

Contents

Preface	xiii
About the Authors	xv
PART ONE	
Mortgage Credit	1
CHAPTER 1	
Overview of the Nonagency Mortgage Market	3
Issuance Volumes	5
Roots of the 2007–2008 Subprime Crisis	5
Defining Characteristics of Nonagency Mortgages	9
Loan Characteristics	9
Risk Layering	18
Agency versus Nonagency Execution	22
Summary	23
CHAPTER 2	
First Lien Mortgage Credit	27
Concepts and Measurements of Mortgage Credit	28
Collateral Characteristics and Mortgage Credit: Assault of the Four Cs in 2006 (Credit, Collateral, Capacity, and Character)	35
The End Game: Foreclosure, REO Timeline, and Severity	46
The Role of Unobservable in 2006 Subprime Mortgage Credit	62
CHAPTER 3	
Second Lien Mortgage Credit	73
Two Types of Seconds	73
Higher Risks in Seconds	75
Recent Performance	80

Why Higher Losses?	80
Summary	81
PART TWO	
Mortgage Securitizations	87
CHAPTER 4	
Features of Excess Spread/Overcollateralization: The Principle Subprime Structure	89
Excess Spread-Based Credit Enhancement	90
OC in Alt-A-Land	97
OC Internal Workings	103
Summary	110
CHAPTER 5	
Subprime Triggers and Step-Downs	111
The Step-Down and the Trigger	111
BBB Stack (on the Knife's Edge)	116
Effect of Triggers and the Loss Waterline	117
Sampling the Subprime Universe	118
2000–2003 Deal Step-Down Summary	118
Step-Down and Credit Effects	119
Summary	122
PART THREE	
Credit Default Swaps on Mortgage Securities	123
CHAPTER 6	
Introduction to Credit Default Swap on ABS CDS	125
Corporate CDS Fundamentals and Terminology	125
Differences Between Corporate CDS and ABS CDS	128
Difficulties in ABS CDS	131
ABS CDS Effect on ABS CDO Management	141
Two New Types of ABS CDOs	142
Summary	143

CHAPTER 7	
The ABX and TABX Indices	145
Background	145
How a Deal Gets into the Index	146
Index Mechanics	149
Index Pricing Over Time	152
ABX Tranche Trading	156
TABX Pricing	157
TABX versus CDOs	159
Summary	160
CHAPTER 8	
Relationship among Cash, ABCDS, and the ABX	161
Fundamental Contractual Differences— Single-Name ABCDS/ABX Index/Cash	162
Supply/Demand Technicals	168
What Keeps the Arbitrage from Going Awry?	171
Summary	173
Appendix: Importance of ABCDS to CDO Managers	173
CHAPTER 9	
Credit Default Swaps on CDOs	177
CDO CDS Nomenclature	178
CDO Credit Problems and their Consequences	179
Alternative Interest Cap Options	182
Miscellaneous Terms	185
Cash CDO versus CDO CDS	186
Exiting a CDO CDS	187
Rating Agency Concerns on CDOs that Sell Protection via CDO CDS	188
Summary	189
PART FOUR	
Loss Projection and Security Valuation	191
CHAPTER 10	
Loss Projection for Subprime, Alt-A, and Second Lien Mortgages	193
Two Ways of Projecting Loss	193
Default Timing	194

Steps in Predicting Collateral Losses	195
Pros and Cons of the Default Timing Curve	201
Historical Model Fit versus Actual	201
Default Timing Is Not Equal to Loss Timing	203
An Alternative Specification	203
Alt-A and Closed-End Seconds	206
Summary	209
CHAPTER 11	
Valuing the ABX	211
Review of Basic Valuation for ABX Indices	211
Review of Valuation Approaches	212
Econometric Approach	214
ABX Valuation	234
The “Simple” or Do-It-Yourself Approach to ABX Valuation	239
ABX After Subprime Shutdown	254
Summary	259
Appendix: Results of Original “Base” Pricing (And Number of Bonds Written Down) and the New “Shutdown” Estimates	260
CHAPTER 12	
ABS CDO Losses and Valuation	269
The Mortgage Loan-Mortgage Bond-ABS CDO Chain	270
Mortgage Deal Losses	270
Subprime Mortgage Bond Losses	273
Alt-A, Second Lien, and Prime Mortgage Bond Losses	276
Aggregating Mortgage Bond Losses in 2006–7 Mezzanine ABS CDOs	276
Aggregating Mortgage Bond Losses in 2005 Mezzanine ABS CDOs	283
Drivers of CDO Losses and the Role of the Manager	284
ABS CDO Valuation and CDO Structure	288
Summary	291

SECTION FIVE	
Subprime Meltdown	293
CHAPTER 13	
The Great Subprime Meltdown of 2007	295
An Earlier Subprime Crisis	296
The Virtuous Cycle	299
Early-Pay Defaults: The First Hint Things Were Changing	301
The 2006 Conundrum	303
Banking Regulators: Not Too Little but Too Late	308
Who Will Rescue the Subprime Borrower?	312
Is Securitization the Villain?	312
Lack of Transparency	316
Spillover	317
Future for Subprime	317
Index	319

<http://www.pbookshop.com>

<http://www.pbookshop.com>