CASH-FLOW vs. MARKET-VALUE CDOs

SILVIU EDUARD DINCA

PH.D. CANDIDATE, UNIVERSITY OF CRAIOVA, FACULTY OF ECONOMICS AND BUSINESS ADMINISTRATION
silviu@dinca.biz

Abstract: During the past few years, in the recent post-crisis aftermath, global asset managers are constantly searching new ways to optimize their investment portfolios while financial and banking institutions around the world are exploring new alternatives to better secure their financing and refinancing demands altogether with the enhancement of their risk management capabilities. We will exhibit herewith a comparison between the cash-flow and market-value CDO securitizations as financial markets-based funding, investment and risks mitigation techniques, highlighting certain key structuring and implementation specifics on each of them.

Keywords: cash-flow CDO securitization, market-value CDO securitization, credit derivatives, balance-sheet CDO securities, arbitrage CDO securities

JEL Classification: E44, F30, G15

1. CDO Securitizations

Collateralized debt obligations (CDOs) are asset-backed securities whose underlying collateral is formed of a diversified pool of cash-flow generating obligations. CDOs are part of an ongoing structured finance’ evolutionary trend that is providing advanced methods of converting financial risks into freely marketable and tradeable commodities. This revolutionary process started with the short-term ABCP and longer-term ABS securitizations and it found support and further catalysts with the development of financial engineering and financial derivatives along with the expansion of the overall global securitization markets.

A) CDOs Family Tree

There are multiple types of CDO classes and structures in the marketplace today, which can be differentiated based on the various classification criterions one might use to sort them out. The main forms of CDOs can be broken down by:

a) Aim of Transaction (Initiator’s Motivation)
   ➢ Balance sheet management (balance-sheet CDOs): they are implemented to optimize initiators’ balance sheet management. They are both true-sale (cash-flow) based CDOs, credit-derivatives based (synthetic) CDOs and hybrid CDOs (combination of cash and synthetic);
   ➢ Arbitrage opportunities (arbitrage CDOs): they are employed to capture the various arbitrage opportunities existing in the global financial markets. They are cash-flow CDOs and market-value CDOs based on both true-sale and synthetic structures.

b) Securitization Technique
   ➢ True-sale CDOs: the transaction follows the true-sale implementation principles. They consist of both balance-sheet CDOs and arbitrage CDOs;
   ➢ Synthetic CDOs: the transaction follows the credit derivatives implementation principles. They contain balance-sheet CDOs as well as arbitrage CDOs.

c) Source of Funds for Principal and Interest Payments
   ➢ Cash-flow CDOs: the repayments are based on the ability of the cash-flows generated by the underlying assets to fully service the principal and interest payments of the newly issued CDOs. They comprise balance-sheet CDOs as well as arbitrage CDOs;
   ➢ Market-value CDOs: the repayments are based on the ability of the marked-to-market value of the underlying assets to fully service the principal and interest payments of the newly issued CDOs. They include mostly arbitrage CDOs on both true-sale and synthetic forms;
   ➢ Hybrid CDOs: they are a combination of cash-flow and market-value CDO structures. They cover balance-sheet CDOs and arbitrage CDOs on both true-sale and synthetic forms.

d) Funding Technology (Liabilities Distribution)
   ➢ Cash-based (true sale) CDOs: the transaction is based on the true-sale securitization principles of risk transfers and funding. They contain both balance-sheet CDOs and arbitrage CDOs;
   ➢ Synthetic (credit derivatives based) CDOs: the transaction is based on the credit derivatives (synthetic) securitization principles of risk transfers and funding and can be further divided into fully-funded synthetic CDOs, partially-funded synthetic CDOs and fully-unfunded synthetic CDOs. They contain balance-sheet CDOs as well as arbitrage CDOs;
Hybrid CDOs: the transaction is a mixture of cash and synthetic securitization. They cover balance-sheet CDOs and arbitrage CDOs.

e) Collaterals Management Style

- Actively managed (dynamic) CDOs: they are actively traded by the collateral managers. They include mostly arbitrage CDOs on both true-sale and synthetic forms;
- Passively managed (static) CDOs: they are traded under very limited conditions by the collateral managers. They include mostly balance-sheet CDOs on both true-sale and synthetic forms.

f) Composition of the Underlying Assets (the Reference Portfolio)

They can differ widely, but the majority of CDOs consist of one or a combination of the following: (a) loans (commercial, middle-market, corporate/SME, secured/unsecured junior/senior, distressed and nonperforming, emerging markets, leveraged and high-yield, leases, PIKs, trade receivables - factoring and forfaiting based, revolving credit lines, mezzanine, municipals, project finance, syndicated, bilateral); (b) bonds (corporate investment grade & high yield, sovereign investment grade & high yield, convertible, emerging markets, distressed and nonperforming, mezzanine, secured/unsecured junior/senior, municipals, project finance); (c) collateralized debt obligations (loans & bonds); (d) mortgage-backed securities (commercial & residential); (e) financial derivatives; (f) hedge funds, private equity, REITs; (g) private placements, equity, trust preferred securities; (h) asset-backed securities (various collaterals); (i) structured finance securities. They cover balance-sheet CDOs and arbitrage CDOs on both true-sale and synthetic forms.

g) Product (Deal) Types

Depending on the combination of the underlying assets and collateral types, one can find different types of CDO transaction structures, such as: collateralized debt obligations (CDOs); collateralized loan obligations (CLOs); collateralized bond obligations (CBOs); collateralized synthetic obligations (CSO), or synthetic CDOs; collateralized fund obligations (CFOs); collateralized insurance obligations (CIOs); commercial real estate CDOs (CRE CDOs); collateralized equity obligations (COEs); structured finance CDOs (SFCDOs), which includes CDOs of ABSs, MBSs, REITs, CDOs, etc. They include balance-sheet CDOs as well as arbitrage CDOs on both true-sale and synthetic forms.

B) CDOs Structuring Specifics

Any CDO securitization is carried out by means of a bankruptcy-remote special purpose vehicle (SPV), called the CDO vehicle, which issues asset-backed securities (the CDOs) to the institutional investors. The eligible collaterals mixture backs these CDOs, which are issued in several classes, each class being formed of several tranches, whereas each tranche is featuring different risk/reward profiles associated with the underlying assets pool. Hence, the CDO vehicle is able to shape its liabilities to comply with a broader range of risk/return investors’ profiles.

By implementing the tranching process a CDO securitization undertakes the redistribution and reallocation of the underlying portfolio’s credit risks and returns to the CDO investors. Thus, CDO vehicle’s liabilities are segregated and dispersed into various tranches, each tranche having a different credit quality and a distinct return level, realizing in this way a structural subordination within the CDO transaction. Consequently, CDOs’ debt servicing relies not only on the underlying collaterals’ diversification and credit quality, but additionally and foremost it entrusts on the transaction’s inbuilt seniority/subordination, overcollateralization and structural protection mechanisms of credit enhancement and liquidity support (either cash-flow or market-value protection and support schemes).

![Figure 1. Simplified generic CDO Securitization transaction structure](Source: Author’s representation)

Following the source of funds for principal and interest repayments principles, one can divide the credit and liquidity quality of CDOs based on either cash-flow structure or market-value structure. Thus, in case of a market-value CDO structure, the protection mechanisms’ quality derives from transaction’s ability to liquidate its assets and repay...
fully and timely entire debt tranches; while in case of a cash-flow CDO structure, the quality of protection mechanisms relies on the size of subordination and the degree of overcollateralization, which must be larger enough so that the after-default cash-flows of the underlying assets to fully cover all debt tranches.

Therefore, the most important structural features of a CDO securitization could be summarized as: (a) securitization technique (true-sale or synthetic); (b) source of funds for principal and interest repayments (cash-flow or market-value); (c) funding technology (cash based or credit derivatives based); (d) collaterals management style (actively managed or passively managed); (e) transaction’s cash-flow and loss allocation system (CDO securitization waterfall); (f) transaction’s credit and liquidity enhancements; (g) transaction’s degree of seniority/subordination, overcollateralization, reserve accounts, excess spreads; (h) transaction’s hedging mechanisms (credit, currency, interest-rate hedging).

The CDO structuring process generates a multiple set of asset-backed securities, called tranches, each of them having different exposures to underlying assets’ risks, different credit ratings, different payment seniorities and different rates of return.

Generally, a CDO structure comprises of (super) senior tranches, mezzanine tranches, subordinated tranches and equity tranches. The waterfall structure rules that the equity tranche (usually unrated) represents the first-loss position and it is the first to absorb losses in the CDO structure. If losses exceed the value of the equity tranche, they are absorbed by the subordinated (non-investment-grade credit rating) and mezzanine tranches (investment-grade credit rating). Finally, the (super) senior tranches (highest credit rating) are the last to be affected by any losses and only in the case that such losses have not been absorbed entirely by the other lower-level tranches. Nevertheless, the waterfall structure stipulates as well the rates of return for each of these tranches, which is opposed to their credit standing: equity tranches carry the highest returns, subordinated tranches and mezzanine tranches lower yields than equity tranche and the (super) senior tranches are compensated with the lowest returns in the CDO structure.

The cash-flows/losses allocation of a CDO securitization is based on a sequential distribution scheme (the waterfall principle) depending on the seniority of tranches within the capital structure of the CDO structure. The payments (both repayment of the principal and payment of the interest) are prioritized firstly to the highest tranches (highest credit rating and lowest returns), with the remaining to be paid out to tranches located progressively lower in the CDO transaction hierarchy (lower credit rating but higher returns). Hence, this subordination of the CDO structure allows, on the one hand, the investors to select the level of exposure that fits better to their risk/reward profiles/appetites and, on the other hand, the issuance of asset-backed securities with different coupons reflecting the various levels of seniorities, risks and returns according to the underlying assets (reference portfolio) structuring particulars.

C) Motivations of CDO Securitization Transactions

Originators and sponsors involved in the broader CDO securitization transactions benefit of multiple key motivations, including: (a) to secure alternative cheaper sources of funding, risks transfer and refinancing; (b) to improve the overall balance sheet management; (c) to employ an effective tool for regulatory and economic capital management; (d) to enhance further the regulatory capital relief; (e) to generate additional fee income; (f) to improve the risk management by reducing the overall credit exposures or adjusting certain risk stratification particulars; (g) to free up lending capacity with respect to certain categories of borrowers or economic sectors and industries; (h) to benefit from additional capital arbitrage returns; (i) to enhance the liquidity management; (j) to access additional means to enhance the overall capital structure arbitrage; (k) to enhance the minimum regulatory capital arbitrage; (l) to make use of an efficient tool for capital ratio management; (m) to improve return on equity and return on assets ratios; (n) to attain portfolios’ risk adjusted performance; (o) to augment credit limit management; (p) to monetize illiquid on-balance sheet assets and to improve their market value; (q) to expand the volume of assets under management; (r) to raise the total valuation of a CDO issuer; (s) to increase the equity capital by means of issuing trust preferred securities; etc.

Broader CDO securitization is providing institutional investors with abundant motivations, including: (a) it provides portfolio diversification by means of multiple industries, sectors and borrowers of interest; (b) it facilitates access to different and better-quality risks adjusted returns profiles; (c) it allows the ability to tailor risk/return profiles by providing better risk/reward performances; (d) it diversifies the overall portfolio risk exposures; (e) it provides a highly versatile and comprehensive tool for portfolio investment management; (f) it upgrades the portfolio risk management; (g) it supplies investment portfolio diversification into new asset classes; (h) it delivers portfolio diversification by investing along a wider credit spectrum; (i) it supplies considerable volume and liquidity of highly rated securities that may not be available in the markets otherwise; (j) it supplies higher yields and risk-adjusted returns relative to other instruments of comparable credit quality; (k) it is offering better perspectives to achieve portfolios’ alpha returns; (l) it facilitates portfolio’s arbitrage opportunities among various asset classes; (m) it provides enhanced portfolio’s leverage; etc.

We will emphasize hereafter some CDO essentials from the repayments source of funds perspective providing a brief comparative analysis between cash-flow and market-value CDOs.

2. Cash-Flow CDO Securitizations
A cash-flow CDO securitization represents a structured finance undertaking of pooling and repackaging a diversified pool of underlying assets with the purpose of redistributing their associated risk/return profiles into multiple classes and tranches of CDO securities issued and placed with the institutional investors by means of capital markets operations. The risk/return profiles of the asset-backed securities are entirely constructed based on the cash-flows generated by the underlying assets pool.

Hence, the structuring process of the cash-flow CDOs is managed so that all classes and tranches of the issued CDOs are fully able to pay off their entire liabilities-side obligations on the back of interest and principal payments (income and asset appreciation) generated inherently by the assets-side collateral (i.e. underlying assets pool). Any cash-flow CDO securitization spans over three main periods: (a) the ramp-up period of assembling transaction’s portfolio; (b) the reinvestment period when principal proceeds are reinvested into new collaterals; (c) the winding-up period (once the collateral pool matures) when operations are terminated and entire debt obligations are fully reimbursed to CDO investors (according to transaction’s waterfall rules), where the payout represents transaction’s total rate of return computed as a sum of income payments and collaterals’ market price at the maturity.

Cash-flow CDOs are mostly actively managed transactions, where the asset (CDO) manager has a broad discretion to purchase, sell and trade the transaction’s collateral, whereas the underlying assets may be static or dynamic (revolving) in nature. Consequently, the main focus of a cash-flow CDO manager is to manage the credit quality of the underlying assets portfolio and he has only a residual focus on the management of the volatility of collateral’s market-value.

From initiator’s motivation (aim of transaction) perspective, cash-flow CDO securitizations can be broken down into balance-sheet CDO deals (which are motivated by balance-sheets management optimization and regulatory/economic capital relief issues) and arbitrage CDO transactions (which seeks to capture the excess spread between the higher-yielding assets and the lower-yielding liabilities of the CDO structure).
Concerning the securitization technique employed in the cash-flow CDO transactions they can be divided into true-sale CDOs (the underlying assets and their associated risks are transferred to the SPV by means of a legally sell process) and synthetic CDOs (underlying assets’ associated risks are synthetically transferred to the SPV by means of credit derivatives). Furthermore, based on the funding technology (liabilities distribution) employed the cash-flow CDOs can be classified as cash-based CDOs (the transaction is based on the true-sale securitization principles of risk transfers and funding) and synthetic-based CDOs (the transaction is based on the credit derivatives securitization principles of risk transfers and funding, which can be further divided into fully-funded, partially-funded and fully-unfunded synthetic CDOs).

Originators and sponsors involved in cash-flow balance-sheet CDO securitization transactions benefit of multiple key motivations additional to those specific to generic CDOs, including: (a) to achieve off-balance sheet treatment; (b) to enhance the liquidity management and assets valuation; (c) to improve return on equity, return on assets, return on economic/regulatory capital, risk-adjusted return on capital ratios; (d) to augment capital credit management, capital capacity and financial flexibility; (e) to allow access to new investors base; (f) to improve asset-liability management by means of a new alternative for asset/liability divestitures; (g) to improve the balance-sheet management in terms of exposures, concentration, diversification, credit spread, capital cost, balance-sheet reduction; etc.

Originators and sponsors involved in cash-flow arbitrage CDO securitization transactions benefit of multiple key motivations additional to those specific to generic CDOs, including: (a) to provide access to trade the arbitrage spread opportunities; (b) to earn the spread between return on the invested assets and the costs of the CDO transaction; (c) to exploit yield mismatches and differences in funding costs between assets and liabilities; (d) to achieve funding through the issuance of debt securities and equity; (e) to improve return on assets ratio; etc. Cash-flow arbitrage CDO securitization is providing institutional investors with plentiful motivations additional to those specific to generic CDOs, including: (a) it delivers portfolio diversification through investments on a broader credit spectrum and long terms to maturity; (b) it provides exposures to the high-yield market via credit rated instruments; (c) it achieves a leveraged return between yield on assets and the financing cost of transaction; (d) it provides investment strategies in opportunistic arbitrage-based products; (e) it monetizes the diversification benefits of uncorrelated assets classes; (f) it achieves higher returns for investments in the same level of credit rated securities; etc.

Originators and sponsors involved in cash-flow synthetic CDO securitization transactions benefit of multiple key motivations additional to those specific to generic CDOs, including: (a) to allow the securitization of credit products (unfunded assets, guarantees, undrawn exposures, credit lines, derivative positions, loans with restrictions on assignment and transferability) that may otherwise be unsuitable for true-sale securitization or for off-balance sheet funding; (b) to allow asset managers to take both long and short views on asset classes, economic sectors/industries without removing the respective assets from the balance sheet; (c) to allow the trading of pure credit-driven views; (d) to allow the transfer of credit risks related to partial claims on a specific reference asset; (e) to exploit arbitrage opportunities between cash and synthetic products; (f) to accomplish a greater flexibility to accommodate tailor-made solutions for credit risk requirements through the use of credit derivatives; (g) to achieve lower closing costs than cash CDO securitizations; (h) to facilitate the avoidance of true sale treatments; etc. Cash-flow synthetic CDO securitization is providing institutional investors with further motivations in addition to those specific to generic CDOs, including: (a) it allows investors to take synthetically long and short positions over the market; (b) it allows investors to gain exposure to otherwise inaccessible assets classes; etc.

3. Market-Value CDO Securitizations

Like any other CDO-based transactions, a market-value CDO securitization represents a structured finance undertaking of pooling and repackaging a diversified pool of collaterals (i.e. underlying assets) with the purpose of redistributing their associated risk/return profiles into multiple classes and tranches of asset-backed securities (i.e. CDOs) issued and placed with the institutional investors by means of capital markets operations. The risk/return profiles of the CDO securities are mainly built-up based upon the market-value revenues generated by trading the underlying assets pool.

Hence, the structuring process of the market-value CDOs is managed so that all classes and tranches of the issued CDOs are fully able to pay off their entire liabilities-side obligations on the back of the cash-flows generated by means of collateral’s principal and interest, collateral’s trading proceeds and collateral’s liquidation incomes provided by the transaction’s assets-side (i.e. underlying assets pool). Any market-value CDO securitization spans over, the same, three main periods: (a) the ramp-up period of assembling transaction’s portfolio; (b) the reinvestment period when interest and principal proceeds are reinvested into new collaterals; (c) the winding-up period (once the collateral pool matures or when it is a call to liquidate the deal) when operations are terminated and entire debt obligations are fully reimbursed to CDO investors (according to transaction’s waterfall rulings), where the payout represents transaction’s total rate of return that takes into account the generated cash-flows (collateral yield), the accumulated losses (collateral credit performance) and the market-value variations (investment performance and volatility) of each collateral asset.

Since the market-value CDOs are periodically marked-to-market they go through a very extensive actively trading process by which the asset manager intends to positively exploit the perceived collaterals pricing appreciations.
and higher yielding in order to enhance CDOs total returns. The asset (CDO) manager enjoys a considerable discretion in buying, selling and trading securities, which can be static or dynamic (revolving) in nature, within the transaction’s collateral portfolio.

To achieve a higher total rate of return, the CDO manager is primarily focused on actively trading the portfolio by dynamically adapting transaction’s leverage based on adjusted collaterals’ market-value. Hence, the manager’s focal point is linked to volatilities of collaterals’ prices and liquidity levels, while managing the credit quality of the underlying assets portfolio represents a residual focus for the CDO manager.

Consequently, market-value CDO’s performance is entirely connected with the fluctuations in the market-value (i.e. pricing) of the underlying collateral assets pool and so it is highly dependent on the ability of the CDO manager to improve the market-value of the transaction’s collateral assets. Therefore, the main goal of any market-value CDO securitization is to maximize transaction’s total returns whilst minimizing the volatility of collaterals’ prices.

From initiator’s motivation (aim of transaction) perspective, market-value CDO securitizations can be broken down into balance-sheet CDO deals and arbitrage CDO transactions. Concerning the securitization technique employed in the market-value CDO transactions they can be divided into true-sale CDOs and synthetic CDOs. Moreover, based on the funding technology (liabilities distribution) employed the market-value CDOs can be classified as cash-based CDOs and synthetic-based CDOs (which can be further divided into fully-funded, partially-funded and fully-unfunded synthetic CDOs).

Figure 4. Simplified generic Market-Value Arbitrage CDO Securitization transaction structure

Source: Author’s representation

Originators and sponsors involved in market-value balance-sheet CDO securitization transactions benefit of multiple key motivations additional to those specific to generic CDOs, including: (a) to achieve off-balance sheet treatment; (b) to enhance the liquidity management and assets valuation; (c) to improve return on equity, return on assets, return on economic/regulatory capital, risk-adjusted return on capital ratios; (d) to augment credit limit management, capital capacity and financial flexibility; (e) to allow access to new investors base; (f) to improve asset-liability management by means of a new alternative for asset/liability divestitures; (g) to improve the balance-sheet management in terms of exposures, concentration, diversification, credit spread, capital cost, balance-sheet reduction; etc.

Originators and sponsors involved in market-value arbitrage CDO securitization transactions benefit of multiple key motivations additional to those specific to generic CDOs, including: (a) to provide access to trade the arbitrage spread opportunities; (b) to earn the spread between return on the invested assets and the costs of the CDO transaction; (c) to exploit yield mismatches and differences in funding costs between assets and liabilities; (d) to achieve funding through the issuance of debt securities and equity; (e) to capitalize on perceived discrepancies between the market value and the theoretical value of the risky assets; (f) to improve return on assets ratio; etc. Market-value arbitrage CDO securitization is providing institutional investors with plentiful motivations additional to those specific to generic CDOs, including: (a) it delivers portfolio diversification through investments on a broader credit spectrum and long terms to maturity; (b) it provides exposures to the high-yield market via credit rated instruments; (c) it achieves a leveraged return between yield on assets and the financing cost of transaction; (d) it provides investment
strategies in opportunistic arbitrage-based products; (e) it monetizes the diversification benefits of uncorrelated assets classes; (f) it monetizes the relative value opportunities for less liquid assets; (g) it achieves higher returns for investments in the same level of credit rated securities; etc.

Originators and sponsors involved in market-value synthetic CDO securitization transactions benefit of multiple key motivations additional to those specific to generic CDOs, including: (a) to allow the securitization of credit products (unfunded assets, guarantees, undrawn exposures, credit lines, derivative positions, loans with restrictions on assignment and transferability) that may otherwise be unsuitable for true-sale securitization or for off-balance sheet funding; (b) to allow asset managers to take both long and short views on asset classes, economic sectors/industries without removing the respective assets from the balance sheet; (c) to allow the trading of pure credit-driven views; (d) to allow the transfer of credit risks related to partial claims on a specific reference asset; (e) to exploit arbitrage opportunities between cash and synthetic products; (f) to accomplish a greater flexibility to accommodate tailor-made solutions for credit risk requirements through the use of credit derivatives; (g) to achieve lower closing costs than cash CDO securitizations; (h) to facilitate the avoidance of true sale treatments; etc. Market-value synthetic CDO securitization is providing institutional investors with further motivations in addition to those specific to generic CDOs, including: (a) it allows investors to take synthetically long and short positions over the market; (b) it allows investors to gain exposure to otherwise inaccessible assets classes; etc.


The interplay between Cash-Flow and Market-Value CDO Securitizations is inspiring for the particular opportunities that each type of transactions provides to both sponsors and investors alike. As per above details, one can note that equally cash-flow and market-value CDOs are featuring meaningful funding, refinancing, investing and risks management advantages to all transactions’ participants, however each category of CDOs is providing some particularities which can be optimally engaged following specific originators’ motivations and objectives.

We will sketch herewith further distinctive features of cash-flow vs. market-value CDOs from the practical transaction’s perspective:

Table 1. Comparison synopsis between Cash-Flow and Market-Value CDO Securitizations outlining the main attributes of Cash-Flow vs. Market-Value CDOs

<table>
<thead>
<tr>
<th>FEATURES</th>
<th>CASH-FLOW CDO SECURITIZATION</th>
<th>MARKET-VALUE CDO SECURITIZATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction objectives</td>
<td>Balance-sheet management optimization; make profit from arbitrage opportunities</td>
<td>Balance-sheet management optimization; make profit from arbitrage opportunities</td>
</tr>
<tr>
<td>Underlying assets treatment and underlying assets regime</td>
<td>Specific to transaction’s rationale: balance sheet management vs. arbitrage opportunities; true-sale vs. synthetic transaction; etc</td>
<td>Specific to transaction’s rationale: balance sheet management vs. arbitrage opportunities; true-sale vs. synthetic transaction; etc</td>
</tr>
<tr>
<td>Source of performance and profits generator</td>
<td>Collateral’s interest and principal payments; collaterals’ market price at the maturity</td>
<td>Collateral’s yields; collateral’s credit performance; collateral’s pricing performance and volatility</td>
</tr>
<tr>
<td>Carrying out transaction objectives</td>
<td>Specific to transaction’s rationale: originator can act as seller of the on-balance sheet assets, as protection buyer for the on-balance sheet assets or as buyer of collaterals sourced from third parties</td>
<td>Specific to transaction’s rationale: originator can act as seller of the on-balance sheet assets, as protection buyer for the on-balance sheet assets or as buyer of collaterals sourced from third parties</td>
</tr>
<tr>
<td>Aim of transaction</td>
<td>Cash-flow based source of funds rationale</td>
<td>Market-value based source of funds rationale</td>
</tr>
<tr>
<td>Securitization technique</td>
<td>True-sale; synthetic</td>
<td>True-sale; synthetic</td>
</tr>
<tr>
<td>Funding technology (liabilities distribution)</td>
<td>Cash-based (true-sale); synthetic (credit derivatives)</td>
<td>Cash-based (true-sale); synthetic (credit derivatives)</td>
</tr>
<tr>
<td>Collaterals management style</td>
<td>Often actively managed, but also passively managed</td>
<td>Broadly actively managed</td>
</tr>
</tbody>
</table>

Source: Author’s representation

5. Conclusions

Both cash-flow and market-value CDO securitizations constitute the most efficient secured funding and investment alternatives available to asset managers, banking and financial institutions in the global capital markets. The ability to raise more stable medium and long-term funding at very competitive terms, to access a broader pool of global investors, to increase the supply of liquidity to financial institutions, to diversify anyone investment portfolios and to enhance the risk-adjusted returns of assets portfolios are the main advantages to sponsors, originators and investors involved in asset-backed securities programs.
In order to capture all the benefits emerging from cash-flow and market-value CDO securitizations, financial institutions should run in parallel, simultaneously both types of CDO securitization programs since they are complementing all together, allowing originators and investors to effectively manage the investments, fundraising and risks management aspects by optimally interconnecting local asset markets with global financial and capital markets.

**References**

[16] European Central Bank, (2008), The Incentive Structure of the Originate and Distribute Model, European Central Bank
[22] KPMG, (2009), New Trends in CDO Securitisation, KPMG
[27] Standard & Poor’s Structured Finance, (2001), Cash Flow CDOs: Continued Growth, Standard & Poor’s Structured Finance