

Innovation Series
GLOBAL CORPORATE TRUST

Hybrid SIVs: On the Road to Success

Why SIVs are becoming increasingly popular
in the face of tightening spreads



THE BANK OF NEW YORK MELLON.



As spreads tighten, managers of Structured Investment Vehicles (SIVs) face increasing challenges to provide the returns that led to the initial growth of the structured finance sector. An experienced administrator can simplify managers' current challenges.



A SIV is a bankruptcy-remote, market neutral, limited-purpose investment company typically domiciled in a tax neutral jurisdiction. It employs arbitrage to secure a spread between assets and liabilities, while generating fee income for the investment manager. SIVs fund the purchase of investment grade fixed-income assets through the issuance of commercial paper (CP) and medium-term notes (MTN). As such, SIVs may also provide access to the CP and MTN markets for asset managers, such as hedge funds, who traditionally have not had access to these instruments.

As open-ended vehicles, SIVs have features of ongoing operating companies, such as the ability to continually issue senior debt and capital, and they manage assets more actively than other structured finance vehicles, like ABCP programs and CDOs. SIVs are required to run capital models and cash outflow tests, while marking assets daily.

This entails active management of credit, liquidity, interest rate, and currency risk in order to obtain the highest ratings possible for the senior debt. During the past year or so, a version of SIV has been developed that is life-limited, without the features of an operating company and the dynamic leveraging of classic SIVs. These new vehicles, known as SIV-lites, have a defined maturity date for their portfolio and static capital structures.

Douglas Magnolia, a managing director and business manager of The Bank's QSR Management Group, has been providing consulting and administrative services to the SIV sector since 1996 and is in a unique position to comment on developments in this sector. "Even in the face of continued spread compression, new sponsors are coming to market using innovative structures like the new hybrid SIV-lites that first appeared in late 2005," said Mr. Magnolia. "SIV-lites are currently in vogue, combining features of a market value CDO with a full-blown SIV, allowing faster execution, greater flexibility on the asset and liability side of the balance sheet, but with shorter duration."

New Sponsors Face Complex Process

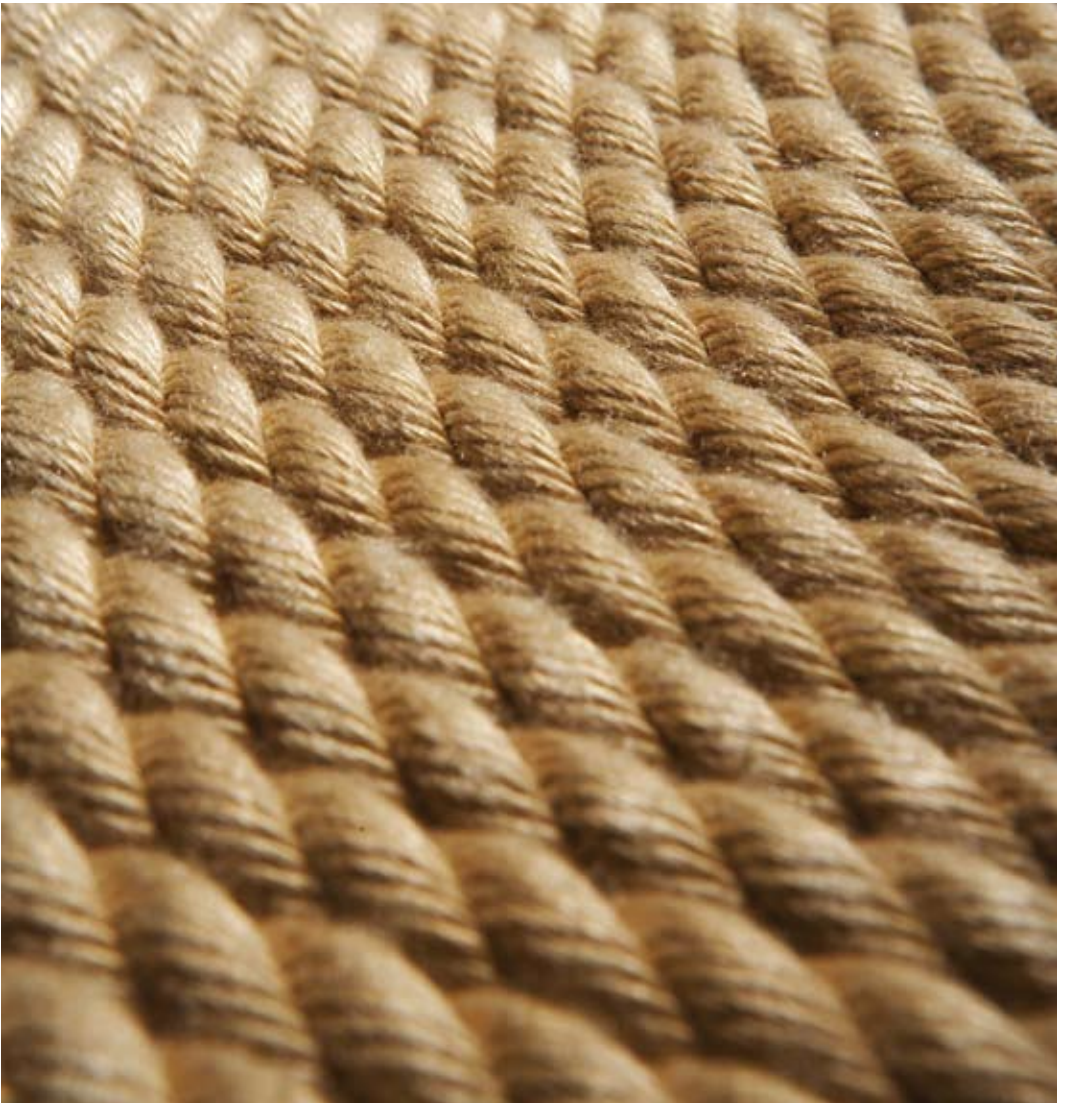
Bringing a new SIV to market can pose a complex operational and scheduling challenge. Sponsors, issuers, and their advisors must focus on many imperatives through the early phases of establishing a new vehicle. As part of the Bank's Global Corporate Trust Division, QSR Management offers potential sponsors a comprehensive suite of services, working to accelerate a market launch by providing critical intellectual property, support throughout the structuring and development phase, and a complete back- and middle-office infrastructure for the ongoing operation of the entity. QSR is also distinguished by its ability to provide treasury services on behalf of its fund clients: interfacing with dealers, placement agents, and counterparties regarding debt execution, hedging, and short-term cash management.

From launch, SIVs are subject to stringent reporting requirements as well as rating agency examination. It is important for sponsors to come to market with a proven team of program participants. QSR's history as the only dedicated third-party provider of comprehensive management services to SIVs has paralleled the growth and development of the sector, and its expertise has rating agency, investor, and regulator acceptance. QSR is particularly proven in the SIV space, where the respected SMQ rating applied by Moody's Investors Service to rate SIV managers recognizes those independent managers that use QSR services and applies credit for such services in the many key areas that exclude credit and asset management.

Spreads Tighten

The development of new SIVs and growth in the traditional SIV market notwithstanding, spreads have tightened dramatically since 2003. Investment managers have been under increased pressure to maintain returns to capital holders. Their focus has sharpened not only on management's investment strategy but also on efficiencies in the vehicle's administration. Mr. Magnolia noted, "As spreads continue to tighten, target investor returns become more difficult to meet, let alone surpass. One area this brings in focus is operations and infrastructure, as this can be quite a significant cost to the structure."

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Extensive Demands On Management

SIVs demand huge investments in staff with trading, credit, liability, analytical, structuring, legal, hedging, and cash flow modeling capabilities, plus technology and operational logistics. While QSR's proprietary risk management and reporting system, EnSIS[®], was originally developed for SIV rating agency risk management and reporting requirements, it has since evolved to provide an invaluable tool for the management of other structured finance vehicles as well, including conduits, SIV-lites, and other hybrids. The functionality of EnSIS[®] covers the ability to conduct hypothetical trade scenarios for the purposes of threshold and rating agency testing, portfolio criteria testing, capital usage calculators using matrix models or extracts from simulation models, sensitivity reporting, cash book and payment instruction management, reconciliations, trade blotter, pricing, funding management, reference data, and a comprehensive reporting suite. The system is available to QSR's clients over the Internet, enabling them to access real-time reporting and analytics.

The Bank of New York Mellon acts as trustee, issuing, and paying agent for QSR Management's SIV clients and provides industry-leading, comprehensive custody services. By streamlining a large number of the critical components necessary to launch and run a SIV, the Bank allows its clients to focus on their core competencies of managing assets and structuring investments. QSR's experience and focus allows its clients to concentrate on their core competencies and deploy resources effectively to meet changing market developments, while leveraging the QSR's leading-edge platform. SIVs, in particular, are dynamic entities that can adapt to changing spread environments, introductions of new asset classes, and perhaps new regulatory regimes, so it is imperative for a sponsor to stay on top of developments and hopefully ahead of the curve.

QSR and the other structured finance units of The Bank of New York Mellon work together to provide potential and existing sponsors with a customized suite of services to meet all the needs of a SIV without conflict on the underwriting or sell side of a deal. This is a unique and uniquely valuable proposition in the current intensifying expansion of this sector of structured finance.

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Douglas Magnolia has 20 years of experience in the capital markets industry and is currently responsible for heading the Structured Investment Vehicle and Conduits business within the Global Corporate Trust Division's Structured Finance Unit. Douglas has been involved with the Structured Investment Vehicle business since the beginning of 2001. Prior to that, he managed a number of different business lines for The Bank of New York Mellon. Previously, Douglas worked at IBJ, where he managed several business lines including Auction Rate Securities, Tender Option Bonds, Secondary Distressed Loans, and Commercial Paper, concentrating on new products and business development.

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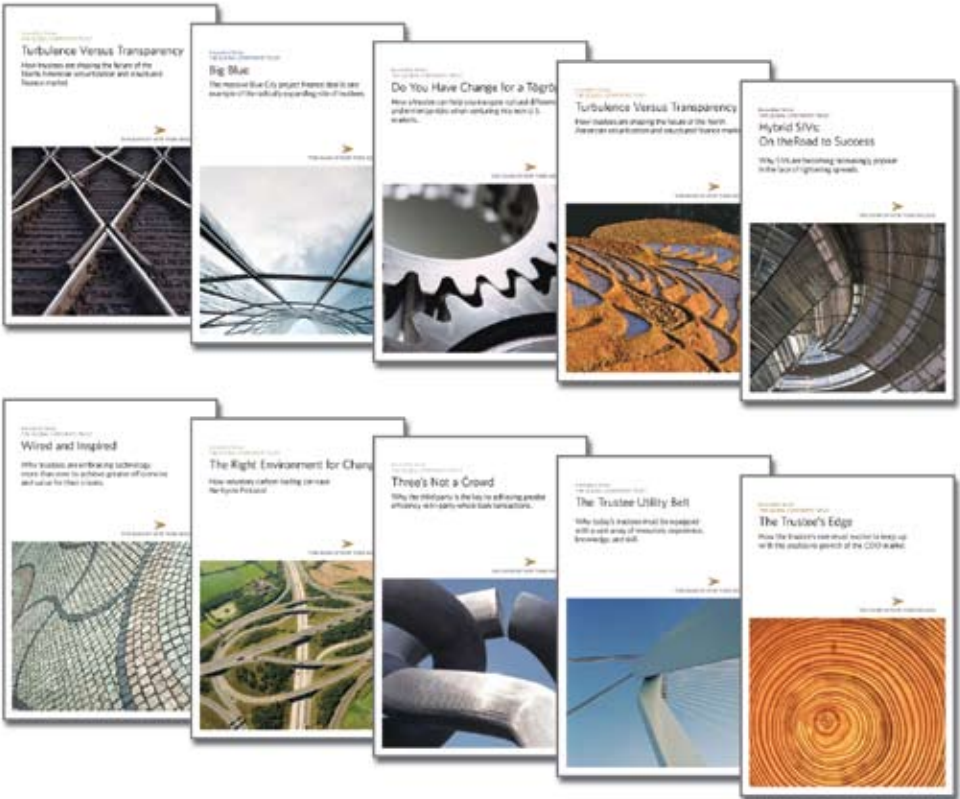
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Who's Helping You?



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How can managers of Structured Investment Vehicles (SIVs) meet the growing challenge to increase profits, in spite of tightening spreads? In this edition of the Global Corporate Trust Innovation Series, you'll discover how new vehicles, such as SIV-lites, are helping managers stay ahead of the curve.

Who's Helping You?



By Douglas Magnolia



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