

## Conclusion

**T**he best financial modelers understand both technical methodologies and business concepts. One without the other produces an Excel expert or a standard financial analyst. An experienced financial modeler can deconstruct a business concept and transfer the idea into an application or programming code that runs accurately, efficiently, and transparently. The same financial modeler understands how changing assumptions impact the transaction and the implications such adjustments have on the performance of the deal.

So far this text has attempted to achieve both technical and conceptual understanding for structured finance. A model has been constructed in a step-by-step technical manner with business-related theories explained along the way. A section has been dedicated to understanding the model's mechanics, outputs, and the ensuing business interpretations. The only part that lacks discussion is the higher level view—about how professionals in different industries look at the model differently and garner information relevant to their position.

### **THE INVESTMENT BANKER'S PERSPECTIVE**

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As some reader's may have noticed, this book is written with a slight bias towards investment banks. Often bankers are the people who construct a transaction model, which is used by most parties involved in a deal. For this reason, a strong focus is put on the bank's perceived risks and protecting against them. Even among banks this risk differs depending on who ends up owning the assets and how the debt is funded.

If the bank is retaining the risk by funding the deal on its balance sheet or through a conduit, then the modeling of the retained debt will be the focus of the bank's analysis. For most sensitivity scenarios, the bank is primarily concerned with a risk rating derived from expected loss and the expectation of loss in general.

However, if the bank is selling the debt into the capital markets, then a greater focus of the modeling will involve debt yield, duration, weighted average life, decrement calculations, and other metrics that investors look for when purchasing

securities. A bank selling a transaction into the capital markets is also concerned with loss because no bank wants to have its name associated with a failed transaction.

Overall, since bankers deal with all parties in a transaction, they are concerned with every part of the model. The issuer may change the asset composition or criteria, which would need to be immediately updated in the model to generate accurate cash flows. Investors might demand certain protections that change the waterfall. A surety might be brought in to wrap the transaction, which affects the liability structure. Or a rating agency might ask for certain scenarios that stress the asset and liability assumptions. All of these situations can be handled with the model framework laid out in this book.

## **THE INVESTOR'S PERSPECTIVE**

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For the most part, the investor and the bank have aligned interests. Structured transactions are even designed in such a way to align those interests. An investor is concerned about loss to exposure, which can be any level of debt from senior to subordinated. Investors also have timing in mind because many are trying to purchase assets that fit a specific profile that depends on yield, risk rating, and duration.

With such concerns, the investor will want to verify loss and prepayment expectations, interest rate environments, and principal allocation structures. If a deal begins to melt down, the investor also needs to know how much the deal can expect to make or lose and how long it will take to get to such a result. The investor primarily examines the liability side of a model to gather information relevant to their decision.

## **THE ISSUER'S PERSPECTIVE**

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Similar to bankers, issuers have a very complex role in structured transactions. Issuers are more familiar with the asset side because it is an integral part of their business. In the early stage of a transaction, the issuer spends a large amount of time examining which assets to include in the transaction pool. Building the pool requires constant analysis of the pool characteristics as loans are added or taken away. Ultimately, the issuer wants to create a pool that will sustain the transaction over time.

At the same time, the issuer wants to get the best funding rate possible. This means that certain risk ratings are desired, which can be achieved by varying amounts of credit enhancement. Beside the asset pool, issuers need to completely understand the liability waterfall, forms of credit enhancement, and the affects of varying assumptions. Only then can they know if they are getting the best possible arrangement.

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## **THE FINANCIAL GUARANTOR'S PERSPECTIVE**

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A market participant that is also concerned with structured finance modeling is a financial guarantor. This could be a monoline insurance company—or a government entity offering a debt wrap or credit guarantee. Since both of these entities offer pledges to pay interest and principal, they are both highly concerned about cash flow and stress scenarios.

A financial guarantor would want to run extreme cases to see if the transaction withstands a certain risk threshold. It would want to know which scenarios cause loss and the probability of such scenarios. This requires a thorough understanding of the assets and their expected performance. Also, importance would be placed on the guarantor's place in the waterfall in respect to what is wrapped and where reimbursements are allocated.

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## **THE BIG PICTURE PERSPECTIVE**

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No matter what role or interest a person has in a structured finance model, he or she should never lose sight of what is trying to be analyzed. What might have worked for one transaction may no longer apply for a new transaction, even though they may at first appear similar. Every time a transaction needs modeling the person responsible should determine what needs to be measured and the best method of getting to the correct result. This could be as simple as copying an old model and changing a few assumptions or as complex as building a new one entirely from scratch.

Experienced modelers slowly build a set of models from which they can take pieces to quickly construct new and unique models. The basic model created in Project Model Builder, for example, can easily be adapted to a project finance model by changing how the cash flows are generated. Imagine that a toll road was being financed through senior and subordinate debt. The only difference then would be to change the asset side of the model so cash flows are produced off of traffic estimates and specialized consultant data.

Also, the example model created in this text is somewhat rudimentary. More powerful models have the ability to generate cash from multiple representative lines or unlimited loans. Asset-specific models go into details that are pertinent to industries such as mortgages, autos, leases, and so on. All of these advanced additions require industry-specific knowledge and analytical standards knowledge.

As modeling experience grows, the challenge is to prevent tunnel vision based on past successes. New asset and esoteric classes that are developing in the structured finance industry require modelers to be open to new techniques and different approaches. The measure of this book's success is its ability to teach a person a technical skill while simultaneously developing business understanding. The ultimate objective is to ascertain those skills and take the next step to develop new and more powerful models.