

Bistro Trust Case

Each group should hand in one copy (typed) of your analysis; please put the group's name on the write-up, as well as each team member's name. Each team member should also bring their own copy of the write up to class, as well as the case itself, so that we can refer to the specifics in our discussion. If your group does not write up the case, you are still responsible for being prepared and ready to discuss the case in class!

Below you will find a set of questions to guide your analysis. You should address all of these questions in your analysis of the case. 8-page limit!

Questions to guide your write up

1. What is the problem facing John Averse and BankUS?
2. Why is BankUS trying to remove its credit exposure to large, stable, and largely investment grade rated companies? How would the removal of these credits affect the average risk of credit that remains with BankUS?
3. Describe the structure of the CLO alternatives and the credit derivative alternative. How does the CLO help BankUS achieve its objective? How does the credit derivative option achieve their objective? What are the advantages and disadvantages of each from BankUS's perspective? (You can skip the third CLO option.) Which option would you recommend if you were John Averse (think in terms of the risks and rewards of the options)?

Note that there is an *inconsistency* in the case in the second CLO option. In the text (page 6), it says that under the second scenario the SPV would sell the \$32 million residual tranche to the capital markets, whereas in Exhibit 14 it says that BankUS would retain the residual tranche. Assume that the structure described in Exhibit 14 is the correct one. (Why is it unlikely that BankUS would try to sell the residual tranche?)

4. How would you, as a bank regulator, view BankUS's use of the CLO option versus the credit derivative option? How much risk is actually removed under the two alternatives? Would you grant BankUS capital relief under either option (or both)? How about the rating agencies? Will their views of these transactions differ from those of the bank regulators?