



# Derivatives & Collateralized Loan Obligations for UK Rail

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# Overview of Derivatives

- Something that comes from another, taken from something preceding,
- Portfolio management tool
- Individual transaction structuring technique

# Defining Derivatives

- Options and Equivalents
  - **Puts**: an elective contract to **sell** an asset
    - Provides down side protection
      - Residual Value Insurance
  - **Calls**: an elective contract to **purchase** an asset
    - Provides upside potential
      - Residual Sharing Agreements
      - **Residual Investment Certificate (RIC)**

# Defining Derivatives

- Forward Sales or Purchase Agreements
  - Purchase and Sales of Residuals - current commitment to buy or sell in the future

# Derivative Applications

- Objective is to achieve an economic outcome via an alternative to a less attractive but common solution – usually the outright sale
- Example: desire to eliminate a residual position without selling the asset today
- How to use derivatives to solve this need
- Two possible solutions

# Solutions Using Derivatives

- Options Approach
  - Sell a call on the asset at a future price, the equivalent of the booked residual, aka the strike price. Collect a premium today.
  - Purchase a put on the asset today at a future price, the equivalent of the booked residual. Pay a premium today.
- Forward Sale: Agreement is made to transfer asset at a fixed price in the future.

# Transportation Asset Derivatives Marketplace

- A Mature - underdeveloped market
- US Experience
  - 1970's residual sharing agreements (RSAs)
  - Residual value insurance develops
  - 1980's Lessee EBO's and FPO's granted
  - Lessor to Lessor market for calls, puts, and forward contracts
  - 1990's all of the above sans RSAs

# Tax and Accounting Matters

- Options Premium's Paid
  - Call Option or RIC
  - Put Option or RVI
- Options Premium's Earned
  - Call Option or RIC
  - Put Option or RVI
- Forward Sales ( or Purchase)

# Future for Derivatives

- Improves market understanding
- Hedging knowledge and pricing techniques
  - may be cloned from other derivative markets
- Information problems
  - asset sales time series
  - comparative option price data