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COMMON TERMS *in* STRUCTURED FINANCE



*3rd Edition*

**Thacher  
Proffitt**

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*Thacher Proffitt*

*is a leading*

*law firm to the*

• A BRIEF HISTORY •

*structured finance*

*and financial services*

*industries.*



Structured finance is an art as well as an integral component of the global capital markets as we know them today.

Structured finance affords issuers and underwriters the opportunity to efficiently access the capital markets to finance any type of borrowing, including mortgage loans, consumer loans, auto loans, student loans, business loans and commercial loans. Lenders, borrowers, businesses and individuals all benefit from reduced interest rates and lower transaction costs.

The structured finance industry began in the 1980s when Wall Street and the mortgage finance industry first created structures to securitize mortgage loans in non-government sponsored programs. Thacher Proffitt consummated one of the first publicly offered mortgage pass-through securitizations. Since that time, we remain at the forefront of the industry, developing and refining transaction structures that are increasingly more complex. Today we are helping issuers, underwriters, monolines, servicers and trustees in the securitization of billions of dollars of debt and assets in a wide variety of available structures and currencies.

For all of its prominence, structured finance remains a highly specialized and complex business with a language that is uniquely its own. Because of our history in this arena, Thacher Proffitt attorneys are well-versed in the terminology and have assembled a primer of common terms.

We hope you find this tool useful and will look to us for *creative legal solutions for the financial world.*

# BASICS ON HOW THE MONEY *moves*



Lenders provide borrowers with loans. While borrowers now use the funds and can repay loans with interest over time, the lenders are left with the debt. To replenish their coffers and continue the business of extending new loans, lenders periodically pool and securitize the loans they have extended.



To securitize a loan, a special purpose entity (SPE) is created. The form of the SPE structure may vary depending on the type of loans to be securitized. In most cases, the owner of each pool of loans transfers them to a separate SPE.

*Thacher Proffitt counsels lenders of all sizes on loan pooling, creating special purpose entities, issuing securities and monitoring their compliance with SEC regulations.*



Once the loans are in the hands of the SPE, securities are created and then sold to an underwriter. In turn, the underwriter sells the securities to investors. This activity generates a payment stream linking investors with lenders and borrowers.

*We also counsel underwriters in their purchase of bonds and selling activity. In addition, our attorneys have leadership roles within the industry's various organizations, including American Securitization Forum and The Bond Market Association.*



With structured finance and the securitization of debt, borrowers and lenders alike are engaging in a far-reaching financial chain. Loans are made. Debt is transformed into securities. Securities are traded in the capital markets. And the proceeds of the sales of the securities return to the original lender for use in making new loans.

*Thacher Proffitt consistently ranks as a leading law firm to the structured finance and financial services industries.*

**1940 Act:** The Investment Company Act of 1940. The 1940 Act imposes substantial reporting requirements on companies that invest in securities and sell their own securities to investors, such as mutual funds. These requirements are too burdensome to be complied with by issuers that are SPEs. All securitization issuers are potentially subject to the 1940 Act, unless one of several exemptions applies.

**ABS CDO:** A CDO backed primarily by a pool of asset-backed securities, mortgage-backed securities and CDO securities.

**Accrual Class:** A class of certificates where the accrued interest otherwise payable to such certificates is allocated to specified classes of certificates as principal payments in reduction of their certificate principal balance. The certificate principal balance of the Accrual Class will be increased to the extent such accrued interest is so allocated.

**Accretion Directed Class:** A class of Certificates designated to receive principal payments primarily from the interest that accrues on specified Accrual Classes.

**Accretion Termination Date:** The date on which the allocation of accrued interest otherwise payable to an Accrual Class that is paid to specified classes of certificates or principal payments in reduction of their certificate principal balance terminates. The Accretion Termination Date is usually when the aggregate certificate principal balance of those certificates has been reduced to zero.

**Advance:** A payment by a Servicer or other party on behalf of an Issuer to cover principal and/or interest shortfalls from delinquent or defaulted loans (liquidity advances) or to pay amounts to preserve, protect or enforce upon the collateral securing a loan (protection/enforcement advances).

**Alt A Loan:** A first lien mortgage loan made to a borrower whose credit is generally within typical Fannie Mae or Freddie Mac guidelines, but with other loan characteristics that do not conform to those guidelines. An Alt A Loan may have a higher Loan to Value or may have excluded certain documentation or verifications required by Fannie Mae or Freddie Mac. Lenders in Alt A loans typically rely more on a borrower's credit score than on the adequacy of the underlying collateral when making their lending decisions.

**Arbitrage CDO:** A CDO whose assets are primarily purchased or acquired in the secondary market, and not from a single originator or group of related originators. The objective of an Arbitrage CDO is to generate for its equity owners income equal to the excess of the aggregate yield earned on its assets over the aggregate financing cost of the CDO debt securities issued.

**ASF:** American Securitization Forum, formed in 2002. The ASF's purpose is to represent and promote the interests of the securitization markets generally, through education, advocacy, commenting on regulatory proposals and other activities. It is the only organization of its type whose members include all types of participants in the securitization markets, including issuers, investors, underwriters, law firms, trustees and insurers.

**Asset-Backed Commercial Paper or ABCP:** Commercial Paper (or CP) issued by a CP Conduit. An investor in ABCP looks to both the assets held by the related CP Conduit as well as any related liquidity and/or Credit Enhancement.

**Asset-Backed Securities or ABS:** A security primarily serviced by the cash flow of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite period of time.

**Auction Note:** A type of security that requires its holders to participate in periodic "auctions" in which investors and prospective investors submit bids setting forth the rate of interest at which they would be willing to hold the Auction Note during the next period. An auction agent appointed by the Issuer determines the rate of interest which will "clear" the bids so that all of the Auction Notes will be outstanding during that period. The disclosure document for this type of security will include substantial disclosure regarding the auction procedures.

**Automatic Stay:** A stay imposed by operation of law, which immediately stops any lawsuit filed against the debtor and virtually all actions against the debtor's property by any creditor, collection agency or government entity, and which provides an injunction against the continuance of any action by any creditor against the debtor or the debtor's property. The automatic stay prohibits, among other things, commencing or continuance of lawsuits, repossessions, foreclosure sales, garnishments and levies, and remains in effect until a judge lifts the stay at the request of a creditor, the debtor obtains a discharge, or the item of property is no longer property of the estate.

**Back-up Servicer:** An entity that is retained to stand ready to assume servicing responsibilities upon the termination of the initial servicer. A “hot” back-up servicer is generally required to maintain a complete set of servicing records and systems for the related financial assets permitting it to assume servicing within a short period after termination of the servicer.

**Balance Sheet CDO:** A CDO whose assets are transferred to the related special purpose entities (SPE) by a single originator or group of related originators. The objective of a Balance Sheet CDO is to finance or transfer risk with respect to such assets.

**Bankruptcy Code:** The United States Bankruptcy Code, or Title 11 (Section 101 et seq.) of the United States Code, as amended from time to time. The Bankruptcy Code is the federal statute which governs bankruptcy filings and proceedings for property located in the United States.

**Bankruptcy Remote:** A term of art which refers to the way special purpose entities are structured so as to make their voluntary or involuntary filing for bankruptcy less likely, or “remote”. The criteria for so qualifying are well-settled and largely set forth in the legal criteria of the rating agencies (and usually available on their respective websites). These criteria include a covenant by each party to the transaction not to put it in bankruptcy, an acknowledgment that only the assets of the SPE are available to satisfy its debts, structural limitations on the SPE, such as the requirement that the vote of at least one independent director for the voluntary filing of bankruptcy, and limitations on the SPE’s activities, including the assumption of additional debt, which make it unlikely that the SPE would engage in any other activity other than the securitization transaction.

**Basel Accord:** International banking supervision accords or recommendations on banking laws and regulations, with a primary focus on capital adequacy to ensure that financial institutions retain sufficient capital to protect themselves against unexpected losses. Basel I (1988) and Basel II (2004) are published regulatory frameworks issued by the Basel Committee on Banking Supervision (the “BCBS”), a committee housed at the Bank for International Settlement (the “BIS”) in Basel, Switzerland. In 2005, the BCBS issued an updated version of the revised Basel II framework incorporating the additional guidance on trading activities and treatment of double default effects. In 2006, the BCBS issued a com-

prehensive version of the Basel II framework. As compared to Basel I, the Basel II framework is aimed at making capital measures more risk sensitive and segregating and quantifying more categories of risk to reflect changes in the markets and changes in products since 1988. U.S. banking regulators issued proposed rules for implementation of Basel II on September 25, 2006, with an expected effective date of January 1, 2009, following a period of parallel application of both Basel I and Basel II. While preliminary work has commenced on the third Basel accord, the scope, goals and timing of that effort are largely unknown.

**Blue Sky:** “Blue Sky” law is the term given to state securities law statutes that regulate the sale of securities to individual and institutional residents of the state. Such statutes include requirements for registration of securities for sale in the state and exemptions from registration for types of securities and securities transactions. In addition, such statutes include requirements for registration of brokers and dealers engaged in the sale of securities in the state and exemptions therefrom, including exemptions for sales by an issuer directly. Many state securities laws have been preempted by Section 18 of the Securities Act of 1933 for “covered securities” as defined therein. However, most asset-backed securities are not “covered securities” and, therefore, are subject to state securities laws. Typically, sales of asset-backed securities are to “institutional investors,” which are generally exempt from state securities laws sales restrictions. In some cases, asset-backed securities are sold to “retail” investors, including natural persons, and issuers may be required to comply with certain registration requirements related to such sales. See also “SMMEA.”

**Bond or Certificate Insurance:** Financial guaranty insurance issued by an insurance company that irrevocably and unconditionally guarantees the timely payment of interest on securities and the ultimate payment of the principal amount of such securities. Bond or Certificate Insurance typically does not guarantee any particular rate of principal payment nor does it typically guarantee basis risk shortfalls, prepayment interest shortfalls or Relief Act shortfalls. Finally, it does not typically cover shortfalls, if any, attributable to the liability of the trust for withholding taxes, if any (including interest and penalties in respect of any liability for withholding taxes), or the failure of the Trustee or any paying agent to make any payment required by the terms of the documents under which the securities were issued.

**Bond / Certificate Insurer:** The entity providing Bond or Certificate Insurance.

**Business Trust:** An entity created to carry on a profit-making business which normally would be carried on through a business organization classified for tax purposes as a corporation or partnership. Generally, business trusts are classified for tax purposes as a disregarded entity or partnership, though they occasionally may be classified as a corporation.

**Cash Flow CDO:** A CDO that finances its asset acquisitions with cash raised in the capital markets and distributes the cash flow generated from its assets to the holders of the related CDO securities pursuant to its priority of payments. A CDO designated as a Cash Flow CDO is generally assumed not to be a Market Value CDO unless otherwise indicated.

**Cap Contract:** A type of Derivative contract in which payments are made when a specified floating rate, usually an interest rate based on LIBOR, exceeds the fixed strike rate specified in the contract. The amount of these payments is equal to the excess of the floating rate over the strike rate, applied to a specified notional balance. The purchaser of the cap contract generally makes a single upfront payment to the cap and the provider makes the payments described above.

**CDO<sup>2</sup> (Squared):** A CDO backed primarily by a pool of CDO securities.

**Check-the-Box:** “Check-the-box” is a colloquial phrase used by tax practitioners to describe the procedure prescribed by tax regulations by which a business entity that is not automatically classified as a corporation may elect to be classified as any of (i) a partnership, (ii) a corporation or (iii) in the case of an entity with a single-owner, one that is disregarded (or non-existent for federal income tax purposes), simply by “checking the box” that corresponds to the desired entity classification on the appropriate tax form. The choice of entity classification generally determines whether the entity itself will be subject to tax or whether its income will be taxable only to its owners.

**Clean-up Call:** The option of a specified entity in a Securitization to purchase all of the remaining assets in the related trust for a specified price which is generally exercisable when the aggregate balance of the pool of assets comprising the trust is less than a specified percentage of the original aggregate balance of those assets. The exercise of a Clean-up Call typically terminates that trust.

**Collateral Interest:** An uncertificated interest in trust assets that is subordinated to, and serves as Credit Enhancement for, a series of certificates issued by the related issuer.

**Collateral Manager:** With respect to a CDO, the party, often a registered investment advisor under the Investment Advisor’s Act of 1940, responsible for managing the CDO’s assets. Collateral Manager and Portfolio Manager are interchangeable terms. The manager of a Static CDO, which permits less management discretion than a Managed CDO, is often referred to as a Collateral Advisor.

**Collateralized Bond Obligation or CBO:** A CDO backed primarily by a pool of high grade or high yield corporate bonds.

**Collateralized Debt Obligation or CDO:** A security backed primarily by a pool of one or more types of debt instruments, such as high grade or high yield corporate bonds, corporate and industrial loans, middle market loans, asset-backed securities, mortgage-backed securities, commercial mortgage-backed securities and/or REIT securities. Typically, the term CDO refers to a Cash Flow CDO.

**Collateralized Loan Obligation or CLO:** A CDO backed primarily by a pool of corporate, industrial and/or middle market loans.

**Comfort Letter:** A letter provided by independent accountants to underwriters stating that certain agreed upon procedures have been performed by such accountants to confirm the accuracy of certain information contained in a prospectus or other offering materials. A comfort letter is usually obtained by underwriters as part of the normal due diligence conducted for a securities offering.

**Commercial Mortgage-Backed Securities or CMBS:** Securities that are primarily secured by, or represent an interest in, a pool of commercial and/or multifamily mortgage loans.

**Commercial Paper Conduit or CP Conduit:** An SPE that invests in securitized interests in financial asset portfolios and/or makes loans secured by financial assets and funds such investments and/or loans through the issuance of Asset-Backed Commercial Paper. Historically, CP Conduits have not been consolidated on the balance sheets of their sponsoring banks and the related liquidity facilities have been given advantageous risk-based capital treatment.

**Commercial Real Estate CDO or CRE CDO:** A CDO backed primarily by a pool of commercial mortgage-backed securities, mortgage-backed securities, real estate B Loans and/or REIT securities.

**Compensating Interest:** With respect to any distribution date, an amount paid by the Servicer equal to the shortfall in interest due to principal prepayments on the mortgage loans. The amount of Compensating Interest is usually capped at the servicing fee payable to the Servicer for the related distribution date.

**Controlled Foreign Corporation or CFC:** A foreign corporation in which more than 50 percent of the voting rights or value is owned by U.S. shareholders on any day of the CFC's taxable year. For purposes of the CFC rules, a U.S. shareholder is any U.S. person or entity that owns 10 percent or more of a corporation's voting interests. Congress enacted the CFC provisions as part of an effort to curb the practice by U.S. investors of deferring or reducing taxes on income earned with respect to investment assets by holding such assets through corporations organized offshore. The main consequence to a U.S. investor in a CFC is that the investor's pro rata share of certain categories of the CFC's income, including passive income, must be included in the investor's gross income, regardless of whether or not any distributions are made by the CFC to the investor with respect to such income. Because many structured finance transactions utilize offshore entities that are treated as corporations for U.S. income tax purposes, it is important to take note of the possible CFC implications to a U.S. investor contemplating the purchase of a substantial equity or equity-like interest in any such offshore entity.

**Counterparty:** A party to a trade or transaction. Typically, Counterparty refers to the parties to a Derivative contract.

**Covered Bond:** An asset-backed security backed by a security interest in a revolving reference pool of assets which "cover" payments on the related securities, generally offered exclusively to investors in European Union countries and usually backed by mortgage loans.

**Credit Default Swap:** An agreement obligating the buyer of credit protection to pay a periodic payment to the seller of credit protection in return for the seller's obligation to make a payment to the buyer if a credit event occurs with respect to underlying reference obligations or reference entities, as specified in the ISDA documentation of the credit default swap. Credit Default Swaps referencing asset-backed securities ("CDS of ABS") have become more common, including in synthetic CDOs, and ISDA is currently working on a project to issue a template for such transactions.

**Credit Derivatives:** An instrument, agreement or security, the market price, value or payment obligations of which are derived from, referenced to or based on an underlying security, interest, benchmark or formula, in respect of which such underlying security, interest, benchmark or formula is, or is related to or derived from, in whole or in part, a debt or other financial obligation of an Issuer.

**Credit Enhancement:** Used to make ABS eligible for a desired credit rating. Credit Enhancement may be provided in the form of various types of insurance, reserve funds or structuring techniques, such as subordination or overcollateralization.

**Credit-Linked Note:** A cash-funded debt instrument which is redeemable by the Issuer in accordance with the terms of that instrument, or the terms of redemption of which are altered, on the occurrence of a specified event or events related to the creditworthiness of a third party or parties. Common provisions in Credit-Linked Notes provide for the reduction in the principal balance, or the amount payable at maturity, of the notes upon the occurrence of a "credit event" in respect of the underlying reference obligations, and the completion of valuation procedures as set forth in the related governing documentation.

**Custodian:** An entity holding collateral on behalf of others. Typically, the Custodian is responsible for reviewing the collateral provided to it to determine whether the criteria set forth in the operative documents are met. Generally, the Custodian is required to deliver a certificate on the closing date indicating that certain specified documents are in its possession with respect to the collateral it is holding. In addition, the Custodian typically is required to deliver a final certificate within an agreed upon period indicating that it is in possession of all of the specified documents. If the Custodian is not in possession of any such specified documents, it indicates the documents that are missing or defective in an exception report.

**Debt-for-Tax:** A type of securitization in which the issuer is not treated as having sold the assets which are used to secure the debt issued, but rather as having borrowed the money. A debt for tax transaction does not give rise to any gain or loss for tax purposes.

**Depositor:** The entity that deposits the mortgage loans into the trust. The rating agencies require that the Depositor be an SPE.

**Derivative:** A financial instrument, the characteristics and value of which depend upon the characteristics and value of an underlying asset, typically a commodity, bond, interest rate, equity or currency. Investors sometimes purchase or sell derivatives to manage the risk associated with the underlying asset or to protect against fluctuations in value. In securitization transactions, derivatives such as interest rate swaps or cap contracts are often used to hedge against a potential mismatch between interest expected to be received on assets and interest expected to be paid under securities issued in the transaction.

**DTC:** The Depository Trust Company. DTC is a clearing agency for securities transactions allowing for the sale of securities by electronic, rather than paper, means.

**Early Amortization Period:** With respect to a credit card, trade receivable or other revolving securitization of short-term receivables, the period prior to the scheduled amortization period upon which, as the result of the occurrence of a credit-related or other event, reinvestment in such receivables is no longer permitted.

**ERISA:** The Employee Retirement Income Security Act of 1974, as amended. ERISA is the U.S. federal law governing pension and other plans, which imposes requirements on the investment of plan's assets whether directly or through insurance companies or other financial services providers. Certain transactions are prohibited under ERISA and the Internal Revenue Code, where a party related to a pension plan (for example, an employer or person who provides services to the plan) enters into a transaction with the plan. Penalties for non-compliance include a 15% excise tax on the related party and possible rescission of the transaction. In the case of an ABS security, ERISA may require that no mortgagor or obligor in the pool be related to any plan purchasing the security. As this is impractical to determine, pension plans are generally not permitted to purchase ABS securities unless the securities are ERISA-Eligible.

**ERISA-Eligible:** Generally, this means that the ABS security may be purchased by a pension plan. ERISA-Eligible refers to certificates or notes which meet the requirements of the Underwriters' Exemption and may also refer to notes that are treated as debt for purposes of ERISA.

**Excess Inclusion Income:** An amount, with respect to any calendar quarter (which might be non-cash accrued income or "phantom" taxable income) equal to the excess, if any, of (a) income allocable to the holder of a residual interest in a REMIC or, under Treasury regulations that have not been issued, an equity interest in a taxable mortgage pool of a REIT over (b) the sum of an amount for each day in the calendar quarter equal to the product of (i) the adjusted issue price of such interests at the beginning of the quarter multiplied by (ii) 120% of the long-term Federal rate (determined on the basis of compounding at the close of each calendar quarter and properly adjusted for the length of such quarter). An investor's share of excess inclusion income (i) would not be allowed to be offset by any net operating losses otherwise available to the investor, (ii) would be subject to tax as unrelated business taxable income in the hands of most types of investors that are otherwise generally exempt from federal income tax, and (iii) would result in the application of U.S. federal income tax withholding at the maximum (30%) without reduction for any otherwise applicable income tax treaty to the extent allocable to most types of foreign investors.

**Excess Servicing or Excess Spread:** The portion of the interest charged to the underlying obligors on the receivables comprising the collateral that is not required to cover the interest portion of debt service payments, the regular servicing fee, any premiums payable to the Bond or Certificate Insurer, any premiums payable to pool insurance providers and any other fees payable to trustees, custodians and other agents.

**Fannie Mae:** In 1938, the Federal government established Fannie Mae to expand the flow of mortgage money by creating a secondary market. Fannie Mae was authorized to buy Federal Housing Administration (FHA)-insured mortgages, thereby replenishing the supply of lendable money. In 1968, Fannie Mae became a private company operating with private capital on a self-sustaining basis. Fannie Mae currently operates under a congressional charter. Lenders sell mortgages to Fannie Mae that comply with its guidelines and loan limits. Fannie Mae does not lend money to home buyers. Fannie Mae operates exclusively in the secondary mortgage market by either paying cash for mortgages that are purchased from lenders and holding those mortgages in its portfolio or issuing mortgage-backed securities in exchange for pools of mortgages from lenders.

**FAS 140:** Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This statement sets forth the accounting and reporting standards for transfers and servicing of financial assets (such as mortgage loans) under generally accepted accounting principles.

**FICO:** A FICO score is a credit score for an individual reflecting his ability and willingness to honor his debts based on payment history. FICO scores are calculated by credit bureaus, which are companies that maintain payment information on all of a consumer's debts and credit accounts as a service to lenders. FICO scores are an important part of the loan underwriting process.

**FIN46:** FASB Interpretation No. 46, Consolidation of Variable Interest Entities, issued in January 2003 and revised in December 2003 (FIN 46R). Prior to FIN46, suppliers of credit enhancement and liquidity support were not required to consolidate the assets and liabilities of the bankruptcy remote special purpose vehicles they were sponsoring. They were simply required to allocate the requisite amount of capital to support their commitments. An interpretation of ARB 51, which requires a business enterprise to consolidate subsidiaries in which it has a controlling interest, FIN46 requires the primary beneficiary of a variable interest entity or VIE to consolidate its assets and liabilities with its own. A primary beneficiary is the party that absorbs a majority of a VIE's expected losses or receives a majority of a VIE's expected residual returns, or both. A VIE is defined in FIN46 as any business entity (i) whose equity is insufficient to permit it to finance its activities without additional subordinated financial support from other parties, or (ii) that is financed by equity investors who are unable to make significant decisions about the entity's operation, or (iii) that is financed by equity investors who do not absorb the expected losses or receive the expected returns of the entity. It is important to note that QSPEs are exempt from the constraints of FIN46 although they might constitute a VIE.

**First Priority Security Interest:** A lien on property that is prior to all other liens on such property.

**Floater:** A security that receives interest payments based on an interest rate that fluctuates each payment period based on a designated index plus a specified margin.

**Freddie Mac:** A stockholder-owned corporation chartered by Congress in 1970. Lenders sell mortgages to Freddie Mac that comply with its guidelines and loan limits. Freddie Mac does not lend money to home buyers. Freddie Mac operates in the secondary mortgage market by either paying cash for mortgages that are purchased from lenders and holding those mortgages in its portfolio or issuing mortgage-backed securities in exchange for pools of mortgages from lenders.

**Free Writing Prospectus or FWP:** A written or electronic communication that offers a security and is delivered prior to the final Prospectus and Prospectus Supplement, as permitted under SOR. An FWP may take a number of forms, including a term sheet or a package of documents. An FWP that has substantially all of the content of the final Prospectus and Prospectus Supplement is referred to as a "virtual red."

**Future Flow Securitization:** A securitization transaction which is not typically backed by cash flows generated by an existing pool of assets, but by cash flows from assets that are generated in the future by an operating company. These transactions usually consist of an SPE issuing debt and using the proceeds thereof to make loans against or buy receivables. The operating company agrees to make all payments on the receivables to an offshore trust. In turn, the trust uses the proceeds of the receivables to service the debt issued by the SPE and, subject to compliance with certain covenants, remits excess cash collections to the operating company. Future flow transactions are dependent on the ability of a company to produce a good or provide a service in the future and are thus highly correlated to the financial and operational performance of the operating company. Financial and export future flow transactions have been the predominant form of cross-border securitization undertaken in the emerging markets of Latin America, Eastern Europe, the Middle East and Africa over the past ten years.

**Ginnie Mae:** A government-owned corporation within the Department of Housing and Urban Development established in 1968. Ginnie Mae does not buy or sell loans or issue mortgage-backed securities. Ginnie Mae guarantees investors the timely payment of principal and interest on mortgage-backed securities backed by federally insured or guaranteed loans.

**Grantor Trust:** A grantor trust is an entity formed to hold assets on behalf of beneficiaries. A grantor trust protects and conserves the assets of the trust without conducting any business activities. A grantor estab-

lishes the trust and contributes assets to the trust. For tax purposes, the beneficiaries generally are treated as the owners of the trust assets and the trust itself generally is not subject to taxation. Grantor trust structures are sometimes used in securitization transactions.

**Government Sponsored Enterprise or GSE:** Any of Fannie Mae, Freddie Mac or Ginnie Mae.

**HELOC:** A home equity line of credit secured by a mortgage on the borrower's residence.

**High Cost Loan:** Loans that exceed certain annual percentage rate and/or points and fees triggers under various federal, state and local anti-predatory lending laws. Also known as "high cost home loans," "high risk home loans," "high-rate, high-fee mortgages," "Section 32 loans," "Subsection 10 mortgages," "predatory loans" and "covered loans."

**HOEPA:** The Home Ownership Equity Protection Act of 1994. HOEPA amends the federal Truth-in-Lending Act so that mortgages that exceed a certain annual percentage rate and/or points and fees triggers as defined under HOEPA are subject to various prohibited acts and practices. In addition to "high cost home loans" or "predatory loans", mortgages that exceed the HOEPA thresholds are also known as "Section 32 mortgages" for the section of Regulation Z which implements HOEPA in the Code of Federal Regulations.

**Home Equity Loan:** A mortgage loan that is secured by equity that the borrower has in the related mortgaged property. A Home Equity Loan may be "closed end" or have a fixed balance at origination that amortizes over the life of the loan or may be "open end" or a "revolving line of credit" which allows the borrower to make draws of cash over the life of the loan up to an aggregate limit.

**Independent Director:** One or more natural persons appointed to serve as a director of a special-purpose entity, the consent of which is required by the SPE's constitutive documents to voluntarily file for bankruptcy or to amend the provisions of the SPE's articles which place Bankruptcy Remote limitations on the SPE's activities. The requirement of an Independent Director is generally driven by the rating agencies' legal criteria for rating structured finance transactions, on the theory that it will make the SPE less likely to file for bankruptcy at the behest of a self-interested parent.

**Inverse Floater:** A class of certificates where the pass-through rate adjusts based on the excess between a specified rate and LIBOR or another index.

**Interest Only or IO:** A class of certificates with no certificate principal balance and which is not entitled to principal payments. Interest usually accrues based on a specified notional amount.

**Internal Revenue Code:** The Internal Revenue Code is the federal tax law of the United States and is often referred to simply as the "Code". Following the last substantial revision of the Code in 1986 since its inception in 1939 and overhaul in 1954, the tax law currently in effect has been referred to as the Internal Revenue Code of 1986, as amended.

**ISDA:** International Swap and Derivatives Association, Inc. ISDA is a trade association that represents participants in the privately negotiated Derivatives industry. Among its activities, ISDA publishes a wide range of industry-standard Derivatives documentation forms covering a variety of transaction types.

**Issuing Entity:** The entity in a Securitization that issues the securities.

**Liquidity Facility:** A general term for any facility, whether a loan or other arrangement (such as a swap or a repurchase agreement) which provides liquidity, rather than credit, support for a Securitization structure. Examples include the liquidity facilities which sponsors of ABCP vehicles provide to enable their ABCP conduits to continue issuing commercial paper to repay maturing commercial paper when there is insufficient market demand at a particular time to issue new commercial paper. A liquidity facility does not provide credit support to a Securitization.

**Loan Modification:** A modification which results in a change to the payment terms under a mortgage loan, including without limitation, (1) capitalization of any amounts owing by adding such amount to the outstanding principal balance of a mortgage loan, (2) extension of the maturity of a mortgage loan, (3) reduction or other change to the related interest rate with respect to a mortgage loan, either on a permanent or temporary basis (which may include extending or delaying the next adjustment date or by changing the gross margin, initial rate cap, periodic rate cap or maximum mortgage rate) or minimum mortgage rate and (4) forgiveness of any amount of interest and/or principal owed by the borrower.

**Loan to Value or LTV:** The ratio of the outstanding principal amount of a mortgage loan to the appraised value of the mortgaged property.

**Lock Out Bond:** A class of certificates which is “locked out” of certain payments, usually principal, for a specified period of time.

**Managed CDO:** A CDO whose Collateral Manager manages the related pool of assets by selling and reinvesting such assets to optimize the CDO transaction’s overall risk and return. The flexibility a Collateral Manager has to manage the CDO’s assets is dependent upon the CDO’s desired risk profile and the Collateral Manager’s prior experience and reputation.

**Market Value CDO:** A CDO for which the Collateral Manager is responsible for maintaining a minimum level of overcollateralization based on the related assets’ aggregate market value, as opposed to their aggregate principal balance, which for certain assets may be adjusted. Unless a CDO is designated as a Market Value CDO, overcollateralization testing for such CDO is based on aggregate principal balances.

**Master Servicer:** An entity that generally oversees one or more other servicers and aggregates information from such servicers.

**Master Trust:** A type of Securitization trust, most often used with credit card structures, which allows revolving assets to be sold into a Master Trust. The Master Trust then either issues certificates directly to investors or, more commonly, issues series certificates to series trusts formed for the purpose of acquiring the series certificates and then issuing notes backed by those series certificates to investors.

**Monoline or Monoline Insurer:** An insurance company that insures payments on securities. Typically, a monoline insurer is rated AAA by at least two rating agencies and will issue an insurance policy that insures the timely payment of interest on each distribution date, and the ultimate payment of principal, on a final distribution date.

**Mortgage Loan Purchase Agreement or MLPA:** The agreement between the seller of mortgage loans and the Depositor, pursuant to which mortgage loans are conveyed. MLPAs typically contain the representations and warranties regarding the mortgage loans and provide for the repurchase or substitution of a mortgage loan with respect to which the seller has breached or has not delivered the specified documentation.

**Net Interest Margin Security or NIM:** A bond which has a principal component and an interest component which is collateralized by a subordinate excess interest bond or bonds from a prior transaction. Typically a NIM securitization converts a portion of the unrated subordinate cash flow into a rated bond.

**Net Monthly Excess Cashflow:** In a securitization, the term “Net Monthly Excess Cashflow” represents the excess of the amount of interest generated by the mortgage loans in the securitization over the amount of money needed to pay interest on the rated bonds (both investment grade and non-investment grade).

**Non-Amortization Senior IO or NAS IO:** A class of interest-only certificates which receives interest payments based on a schedule of notional balances.

**No Petition Covenant:** A covenant in Securitization documents, whereby the parties to the Securitization transaction agree, generally during the applicable preference period of the securities issued by the SPE, not to petition a court for the involuntary filing of bankruptcy of that SPE. This covenant is designed to increase the Bankruptcy Remoteness of the SPE.

**Notional Amount:** An amount to which a rate is applied in order to calculate periodic payment obligations. Derivative contracts generally provide for payments calculated in this manner. The notional amount generally is not itself paid under the terms of the derivative contract; rather, it is used solely to calculate other payment obligations. The term notional amount is also used in connection with Interest Only or “IO” securities, which provide for payments of interest based on a notional amount and are not entitled to principal payments.

**NRSRO:** A nationally recognized statistical rating organization.

**OC Test or Overcollateralization Test:** A test which measures the amount of Overcollateralization at specified times. If the OC Test indicates that the amount of Overcollateralization meets or exceeds a specified level, amounts that are otherwise used to achieve such specified level are payable either to holders of subordinate securities or to the residual holder.

**Owner Trust:** An entity formed to hold financial assets and issue multiple classes of asset-backed or mortgage-backed securities. An owner trust generally is classified for tax purposes as either a disregarded entity or a partnership and generally issues securities that are classified as debt for tax purposes.

**Overcollateralization:** The amount, if any, by which the aggregate outstanding principal balance of the collateral exceeds the aggregate outstanding principal balance of the securities backed by such collateral. Overcollateralization is used as a form of Credit Enhancement in certain asset-backed transactions.

**Pass-Through:** A pass-through certificate is generally issued by a grantor trust or other entity which is not considered to be a taxable entity. The certificates evidence ownership of the underlying assets of the trust. Typically, pass-through certificates are issued in a single class with each holder having a pro rata interest in the assets of the trust.

**PFIC or Passive Foreign Investment Company:** A passive foreign investment company (PFIC) is any foreign corporation that meets certain thresholds with respect to the level of passive investment activity conducted by it. Specifically, any entity will constitute a PFIC if either (i) 75 percent of the entity's gross income consists of passive income or (ii) 50 percent of the entity's assets generates (or is held to generate) passive income. Passive income includes the type of income typically associated with investment activity, such as dividends, interest and net gains from the sale of investment assets. The PFIC rules operate to discourage U.S. persons from holding investments offshore to reduce or defer taxes on income with respect to such investments. U.S. shareholders of a PFIC are subject to tax on income of the PFIC that is distributed to them and, in addition, are charged interest on income of the PFIC that is not distributed to them. An investor in a PFIC may avoid this result by making an election to treat the PFIC as a qualified electing fund (QEF), in which case the investor will pay tax on the income of the PFIC regardless of whether such income is distributed to the investor. Because structured finance transactions utilize offshore entities, it is important to understand the possible PFIC implications to a U.S. investor of purchasing any equity or equity-like interest in any such offshore entity, including whether the arrangement contemplates the availability of a QEF election to such investor.

**Planned Amortization Class or PAC:** A class of certificates with a certificate principal balance that is reduced based on a schedule of principal

balances, assuming a certain range of prepayment rates on the underlying receivables.

**Predatory Lending:** A term generally applied to abusive and unscrupulous lending practices, which may involve such practices as repeated and unnecessary refinancing of loans to reap additional interest and fees, mandatory arbitration provisions, steering borrowers to loans that do not meet a borrower's needs or repayment abilities, forcing borrowers to purchase more insurance than required, making loans based solely on the equity in a home, excessive fees, prepayment penalties, negative amortization, balloon payments and outright fraud.

**Pre-funding:** A process whereby a portion of the proceeds of the issuance of securities is deposited into an account established on the closing date of a Securitization for the purpose of funding the purchase of additional receivables by the Issuer for a specified period of time. The purchase of additional receivables is subject to specified criteria set forth on the governing documents.

**Prepayment Assumption:** An assumption of the rate of principal prepayment on mortgage loans for a certain period of time, such as monthly.

**Prepayment Penalty:** With respect to any mortgage loan, any penalty or premium payable in connection with a principal prepayment (other than a regular scheduled monthly payment) on such mortgage loan pursuant to the terms of the related mortgage note.

**Prime Loan:** A loan made to a borrower with the highest credit classification ("A" credit).

**Prospectus:** The disclosure document that is filed as part of a registration statement which describes the securities being offered.

**Prospectus Supplement:** The disclosure document which supplements the Prospectus and describes specific terms about the securities being offered.

**Pool Insurance:** A "first loss" insurance policy that insures some or all of the assets of a trust. Pool Insurance policies generally make payments when specific assets in a trust covered by the Pool Insurance become delinquent by a specified number of payments. A Pool Insurance policy is in a "first loss" position because it covers losses on the assets before any other form of Credit Enhancement.

**PO or Principal Only:** A class of certificates which is not entitled to interest payments.

**Qualifying SPE or QSPE:** A special purpose entity to which financial assets are transferred in a “sale” under FAS 140. In order to be “qualifying” under FAS 140, the SPE must meet certain requirements, including having significant limitations imposed on its discretion and ability to sell assets.

**Rating Agency:** An entity that provides investors with “ratings” of the creditworthiness of an entity or the likelihood of repayment of a specific security based on analysis of assets, liabilities and other factors as compared on a statistical basis with other similar businesses or securities.

**Real Estate Mortgage Investment Conduit or REMIC:** A fixed pool of mortgage loans for which a special tax election is made and that issues one or more classes of regular interests that may be separated into different maturity and risk classes and that are classified as debt for tax purposes, and a single class of Residual Certificate.

**Real Estate Owned or REO:** A mortgaged property acquired as a result of the foreclosure of a mortgage loan.

**Realized Loss:** A Realized Loss occurs when all of the proceeds received with respect to an asset are less than the outstanding principal balance of the asset, plus interest and specified expenses.

**Recourse:** A loan that allows the lender, if the borrower defaults, not only to foreclose on the collateral but also to seek judgment against the borrower’s or guarantor’s assets.

**Reference Obligation:** Means any obligation specified as such or of a type described in a confirmation for a Credit Default Swap transaction, including any substitute Reference Obligations if allowed pursuant to the related documentation, as to which credit events may occur pursuant to the terms of the Credit Default Swap.

**Reformation:** In the event that it is determined that a FWP provided at the time of contract of sale included an error or omission which may create liability under Rule 159, “reformation” is the process used to terminate the original contract of sale and enter into a new contract of sale based on the corrected disclosure.

**Regulation AB:** Federal securities law regulations, adopted in December 2004 and effective in January 2006, which govern a number of special issues relating to public offerings of ABS in the areas of SEC registration, disclosure, communications, reporting and transaction monitoring. Prior to Regulation AB, there was no comprehensive set of SEC regulations on these topics and instead, the area was primarily governed by a series of no-action letters and informed SEC staff positions.

**REIT:** A Real Estate Investment Trust; a corporation or trust that invests in real estate and/or loans secured by real estate and issue shares in such investments. A REIT is similar to a closed-end mutual fund and is granted special benefits under the U.S. tax code. A REIT pays corporate income tax only on its non-distributed net income provided it distributes annually at least 90% of its income and meets certain other tax tests.

**Residual:** In a Securitization, the residual is the Tranche which receives any cash flow from the collateral that remains after the payment obligations to the other Tranches have been met. In REMIC transactions, the term residual also may refer to the “residual interest” issued by every REMIC which bears the income tax consequences of the REMIC and which may or may not be entitled to distributions of cash. The holder of the REMIC residual interest must pay tax on the REMIC’s taxable income and may claim taxable losses suffered by the REMIC. Because of the timing of taxable income and losses in most securitizations, REMIC residual interests generally have overall negative tax consequences.

**Residual Certificate:** A security issued in a REMIC securitization representing ownership of the Residual interest in one or more REMICs.

**Reverse Mortgage:** A nonrecourse loan made to older homeowners, generally not less than 62 years of age, secured by a lien on the related mortgaged property, that does not require a scheduled monthly payment of principal or interest prior to maturity. Instead, accrued interest at the applicable mortgage rate is added to the outstanding amount of the related mortgage loan, and the entire outstanding amount is payable in a lump sum at maturity.

**Rule 159:** A securities regulation added by SOR which states that the seller is subject to securities law liability based on whatever disclosure (including any FWP) was provided at the time the investor entered into a contract of sale for the purchase of a security, without regard to any information (including the final Prospectus and Prospectus Supplement)

that was provided only after the time of contract of sale. See “Reformation.”

**Securities Offering Reform or SOR:** A set of federal securities regulation changes, effective December 1, 2005, which substantially changed the rules applicable to offering period communications for all securities that are publicly offered in the United States. See “Free Writing Prospectus.”

**Securitization:** A process where financial assets are pooled and transferred to a trust or other SPE. The SPE Issuer issues securities that are sold to investors in the capital markets. The securities are rated based on the likelihood that cash flow from the financial assets plus any Credit Enhancement will be sufficient to pay the principal and interest on securities.

**Servicer:** An entity that collects payments from receivables, distributes such collections to the investor/owner of the asset, administers the asset upon the obligor’s failure to make scheduled payments and provides reports to the investor/owner of the asset.

**Shifting Interest:** A term that refers to the allocation of principal prepayments between senior and subordinate securities in a Securitization structured without Overcollateralization. In a typical Shifting Interest structure, the subordinate securities are not entitled to any principal prepayments on the assets for a specified period of time, after which those securities begin to receive a growing portion of the aggregate principal prepayments, until a specified time when the senior securities and the subordinate securities share the principal prepayments on the assets on a pro rata basis.

**SIFMA:** The Securities Industry and Financial Markets Association is an industry advocacy group serving the broker dealer community in the fixed income markets. The SIFMA has a subgroup that focuses on ABS, which has historically been an effective advocate of the views of the ABS dealer community in the regulatory area. SIFMA was formed when the Bond Market Association merged with the Securities Industry Association in November 2006.

**Simple Interest Loan:** A loan on which interest accrues based on the outstanding principal balance and the number of days elapsed since the preceding payment of interest was made. Payments received on a simple

interest mortgage loans are applied first to interest accrued to the date of payment and then to reduce the unpaid principal balance of the loan.

**SMMEA:** The Secondary Mortgage Market Enhancement Act of 1984. This statute preempts state “Blue Sky” or securities laws, except for the laws of certain states that are listed below, with respect to requiring registration or qualification of “mortgage-related securities.” “Mortgage-related security” is defined under the Securities Exchange Act of 1934 Section 3(a)(41) as a security rated in one of the two highest rating categories that represents ownership in residential or commercial real estate loans originated by a financial institution of a type specified in the statute. As of January 1, 2007, the following seven states regulate the sale of SMMEA securities: Arkansas, Indiana, Louisiana, Minnesota, New Mexico, Oklahoma and Utah. In those states, issuers of mortgage-related securities are required to comply with state securities laws relating to the registration or qualification of such securities, or exemptions therefrom.

**Special Hazard:** A hazard (including earthquakes, mudflows and, to a limited extent, floods) not insured against under typical hazard insurance policies or fire or flood insurance policies required to be maintained in respect of a mortgaged property.

**Static CDO:** A CDO whose Collateral Manager has minimal discretion to manage the related assets (typically only the ability to dispose of defaulted and/or credit risk assets). Investors in a static CDO prefer the risk of a specific prediscovered portfolio as opposed to the risks presented by the more active, but less predictable, management by the Collateral Manager.

**Structured Investment Vehicle or SIV:** A structured investment vehicle, or SIV, is a limited-purpose operating company that, through a manager, undertakes arbitrage activities by purchasing mostly highly rated medium- and long-term fixed income assets, such as asset-backed securities, CDOs or corporate bonds, and funding those purchases by issuing (i) senior debt, such as short-term, highly rated commercial paper (CP) and medium-term notes (MTNs), as well as (ii) subordinated equity-like capital notes, which act as credit enhancement for the more senior debt. In terms of structure, it is similar to a CDO vehicle, but unlike a CDO vehicle, a SIV is an on-going open-ended vehicle that can change-size and re-finance itself by continually issuing senior debt and capital

notes. In addition, unlike a CDO funded through the CP market, commercial paper issued from an SIV do not have to be backed up with liquidity agreements between the issuing vehicle and banks in order for the commercial paper or MTNs to receive a favorable rating. In general, a SIV generates returns by capturing the difference in credit spreads between its long-term assets and its cheaper short-term liabilities.

**SIV-Lite:** An SIV-lite is a cross between a traditional SIV and a CDO vehicle. It was developed as credit spreads tightened in the market place, which made managing traditional SIVs more difficult. Unlike traditional SIVs, a SIV-lite is a one-off issuance and thus has a static capital structure. In addition, it is a special purpose vehicle with a portfolio of assets that have a defined maturity date. It thus resembles a CDO vehicle, however, unlike a CDO vehicle, expensive liquidity facilities remain unnecessary as part of its capital structure.

**Structured Finance:** A broad term that refers to the sale and financing of financial assets using techniques that isolate the assets from the seller. “Financial assets” typically include mortgage loans, auto and other consumer loans, credit card accounts, HELOCs, business and commercial loans, leases, and other assets that convert to cash.

**Subordination:** Subordination refers to Credit Enhancement in the form of subordinated securities. Subordination is intended to enhance the likelihood of the regular receipt by the holders of securities having a higher priority of distribution of the full amount of interest and principal distributable thereon, and to afford such security holders limited protection against Realized Losses incurred with respect to the collateral. The limited protection afforded to holders of the senior securities by means of subordination will be accomplished by the preferential right of the holders of the senior securities to receive, prior to any distribution of interest or principal being made in respect to any securities having a lower priority of distribution, the amounts of interest due to them and principal available for distribution.

**Sub-prime Receivable:** A loan made to a borrower with the lowest credit classification (“B” or “C” credit). Sub-prime Loans are typically characterized by high rates of interest, points and fees at origination.

**Substantive Consolidation:** Under the doctrine of Substantive Consolidation, a bankruptcy court may, if appropriate circumstances are determined to exist, consolidate the assets and liabilities of different entities by merging the assets and liabilities of the entities and treating the related entities as a consolidated entity for purposes of the bankruptcy proceedings. The inter-company claims of the debtor companies are eliminated, the assets of all debtors are treated as common assets and claims of outside creditors against any of the debtors are treated as against the common fund. Substantive Consolidation can be used with similar effect to extend the debtor’s bankruptcy proceeding to include in the debtor’s estate the assets of a related entity which is not a debtor in a case under the Bankruptcy Code. In addition, a court can consolidate estates as to certain claims (e.g., unsecured claims), even if it does not consolidate estates as to all claims.

**Synthetic CDO:** A CDO transaction in which the pool of “assets” are primarily credit derivatives entered into by the related SPE, and not assets purchased for cash, and the “liabilities” are portfolio credit derivatives and/or cash securities referencing such asset pool.

**Target Amortization Class or TAC:** A class of certificates with a certificate principal balance that is reduced based on a schedule of principal balances, assuming a certain targeted rate of prepayments on the related collateral.

**Titling Trust:** A “master trust”- style trust which is established to take title to receivables in order to perfect the securitization’s interest in the sold assets. The titling trust generally issues special units of beneficial interest, which are acquired by securitization trusts, which then issue securities purchased by investors. The undivided interest in the trust is generally retained by the originator.

**Total Return Swap:** A swap contract by which one party to the swap agrees to make payments to the other party to the swap of all cash flows from a specified asset or assets, plus any increase in the market value of the assets since the last payment date or the effective date of the swap, whichever is the more recent, and the recipient of these amounts undertakes to pay periodic payments based on or related to interest rates, plus any decrease in the market value of the assets since the last payment date or the effective date of the swap, whichever is the most recent. As such, though the asset is transferred to the buyer, the “total return,” or economics, of the asset is retained by the seller.

**Thacher Docs:** Documents originally drafted by Thacher Proffitt and used as models by other parties for securitizations, purchase and sale transactions and financing transactions.

**Tranche:** One of several related securities issued in a Securitization transaction. Tranches in the same transaction usually have different maturity, subordination and interest rate characteristics.

**Trigger Event:** The occurrence of a specified event relating to the performance of receivables in a Securitization or of a servicer. Generally, if a Trigger Event occurs, amounts required to be retained in any spread or reserve account or the level of any other credit enhancement is increased.

**True Sale:** The issue of whether, in the event that the transferor of assets into a special-purpose vehicle were to become a debtor in a case under the Bankruptcy Code, a U.S. bankruptcy court would, upon a motion of a party in interest, recharacterize the sale by the transferor of all of its right, title and interest in the transferred assets pursuant to the related transfer agreement, where such a recharacterization would have the effect of rendering the transferred assets property of the bankruptcy estate of the transferor under Bankruptcy Code Section 541.

**Trust Certificates:** A security that represents all or a portion of the beneficial ownership interest in a trust.

**Trustee:** A banking institution or trust company appointed to act on behalf of investors. Prior to an event of default, the Trustee is required to perform only such duties as are specifically set forth in the governing document. During the continuance of an event of default, the Trustee is generally required to act in the manner in which a similarly situated prudent person would act.

**Underwriter:** An entity that purchases securities from a Depositor for sale to third-party investors. Typically, an underwriter enters into an underwriting agreement with the Depositor which sets forth terms pursuant to which the Underwriter agrees to purchase the securities.

**Underwriters' Exemption:** In order to permit pension plans and buyers using pension plan assets to invest in ABS Transactions, the Department of Labor has issued exemptions to certain underwriters who request the exemption. If the requirements of the Underwriters' Exemption are met, a pension plan may invest in the ABS security without incurring taxes or other penalties under ERISA or the Internal Revenue Code.

**Warehousing:** The short-term financing of financial assets prior to securitization of those assets.

**Weighted Average Coupon or WAC:** A rate equal to the weighted average of the net mortgage rates on the mortgage loans, weighted on the basis of the principal balances of such mortgage loans.

NOTES

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Thacher Proffitt is a preeminent law firm in the field of securitization and structured finance. Thacher Proffitt has consistently led the industry's evolution since its origin over 20 years ago.

Our Structured Finance Practice Group includes more than 140 of the Firm's 350+ attorneys, who provide clients with the critical mass of resources and experience necessary to provide the highest level of legal representation for any transaction.

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NEW YORK, NY  
Two World Financial Center  
New York, NY 10281  
212.912.7400  
Fax: 212.912.7751

WASHINGTON, DC  
1700 Pennsylvania Avenue, NW  
Washington, DC 20006  
202.347.8400  
Fax: 202.626.1930

WHITE PLAINS, NY  
50 Main Street  
White Plains, NY 10606  
914.421.4100  
Fax: 914.421.4150

SUMMIT, NJ  
25 DeForest Avenue  
Summit, NJ 07901  
908.598.5700  
Fax: 908.598.5710

MÉXICO CITY, MÉXICO  
Thacher Proffitt & Wood, s.c.  
Paseo de Tamarindos  
No. 400-B Piso 22  
Col. Bosques de las Lomas  
05120, México D.F.  
México  
+(52) (55) 3000.0600  
Fax: +(52) (55) 3000.0698 or 0699