Appendix A:

Term Sheets for High-Risk Complex Financial Instruments

Financial institutions must use term sheets when marketing high-risk complex financial instruments. As this is often the first document reviewed by an investor/counterparty, it is essential that a term sheet convey significant terms and critical information clearly. The Policy Group recommends that term sheets be used when marketing high-risk complex financial instruments, whether in the form of a security, a derivative or other instrument, and that any such term sheets include the following categories of information, where applicable:

- A brief overview of the issuer and its capital structure, including a description of all liabilities to be offered. For each liability, the term sheet should include at least the expected notional, coupon, rating, relative seniority, average life (with underlying assumptions noted) and final legal maturity. For derivatives, the term sheet should identify the swap counterparty and credit support provider, if there is one.

- Identity of the collateral or asset manager, if any.

- Significant characteristics of the expected portfolio, including information regarding expected spread, ratings, geography, industry, asset class, correlation and any minimum or maximum parameters, as well as the significant terms of any hedges (e.g., interest rate, currency), expected to be purchased by the issuer.

- Significant terms, including major service providers (e.g., trustees, swap counterparties, guarantors), denominations, currency, exchange listing (if any), call periods, payment dates, pricing and closing dates, reinvestment periods, call periods, PIK provisions, defaulted asset provisions, termination provisions, make-whole payments, quality and coverage tests, the ramifications of failing applicable tests, substitution/reinvestment/management parameters, payment events (e.g., credit events, floating amount events), voting rights and payment...
waterfall terms. Where possible, information should be displayed graphically (e.g., the waterfall may be displayed as a flow chart, rating diversity may be displayed in a pie chart, etc.). Expected or current levels of quality and/or coverage tests should also be displayed against trigger levels.

- Scenario analysis that includes a breakeven analysis for debt and an IRR (or similar) analysis for equity tranches. The analysis should be done over a range of assumptions, including severe downside stress scenarios. Scenario analysis should also include an analysis of what assumptions would result in a significant percentage loss (e.g., 50%) of principal or notional. All implicit and explicit assumptions should be clearly indicated and calculation methodologies should be explained. Significant assumptions should be stress-tested with the results plainly disclosed.

- Investor eligibility requirements (e.g., QIB/QP, Reg. S, ERISA) and expected tax treatment.

- Appropriate risk factors, including risks associated with the instrument structure, leverage, market (interest rate, currency, credit) risks, hedging (if any) effectiveness, counterparty risks, and conflicts of interests with service providers (e.g., multiple roles).

- Appropriate disclaimers.