form, as well as insurance and other documents. The document custodian is charged with safekeeping, document review, borrowing base calculations, and reporting.

Each time the loan is sold prior to a final securitization, the documents may be transferred between document custodians, which may include a custodian for a warehouse lending agent, a commercial paper conduit, or a warehouse lending bank. Therefore, these documents may change hands dozens of times before securitization.

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At each step, the custodian must review and certify the documents in the collateral file. The need for continual shipping, reshipping, and re-review of the file creates a greater risk for loss of documentation, as well as delays in the process.

The best way to mitigate this risk is to serve clients as overall custodian for each issue, ideally holding the collateral file from loan origination and repurchase investment to securitization and possibly beyond. That would allow for one file review, one asset certification, in addition to one custodian holding the collateral file through each change of loan ownership. Each subsequent purchaser would benefit from timing efficiency and cost savings as a result of reduced administrative handling.

The Bank of New York Mellon is able to achieve multiple, state-of-the-art efficiencies through its document custody service centers. Operated by the Bank's affiliate, The Bank of New York Trust Company, N.A., the document custody centers service mortgage loan files, beginning in the warehousing phase of a transaction through to post-securitization, from its centers in New York, Texas, and California; as well as international locations in Europe and Asia-Pacific.

These document custody centers are capable of managing in excess of five million mortgage files under various warehousing and custody arrangements—from the warehousing phase of a transaction to post-securitization. Staff members perform a variety of functions that include document and portfolio reviews, certification, reporting and analytics, and more.



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Collateral Agent

The collateral agent is the custodian between the buyer and seller of a repurchase agreement, maintaining cash and securities accounts for both parties, verifying collateral eligibility, and providing daily reporting to both parties.

Efficiency requires a sophisticated collateral management platform that supports complex collateral selection criteria and optimizes results for both counterparties. The Bank of New York Mellon's underlying infrastructure, for example, is based on a proprietary collateral management system designed to efficiently handle all asset types denominated in any currency, and targeted toward a global client base. It can process a wide array of transaction types, including tri-party repurchase agreements (for equities, fixed income, and whole loans), portfolio swaps, collateralized loans, swap collateralization deals, and more.

This collateral management system offers significant benefits to tri-party participants, replacing the traditional, manually intensive method of confirming tri-party transactions via phone or fax.

For dealers and originators, the interface provides the detail needed to create multiple pools of collateral across multiple asset types. For investors, the interface provides a platform for matching trades and monitoring activity via the Internet.

Tri-party Collateral Management: Summary of Benefits

Global coverage on an integrated platform—cost efficient, real-time, fails-free 24/5 securities settlement.

Eliminates Unsecured Daylight exposure and Income risk.

Sophisticated collateral selection: enforce diversification and credit quality; control adequacy, volatility, and liquidity.

Cutting-edge infrastructure: economies-of-scale facilitate extensive data warehousing, access to more asset classes and markets, auto-substitution, auto-allocation and optimization technology, same-day reporting.

Introduction to new counterparts: A “Global Collateral Clearing House.”

Enables INVESTORS to outsource collateral operations, control risks better, access new business opportunities, and maximize risk-adjusted returns.

Enables DEALERS to convert fixed into variable cost, finance more diverse inventory across product/geographic silos, optimize usage, continue to trade collateral beyond local market cut-off times and leverage operational efficiencies conferred by a centrally settled pool of collateral.



The Bank of New York Mellon's service platform and product suite offer a single source for all trustee needs.

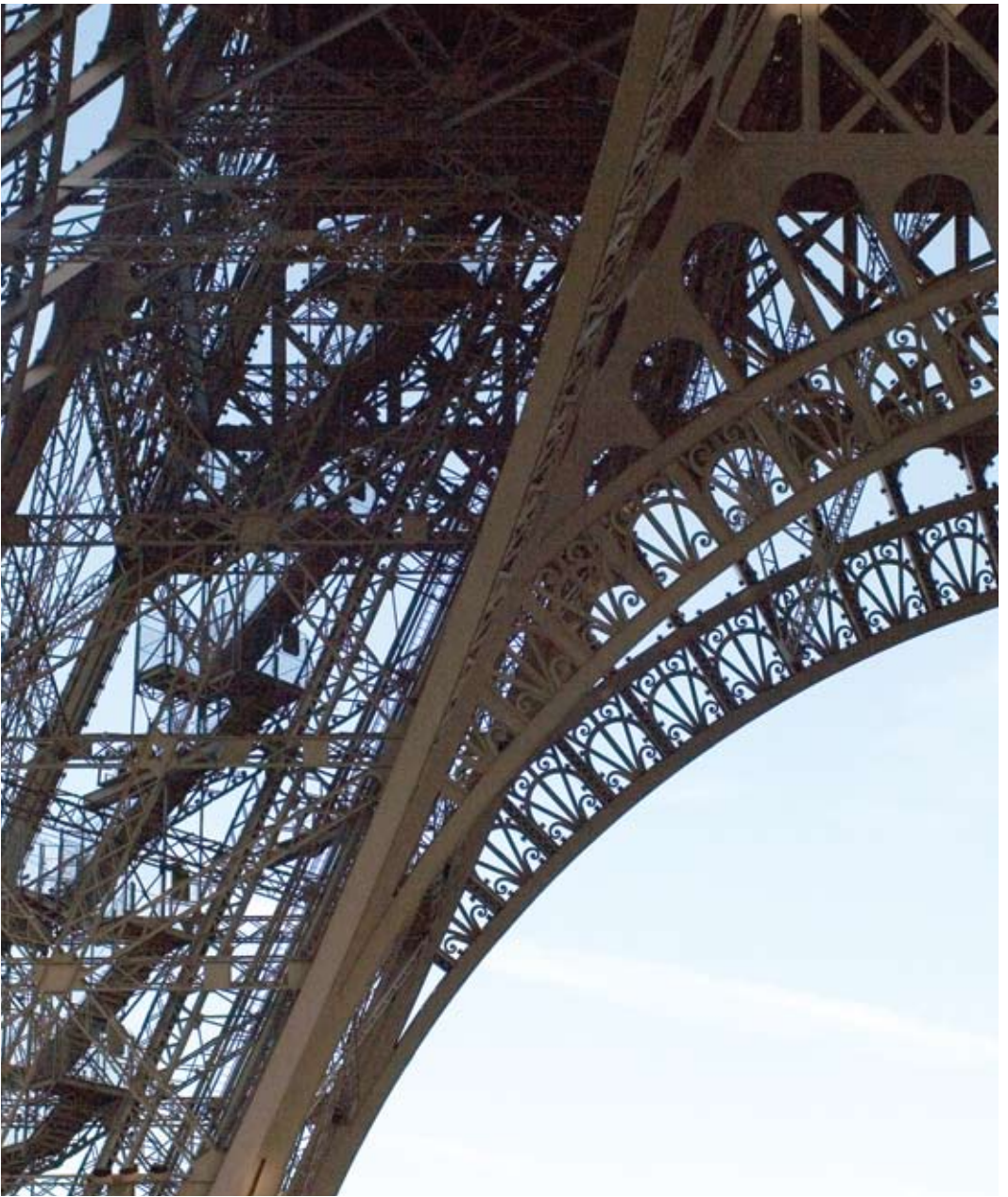
Trustee Role

For many issuers, and for many types of debt, a trust indenture mandates the appointment of a trustee to provide a central point of contact and serve as the noteholder's representative. Divergent legal environments influence the role of the trustee and the extent of any administrative duties undertaken; however, the core administrative services remain largely the same.

In today's demanding, complex, and competitive capital markets, issuers can be faced with selecting a trustee that has only a limited understanding of a trustee's duties, the services provided, and knowledge of how a trustee can add value. Choosing the right trustee could influence an issue's rating as well as its potential performance in the secondary market. In addition, the diversity of structures, governing laws, and differing expectations require a trustee to be flexible and innovative in approach to each transaction.

At The Bank of New York Mellon, our service platform and product suite offer a single source for all trustee needs. Service delivery is supported by highly focused teams in Europe, the Americas, and Asia-Pacific, ensuring a high level of familiarity and understanding of each market's needs.

This fully integrated global business structure brings teams together to capitalize on available resources, and enables inclusive administration and smooth management of multifaceted and multijurisdictional transactions. The ability to operate as trustee under a number of local and international laws, as well as through our network of offices, partnerships, and affiliates around the globe, allows us to manage even the most sophisticated cross-border transactions.



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Evolution of Tri-Party Market

Current trends point to further and rapid expansion of the tri-party marketplace, including globalization of securities markets, consolidation of financial intermediaries, transition of tri-party arrangements to electronic trading and tracking platforms, and matrixing of the tri-party method onto other consumer loan products.

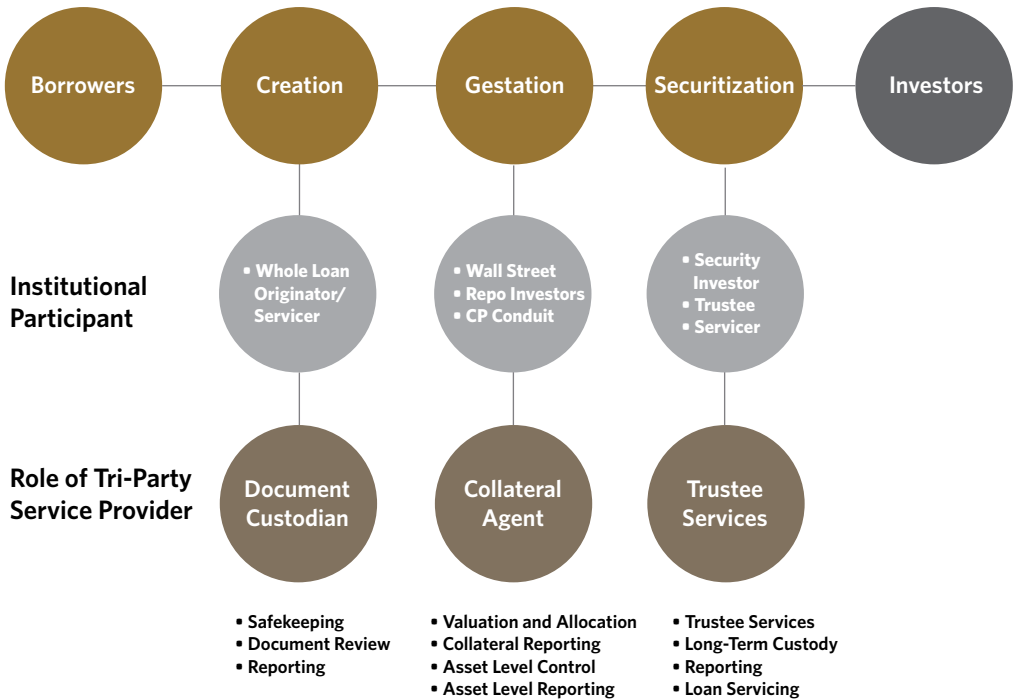
As tri-party repurchase arrangement volume continues to grow, spreading worldwide and into other consumer debt products, the delivery of tri-party services must be streamlined to meet rising demand.

Today, The Bank of New York Mellon handles more than \$1.3 trillion daily in tri-party balances, with whole loans representing one of the fastest growing segments. As such, the Bank is continually engaged in studying and streamlining the entire whole loan tri-party transaction process across its life cycle, from origination and interim funding to securitization and beyond.

Expansion of our document custody centers, build-out of our collateral management platform to support complex collateral selection criteria, and worldwide standardization of our trustee platform and product suite are the first steps toward providing clients with greater and greater efficiency, cost savings, and transparency throughout each transaction's life cycle. Greater efficiency throughout the tri-party repo process should translate into savings for the originator, which in turn should provide borrowers with lower interest rates on future loans.

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Whole Loan Tri-Party: Asset Life Cycle.





Harold Fudali is the head of the Collateral and Trust Services team of our Global Structured Finance Services unit. He leads a team of professionals spanning both broker-dealer services and global corporate trust in developing and providing world-class services related to non-securities assets held for entities both in the U.S. and internationally. His primary area of focus relates to the Tri-Party Repo product offering, working to enhance our mortgage-related products on both the loan-level and trust-receipt level, and to enhance and develop current systems and processes to handle mortgage whole loans and other assets globally.

Prior to joining The Bank of New York Mellon, Harold worked for JPMorgan Chase and its heritage firms for more than 19 years, where he held a variety of management roles spanning broker-dealer services, escrow, collateral management, and structured finance. His work and experience in these markets have established him as a seasoned industry veteran and well-known and respected subject matter expert in his field.

This article first appeared in *Euromoney's 2007/2008 Structured Credit Products Handbook*.

The author wishes to thank Patrick Tadie, Executive Vice President, Head of Global Structured Finance and James Malgieri, Executive Vice President, Global Collateral Management, The Bank of New York Mellon, for their contributions to this article.

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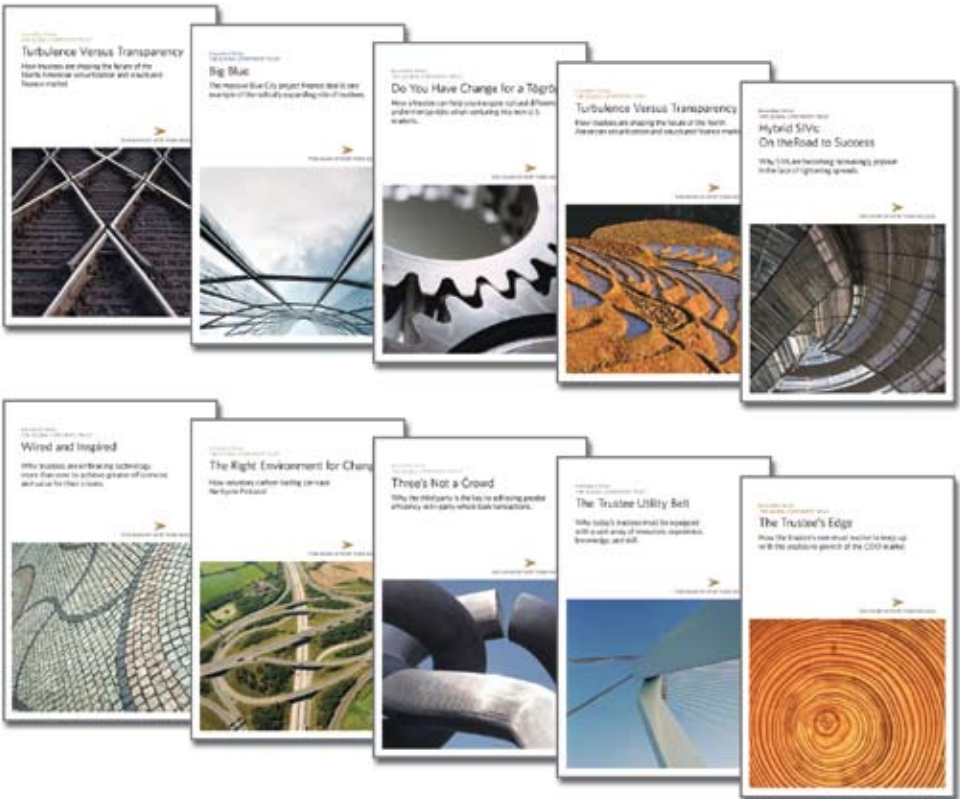
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Come see the future
of Global Corporate Trust.

Innovation Series

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Who's Helping You?



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Tri-party repo has experienced rapid growth in the past decade and will continue to grow rapidly. Mortgage whole loans are used as collateral to secure financing in repo transactions. In this edition of the Global Corporate Trust Innovation Series, you'll learn how The Bank of New York Mellon can perform three different roles in a tri-party transaction, and excel in all of them.

Who's Helping You?



By Harold Fudali



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