Sample Subprime MBS Structure

Senior/Sub 6-Pack Structure vs. the XS/OC Structure

Collateral
Deal with 6-Pack Structure
Deal with XS/OC

Debt Collateral Face Value - Total Principal Payments
Credit Enhancement

Deal with 6-Pack Structure
Deal with XS/OC

Note: The scale in Figure 1 does not accurately reflect relative size of bonds. IO = Interest on the Bonds. Source: UBS

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Sample Subprime RMBS Payments

Monthly Mortgage Payments

REMIC Trust
Accounts
Interest Payments
Principal Payments

Sample RMBS Interest Waterfall

Scenario 1: Sequential Principal Repayment

Accounts
Scheduled Principal & Prepayments

Principal Payments
Payments Before Step Down

AAA
AA
A
BBB
BBB-
Residual

Scenario 2: Performance Test Passed the Credit Enhancement "Steps Down" to Paying Principal to Subordinated Notes.

Accounts
Scheduled Principal & Prepayments

Principal Payments
Payments Before Step Down

AAA
AA
A
BBB
BBB-
Residual


Allocation of Interest

Accounts
Interest Payments

AAA
L + % of Net WAC

AA
L + % of Net WAC

A
L + % of Net WAC

BBB
L + % of Net WAC

BBB-
L + % of Net WAC

Residual
Excess Interest

Interest Shortfalls

AAA

AA

A

BBB

BBB-

Residual
Losses

Step 1 - Interest Paid Sequentially to Bonds Capped at AFC
Step 2 - Excess Interest to Cover Collateral Losses
Step 3 - Remaining Excess Interest to Pay AFC Shortfalls

Table 2
Summary Statistics for CDO and CDO² Tranches in our Simulation under Baseline Parameters

<table>
<thead>
<tr>
<th></th>
<th>Attachment points</th>
<th>Default probability</th>
<th>Expected payoff</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CDO</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Junior</td>
<td>0%-6%</td>
<td>97.52%</td>
<td>0.69</td>
<td>NR</td>
</tr>
<tr>
<td>Mezzanine</td>
<td>6%-12%</td>
<td>2.07%</td>
<td>&gt; 0.99</td>
<td>BBB–</td>
</tr>
<tr>
<td>Senior</td>
<td>12%-100%</td>
<td>&lt; 0.00%</td>
<td>&gt; 0.99</td>
<td>AAA</td>
</tr>
<tr>
<td><strong>CDO² ([16, 12])</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Junior</td>
<td>0%-6%</td>
<td>56.94%</td>
<td>0.93</td>
<td>C</td>
</tr>
<tr>
<td>Mezzanine</td>
<td>6%-12%</td>
<td>&lt; 0.00%</td>
<td>&gt; 0.99</td>
<td>AAA</td>
</tr>
<tr>
<td>Senior</td>
<td>12%-100%</td>
<td>&lt; 0.00%</td>
<td>&gt; 0.99</td>
<td>AAA</td>
</tr>
</tbody>
</table>

Note: While the parameter values used in our simulation do not map into any particular market, they were chosen to mimic broadly the types of collateral and securitizations commonly observed in structured finance markets.
Figure 1
Sensitivity of CDO and CDO² to Changes in Default Correlation

A: CDO

Expected payoff (scaled by baseline payoff)

Default correlation

- Collateral
- Junior
- Mezzanine
- Senior

B: CDO²

Expected payoff (scaled by baseline payoff)

Default correlation

- Collateral
- Junior
- Mezzanine
- Senior

Note: Figure 1 explores the sensitivity of the original collateralized debt obligation and the CDO² tranches to changes in default correlation for bonds within each collateralized debt obligation. The correlation in defaults for bonds belonging to different collateral pools remains fixed at zero. The figure displays the expected payoff as a function of the default correlation, normalized by the expected payoff under the baseline calibration.

Assumes rho = 0.20
Figure 2
Sensitivity of CDO and CDO$^2$ to Changes in Default Probability

Note: Figure 2 explores the sensitivity of the original collateralized debt obligation and the CDO$^2$ tranches to changes in the default probability for bonds in each collateralized debt obligation. The figure displays the expected payoff as a function of the default probability, normalized by the expected payoff under the baseline calibration.

Assumes $p_{\text{Default}} = 0.05$
Source: Coval et al. (2009).