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AIG Email from Forster regarding Topics to Discuss

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From: Forster, Andrew
Sent: 07/21/2005 06:48:31 AM
To: Fewings, Tom; Teasel, Sheridan; Budnick, Adam; Gorton, Gary; Frost, Alan
Subject: Topics to Discuss

In advance of our 2pm/9am call I thought I would put down some very quick questions just to give us a starting point for discussion, its by no means all inclusive but simply some of the issues that have been raised of late in one form or another.

I guess the basic premise for the discussion is how effective is our modelling and what exposures are we taking on: To that end:

- Are the loss/trading triggers effective enough - since ABS can take an age to get downgraded to CCC type levels can we have masses of migration before anything gets triggered?
- Are we imposing strict enough haircuts on collateral for OC trigger purposes. I note for example that some deals do not call for collateral to get haircut until it is CCC and in some deals (eg very recent Monroe deal they start haircutting collateral at BBB)
- We are taking on a huge amount of sub prime mortgage exposure here and it is clearly a fast evolving market. Should we be trying to impose some quality tests on the underlying servicers/managers/deals? For example everyone we have talked to says they are worried about deals with huge amounts of IO exposure and yet I regularly see deals with 80% IO concentrations currently. Are these really the same risk as other deals? Similarly managers can pick up spread by buying deals more biased to low FICO scores, or with new collateral types such as option ARMs, or with heavy geographic concentration. Are we happy that the agencies have it right and that we should be treating everything the same in our model?
- What are we doing about interest rate risk? We have heard from several guys that one arb people are using to get spread is to buy deals with a lot of fixed rate loans since they pay high nominal coupons. The coupon of course comes from the fact that there is a huge amount of interest rate risk embedded in the deal and if you correctly hedged this the coupon would be much much lower. In a Cdo structure the ability or desire to hedge effectively may not be there so are we taking a lot of rate risk in deals?
- Do we have a consistent and informed view on other asset types? It seems that we are encouraging guys to remain focused on sub prime RMBS and we exclude many "other" asset types. Is there a benefit to allowing managers to invest in a more diversified pool? Does it depend on manager? Are there still some assets we want to exclude (eg Healthcare)
- Given we know the agencies differ on the ratings of several deals are we confident we are not allowing a lot of single rated assets into the pools we cover?
- Do we know enough about each manager to decide whether they are not just out to create the biggest arb possible and that they know enough to select a decent pool of assets even if the deal is static?

Just some ideas to get the juices flowing…..

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