∧ (logical and), 64
∨ (logical or), 64
⇐ (payment operator), 110
:= (assignment), 26
¬ (negation), 64
“I” structure, 99
“Y” structure, 100
acceleration, 116, 121, 139, 220
Adjustible Rate Mortgage (ARM) characteristics, 48, 50, 235
hybrid, 3
nreset shock, 219
alias, 27
allocation. See sizing
amortization, 12, 66
ever, 137
negative, 86
of senior bonds, 182–183
percentage, 66
schedule, 131
slow, 96
turbo, 116, 139
Amortized Default Balance (ADB), 68
analysis, 217–234
dynamic, 14
static, 14
architecture, 19, 33–37, 144–170
array
in Excel, 270, 289
passing as Variant, 294–295
asset
backed credit default swap (ABCDS), 10
backed index (ABX), 10, 252
backed security (ABS), 13, 48, 217, 233, 251, 275
buy back, 219
cash flow analysis, 61–75
seller, 1, 5
Available Funds Cap (AFC). See WAC cap balance,
actual, 72
performing, 72
Zero Prepay- (ZPB), 63
balloon loan, 51
baseline O/C, 118
basis risk
-Carry Forward Amount (BRCFA), 114, 132, 145, 221
gap, 133
bespoke tranche, 12, 269
Binomial Expansion Technique (BET), 278–280
binary search, 189, 192
block, 102
Bloomberg, 299–301
Bond-Equivalent Yield (BEY), 307
buy back, 219
C++, 16, 26
constructor, 26
instantiation, 26
call
-by reference, 36
-by value, 36
cleanup, 219
call period, 138
non-call multipliers, 107
rights, 219
risk due to, 219
cap. See corridor
cash cap table, 213
cash flow, 3
actual, 66–75
delayed, 128–130
diversion, 138
examples, 3–4, 170–176
notation in model, 102–104
of collateral, 3, 48–94
cash flow (Continued)
of liabilities, 98–176, 305
zero-prepay, 63–66
CDX, 259
certificate holder, 6
child class, 38
Cholesky decomposition, 246, 275
class
Application, 22
architecture, 19, 33–37, 89–93, 144–170
child, 38
Collection, 21, 145, 292–293
Excel, 297
inheritance. See inheritance instantiation of object, 21
method, 24–26
module, 26
“N”, 6–7
“P”, 6–7, 142
parameterized, 42, 89
parent, 38
“R”, 6–7
Waterfall, 104
Workbook, 297
Worksheet, 297
WorksheetFunction, 35
“X”, 6–7, 141
cleanup call, 219
CMO Description Information (CDI), 10
code
backwards compatible, 291
benchmarking, 291
brittleness, 104
independence/sharing, 89
migration, 285
modularity, 89, 286
module, 26, 46
profiling, 299
collateral
cash flow model, 48–94
group, 102
primary group, 102, 113
collateralization
cross, 101, 150
step down, 118
over. See Over-Collateralization (O/C)
under, 5, 117
Collateralized Debt Obligation (CDO), 142, 171, 240, 269
single-tranche (STCDO), 12
Collateralized Mortgage Obligation
(CMO), 3
Collection class, 21, 145, 292
compilation, 293–299
convergence
of bond sizing, 192
of Moody’s collateral model, 84–86
convexity, 236
negative, 218
copula
“one-factor” model, 249, 282
Gaussian, 244–249
in Excel, 276–277
correlation, 244–248, 282
base, 260, 264
-coefficient, 247
compound, 260
implied, 262, 264
multivariate normal, 246–247
sensitivity, 220
corridor, 6–7, 130
ceiling or cap, 131–134
NIM, 7, 133
optimal strike for NIM, 134
strike, 131
coupon, 105
step up, 138, 225
covariance, 282
coverage test, 138–140
CPLEX, 54
credit
-card model, 315–319
index. See synthetic structure
tranching, 99
Credit Default Swap (CDS), 1, 10, 256–260
loss leg, 256–258
partial payment, 283
premium leg, 256–258
PV01, 258
up front fee, 259
cross-collateralization, 101, 114
current subordinated amount,
116–118
data member, 23
public, 206
data table, 19, 170–176
day count, 105, 112
declaration, 23, 24
decrement table, 213
Index

default
  absorbing state in Markov chain, 250
  barrier, 242
  delay to realized loss, 67–68
  probability of, 242
  rate, 241
  risk, 219–221
  stochastic model, 238–244
  table, 241, 270
  time, 238

defined term, 102

definition, 24
delinquency, 140–141
delta, of synthetic tranche, 266, 268
Dijkstra, Edsger, 285
discount margin, 225
distribution (of cash)
  among seniors, 123–124
  among subordinates, 125
  of principal, 122–123, 126
  pro-rata, 100, 150
  sequential, 100

diversity score, 278
due diligence, 6
duration, 220, 307–312
  asset, 308, 311–312
  interest-rate, 308
  Macaulay, 309
  spread, 308–311
  dynamically linked library (DLL), 295, 297–299

early amortization, 137
eigenvalue/vector, 240
Excel, 16, 283–289
  array, 270
  CTRL-SHIFT-ENTER, 270, 276, 289
  data dimensionality, 287–288
  data table, 19, 170–176
  formula auditing, 18, 287
  Graphical User Interface (GUI), 288
  keyboard sequences, 289
  macro, 46, 285
  migration , 285–286
  named range, 286–287
  pivot table, 19
  regular formulae, 288
  Solver, 55, 97, 210–213
Excel built-in
  AND, 288
  BINOMDIST, 279

FREQUENCY, 289
  HLOOKUP, 289
  IPMT, 172
  LINEST, 289
  MATCH, 270, 274, 279
  MAX, 280
  MINS, 280
  MINVERSE, 270
  MMULT, 270, 276
  NORMSDIST, 276
  NORMSINV, 276
  OFFSET, 270, 279
  PMT, 20
  PPMT, 172
  RAND, 275–277
  SUM, 280
  SUMIFS, 94
  SUMPRODUCT, 94–96
  TRANSPOSE, 270
  VLOOKUP, 174, 289

excess
  O/C, 116
  -Reserve Fund Account (ERFA), 132, 135–137, 154–155
  spread, 3, 220, 315
expenses, 69, 113
  insurance premium, 109
  liability model, 108–110
  servicer fee, 109

Fair Issac Company (FICO), 52, 61
foreclosures (FCL), 68
Frontline Solver, 54–55

Gaussian copula, 244–249
Generalized Reduced Gradient (GRG), 54
Graphical User Interface (GUI), 207
gross principal distributions, 122–123

Guarantor, 98, 108–109

Hannibal, 235
hazard rate, 242, 312–315
hedging, 10, 12
  interest rates, 130–135
  over/under, 132
  synthetic index, 264–269
Heinlein, Robert, 68
home equity, 14, 48
### Index

**index.** See synthetic structure

**inheritance.** 203–207
- full, 41
- multiple, 89–93
- weak, 37, 89

**instantiation.** 21
- in C++, 26

**interest.**
- advanced, 69
- collateral model, 69
- coverage (IC) test, 139–140
- deferred, 130
- liability model, 110–115
- net, 69
- on deferred payments, 130
- only (IO) bond, 99
- performing, 69
- shortfall, 130
- waterfall, 139, 147–150

**Zero Prepay- (ZPI),** 64

**interest rate.**
- corridor, 6–7, 132–134
- Moody’s model, 78
- NIM sensitivity, 231–233
- risk, 221
- S&P model, 78
- sensitivity, 218
- swap, 134–135

**interface.** See inheritance, weak

**Intex,** 10

**Jensen’s inequality,** 236

**junior tranche,** 99

**Knuth, Donald,** 285

**leg,** 102

**legal sale,** 1

**leverage,** 266–267

**liability cash flow model,** 98–178
- parameters, 107

**London Inter-Bank Offered Rate (LIBOR),** 3, 12, 78, 87, 223

**lien.**
- first, 52
- second, 14, 52

**linear programming,** 53

**MPS format,** 55

**loan,** 8, 49–52
- age, 50
- balloon period, 51
- prefunding period, 51
- prefunding rate, 51
- prepayment characteristics, 50
- rate characteristics, 50–51
- To-Value ratio (LTV), 61, 233

**loss,** 8, 62
- collateral model, 60–61, 66–68
- coverage, 80–81
- delay, 62
- distribution, 62, 83
- given-default (LGD), 68
- let, 253–257
- Moody’s model, 80–86
- NIM sensitivity, 231–233
- S&P model, 60–62
- severity, 62, 68, 83
- table, 270
- trigger, 141

**margin,** 105

**mark to market,** 8

**Markit,** 259

**Markov process,** 56, 240

**member,** 20, 23
- private/public, 24

**method,** 24–26
- argument, 26
- call or invocation, 26
- private/public, 20

**Metropolis algorithm,** 58


**migration of applications,** 285

**Miller, Henry,** 48

**model.**
- active architecture, 158–170
- collateral, 48–94
- credit card, 315–319
- liability, 98–176
- Moody’s, 80–86
- passive architecture, 144–158
- pricing, 8
- PSA, 61

**risk neutral,** 241–244

**S&P, 60, 75–80
- sizing, 8, 61
- static vs. stochastic, 235–238
- synthetic index, 251–269

**module,** 19, 23, 26

**Monte Carlo simulation,** 14, 237, 249–251
- accuracy, 251, 260
- in Excel, 270–278, 293
number of paths, 251
stability, 291–292
stratified sampling, 251
Monthly Payment Rate (MPR), 315
Moody’s
Binomial Expansion Technique (BET), 278–280
collateral cash flow analysis, 80–86
convergence of loss coverage, 84–86
diversity score, 245, 278
interest rates, 78, 82
IRR test, 189–190
loss coverage, 81
loss distribution, 82–84
prepayments, 82–83
sizing admissibility, 190
WAC reduction, 82
mortgage,
-backed security (MBS), 3, 13, 48
Collateralized Mortgage Obligation (CMO), 3, 14
adjustable rate (ARM), 3, 49–52
interest-only (IO), 97, 99
negative convexity, 218
Non-Accelerating Senior (NAS), 99, 177
(non) compliant loan, 6, 14
option ARM, 45, 48, 86
pass through, 14
payment, 303–304
Planned Amortization Class (PAC) bond, 99
principal-only (PO), 99
slow amortizing, 96
Z bond, 99
MPS format, 55
Net Interest Margin (NIM), 7, 99, 141–144
chain, 143
corridor, 7, 133, 182
discontinuous yield, 200–201
non-recourse funding of, 144
prepay curve, 50–52
sensitivities, 230–232
sensitivity to O/C step down, 118
sizing, 198–203, 210–213
stress assumptions, 199
Newton-Raphson search, 200, 205, 307
normal distribution, 246–247
notation, 102–108
object, 21
destruction, 25, 44
instantiation, 21
- oriented program, 16
persistence, 26
optimality, 54
optimal senior balance, 122
optimization, 90
admissibility in sizing, 190
binary search, 189, 192
combinatorial, 180
feasibility, 54
Newton-Raphson search, 200, 205, 307
objective function, 54, 59, 90
simulated annealing, 56
sizing NIM, 198–203
sizing structure, 180
summary of applications, 205
zero-one programming, 53
option ARM, 45, 48, 86
minimum payment, 86
teaer rate, 87
originator, 5–6
Over-Collateralization (O/C), 5, 99, 220
baseline, 118
excess, 116
remedy, 139
step down, 118, 141, 225
supplemental test, 139
target, 118–119
test 138–139
trigger, 116
Owner’s Trust Equity (OTE), 7, 99, 142–143
prepay curve, 50–52
pricing, 200
sensitivity to O/C step down, 118
par value test. See Over-Collateralization (O/C), test
parallel pay, 114
parameterized class, 42, 89
parent class, 38
path variable, 236
pivot table, 19
pointer, 27
prefunding, 8, 72, 134
period, 5, 51, 72
rate, 51
risks, 217
prepayment, 60, 71
(in)voluntary, 66, 220
Moody’s, 82–83
NIM sensitivity, 231–233
Index

prepayment (Continued)
  penalty, 50, 218
  penalty period, 50
  risks, 217–219, 225
  S&P, 79
price-to-yield
calculation, 306–307
table, 215, 233
pricing bid, 216
primary collateral group, 102, 113
principal
  advanced payments, 123
  loss, 130
  performing payments, 70
  waterfall, 124, 150–154
  -only (PO) bond, 99
  write down, 130
Zero Prepay- (ZPP), 64
priority of payments cross-collateralized, 114
  parallel, 114
  pro-rata, 100, 115
  sequential, 100, 114
probability distribution, 14
  Bernoulli, 242
  Beta, 281
  binomial, 253, 278
  estimation of quantile, 293–294
  normal, 246
  sampling from cumulative, 242
  uniform, 241
procedure. See method
  pro-rata
    parallel pay, 115
    paydown, 100
prospectus
  how to read, 126–128
  stresses, 132
  -supplement (Prosup), 8, 132
Public Securities Association (PSA), 61
  alternatives to, 73–74
random sampling, 248, 291–292
  stratified, 251
recovery, 7, 60, 70, 128, 220
  recurrence equation, 103
reinvestment period, 5
repline. See loan
reservoir, 135
residual, 141–144
  arbitrage, 143
  basis risk, 222
front-loaded cash flows, 143
  sensitivities, 219, 222, 230–233
risk, 1, 217–222
  ARM reset shock, 219
  correlation among defaults, 220
  counterparty, 222
  default, 219–221
  empirical analysis, 223–233
  extension, 218
  interest rate basis, 133, 221
  negative convexity, 218
  -neutral model, 241–244
  prefunding, 217
  prepayment, 217–219
  priority of payments, 220
  residual sensitivities, 219, 222, 230–233
  spread gap, 221–222
S&P, 75–80
  interest rates, 77–78
  LEVELS, 60, 76
  loss coverage, 76
  loss distribution, 81
  prepayments, 79
  sizing admissibility, 190
  WAC reduction, 79
salvage. See recovery
securitization, 3–10
  of credit cards, 48
seller, 1, 5
  senior, 98
  distribution, 124
  sizing algorithm, 105
servicer, 6, 109
  actions for option ARM, 86–88
  advance, 7, 62, 68, 98, 220
  clean-up call, 219
  fee, 109
  rights, 6
  unrecoverable asset, 221
settle date, 5
Simplex method, 54
  simulated annealing, 56–69
sizing, 8, 179–216
  admissibility, 190
  class architecture, 203–209
  combining agency allocations, 196–198
Index

convergence, 192
discontinuities in, 194
multiple NIMs, 202–203
NIM, 198–203, 210–213
(non)fully funded structures, 190–193
reserved bond, 181, 190
senior bonds, 181–185
speeding up, 193–195
stress assumptions, 199–200
subordinate bonds, 185–198
Special Purpose Vehicle (SPV), 1
spread, 105
conversion to probability of default, 241–242
convexity, 222
duration, 221
risk gap, 133–134, 221–222
staging account, 135
step down date, 118–119
Stoppard, Tom, 16
structure
cash, 1, 11, 99–101
leg, 102
(non)fully funded, 190–193
residual, 116, 141–144
sizing, 179–216
synthetic, 10–13, 251–267
waterfall, 61, 98, 110
subordinate, 98
distribution, 125
sizing, 185–198
survival
probability, 243
percentage, 66
swap, 130, 134
balance-guarantee, 132
counterparty, 6, 109, 135
credit default-. See credit default swap (CDS)
day count conventions, 131
injecting cash into waterfall, 135
interest rate, 6, 221
waterfall, 135, 155–158
syndicate, 5, 8
synthetic structure
basket or index, 10, 15, 251
CDX/ITRAXX/TRAC-X, 259
delta, 266, 268
hedging, 264–269
modeling, 251–269
Nth-to-default, 253
PV01, 258
relative-value analysis, 260–264
spread sensitivity, 221
“street” model, 15, 249
(un)funded tranche, 12
take out, 8
target O/C, 119–121
Taylor expansion, 236–237
time-to-default, 242–244, 249
trade date, 5
tranche, 98
bespoke, 12, 269
block, 102
clean-up call, 219
convexity (gamma), 268
delta, 266
junior/subordinate, 99
mezzanine, 99
residuals, 141–144
senior, 98
sensitivity to correlation, 245, 265
super-senior, 12
synthetic credit index, 252–253
transition matrix, 56, 238–241, 270
cumulative probability matrix, 241
decomposition by eigenvectors, 240
within Monte Carlo simulation, 249–250, 270–278
trigger, 108, 137–141
delinquency, 137, 140–141
interest coverage , 139
loss, 137, 141
O/C test, 138–139
quality test, 138
true sale, 1
trust, 1, 5
receipt, 6
trustee, 6
turbo amortization, 116
type, 20
abstract, 24
circular, 32
coercion, 30
declaration, 23
infinite or recursive, 31
matching, 25
primitive, 24
user, 24, 30
variant, 30
under collateralization, 5, 116–117
underwriting, 5, 49

variable,
  alias, 27
  assignment, 20
  declaration, 23
  global, 23
  local, 25
  pointer, 27
  scope, 23, 25

Visual Basic
code style, 290–295
Collection class, 21, 145, 292
compilation, 295–299
data member, 23
Design Studio, 295–296
inputting arrays, 294–295
line continuation, 24, 290
macro, 46
module, 19
procedure, 19
Randomize built-in, 291
Rnd built-in, 281

Visual Basic keyword
  And, 35
  Array, 171
  As, 23, 32–33
  Byref, 36
  Byval, 36
  Calculate, 276
  Declare, 299
  Dim, 21
  Each, 292
  End, 21
  For-Next, 21
  Function, 24
  If-Then-Else, 35
  Implements, 38–39
  Lbound, 287
  Me, 92
  Mod, 35
  New, 21
  Nothing, 26, 44
  Option Explicit, 23, 290
  Optional, 159
  Private, 27
  Public, 21
  Range, 22
  Redim, 23
  Select Case, 40
  Set, 21
  Step, 276
  Stop, 40
  Sub, 21
  To, 26
  True, 35
  Type, 30
  Ubound, 171, 287
  Volatile, 295
  While-Wend, 93
  With, 297

Visual Basic types
  Boolean, 26
  Double, 23
  Integer, 23
  Long, 29
  String, 40
  Variant, 30
  Voltaire, 98

WAC cap, 112–132, 221
collateral group, 112
group, 113
warehousing, 8
waterfall, 61, 98, 110
  abstract architecture, 149
  active, 158–170
  deferred interestm, 131
  deferred principal, 131
  ERFA, 134, 136, 154–155
  interest, 114, 139, 147–150
  passive, 144–158
  principal, 124, 150–154
  swap, 135, 155–158
Weighted-Average Coupon (WAC), 49
cap. See WAC cap
  minimization during allocation, 185–198
  reduction, 63, 69, 79, 82
Weighted-Average Life (WAL), 19, 220,
  225–227
target in sizing seniors, 105, 182–185
Weighted-Average Maturity (WAM), 49
  slow amortizing, 96
Weighted-Average Rating Factor (WARF),
  278
WorksheetFunction, 35
write down, 124, 128–130
yield-to-price, 305–306