

**ILLINOIS COMMERCE COMMISSION
DOCKET NO. 06-0448**

**DIRECT TESTIMONY
OF
CURTIS PROBST**

**Submitted On Behalf
Of
AMEREN ILLINOIS UTILITIES**

August 17, 2006

1 **ILLINOIS COMMERCE COMMISSION**

2
3 **Docket No. 06-0448**

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5 **DIRECT TESTIMONY**

6 **OF**

7 **CURTIS PROBST**

8
9 **I. INTRODUCTION**

10 **Q. Please state your name, position and business address.**

11 A. My name is Curtis Probst. I am a Vice President and Head of the Asset-Backed
12 Securities (ABS) Finance Group of Goldman, Sachs & Co. (Goldman Sachs). My
13 business address is 85 Broad Street, New York, NY 10004.

14 **Q. On whose behalf are you testifying?**

15 A. I am testifying on behalf of Central Illinois Light Company d/b/a AmerenCILCO,
16 Central Illinois Public Service Company d/b/a AmerenCIPS and Illinois Power
17 Company d/b/a AmerenIP (collectively, the “Ameren Illinois Utilities”).

18 **Q. What is the purpose of your testimony?**

19 A. The purpose of my testimony is to: (i) give a brief overview of the asset-backed
20 securities market, (ii) explain certain significant factors regarding the structuring and
21 pricing of the securitization bonds at issue here (the Rate Mitigation Bonds), (iii)
22 summarize the pricing and closing process for the Rate Mitigation Bonds, and (iv)
23 discuss the elements critical to obtaining the highest feasible credit rating (and the

24 relationship between obtaining the highest credit rating and achieving the lowest cost)
25 for the Ameren Illinois Utilities' proposed issuance of Rate Mitigation Bonds.

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27 II. THE ASSET-BACKED SECURITIES (ABS) MARKET

28 **Q. Please describe asset-backed securities in general.**

29 A. ABS are financial instruments that are secured by and payable from the ongoing cash
30 flow stream associated with an identifiable asset or pool of assets. In the case of the
31 Rate Mitigation Bonds, the identifiable asset is the bondable property (the Bondable
32 Property), primarily the right to receive cash flows generated from the billing and
33 collection of a bond charge. Collections of the bond charge constitute the source of
34 cash flow that is used to pay the principal and interest on, and other costs of, the Rate
35 Mitigation Bonds. In most ABS transactions (also generally referred to as a type of
36 securitization), the cash flows underlying the transaction are "bankruptcy-remote"
37 from the entity from which the cash flows are obtained (in the case of the Rate
38 Mitigation Bonds, each of the Ameren Illinois Utilities). The ownership of the asset,
39 the Bondable Property in this case, as well as the risks and rewards associated with it,
40 is normally sold to one or more special purpose entities (each, an SPE) that is
41 insulated from the bankruptcy and credit risks of the seller, as described below. In
42 the case of the Rate Mitigation Bonds, the sellers are each of the Ameren Illinois
43 Utilities.

44 As a result of the combination of an earmarked source for an identifiable cash
45 flow and remoteness from the seller's credit and bankruptcy risks, asset-backed
46 securities are generally perceived to have low risk and may receive a higher credit

47 rating than debt securities issued by the seller. This often results in a lower financing
48 cost for the securitization as compared to conventional financing alternatives.

49 ABS are relatively common instruments in the fixed income markets, and in
50 2005, U.S. public ABS issuance exceeded \$700 billion¹ (including securities backed
51 by auto loans, credit card receivables, student loans, and other asset types).

52 **Q. What are rate mitigation bonds?**

53 A. Bonds like the Rate Mitigation Bonds are asset-backed securities that are backed by
54 non-bypassable charges on customers' electric bills and initially were supported by,
55 among other things, enabling state legislation. The Rate Mitigation Bonds at issue
56 here are expected to be supported by new enabling state legislation that provides for
57 deferral of certain power procurement costs and the recovery of those deferred costs
58 through the issuance of Rate Mitigation Bonds. Rate Mitigation Bonds, as described
59 above, have been issued in connection with industry restructurings and for other
60 purposes under various names, including transition bonds, in a number of states. I
61 generically refer to them as Rate Mitigation Bonds in this testimony.

62 **Q. Please summarize the rate mitigation bond offerings completed to date.**

63 A. To date, over \$36 billion of Rate Mitigation Bonds have been issued on behalf of
64 numerous investor-owned utilities in different states including California,
65 Connecticut, Illinois, Massachusetts, Michigan, New Hampshire, New Jersey,
66 Pennsylvania and Texas.

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¹ Source: Asset-Backed Alert. January 13, 2006.

68 III. THE STRUCTURING AND PRICING OF RATE MITIGATION BONDS

69 **Q. What are the primary factors relative to the structuring and pricing of rate**
70 **mitigation bonds that may impact the level of bond charges?**

71 A. Those factors include the interest rate on the Rate Mitigation Bonds, the timing of
72 principal repayment for the Rate Mitigation Bonds and the transaction costs,
73 including credit enhancement, associated with issuing, supporting and servicing the
74 Rate Mitigation Bonds. This portion of my testimony discusses ~~generally~~ the major
75 parameters that generally impact determination of an interest rate for a bond. Factors
76 associated with the costs of credit enhancement are discussed elsewhere in my
77 testimony.

78
79 A. Interest Rate on Rate Mitigation Bonds

80 **Q. What parameters determine the interest rate for a bond?**

81 A. There are several parameters that typically impact determination of the interest rate
82 for any bond. These parameters include perceived credit risk, timing of principal
83 repayment, type of interest (fixed-rate or floating-rate), perceived liquidity and
84 market conditions.

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86 B. Credit Risk

87 **Q. How does the market evaluate credit risk?**

88 A. The most widely accepted measure of a bond's credit risk is its credit rating. The
89 highest long-term credit rating available is a triple-A rating, which signifies the
90 lowest degree of credit risk. All other things being equal, obtaining a triple-A credit

91 rating (through mitigating credit risks to the greatest extent possible) should lead to a
92 bond pricing at a lower interest rate than if a lower credit rating were obtained.

93 **Q. Are all triple-A rated bonds priced at the same interest rate?**

94 A. No. As mentioned previously, various other factors including the timing of principal
95 repayment, type of interest, perceived liquidity and market conditions may also
96 impact pricing. Additionally, credit ratings are, by their nature, broad categories to
97 describe a bond's relative credit risk, and the market may perceive varying degrees of
98 credit risk within a given rating category.

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100 **Q. Will structuring rate mitigation bonds to a triple-A rating result in the lowest**
101 **bond charge?**

102 A. Generally, yes. However, it is important that the benefits of a lower interest rate from
103 obtaining a triple-A credit rating offset the costs of obtaining that triple-A credit
104 rating (i.e., the costs associated with credit enhancement). Typical credit
105 enhancement provisions for bonds of this type, and the process for obtaining a credit
106 rating more generally, are summarized elsewhere in this testimony. In general,
107 because of the statutory and regulatory provisions supporting Rate Mitigation Bonds,
108 credit enhancement (e.g., the Capital Subaccount, as described elsewhere herein)
109 ~~generally~~normally entails minimal out-of-pocket expense. So long as the rating
110 agencies continue to rely primarily on these statutory and regulatory protections in
111 assigning a credit rating to Rate Mitigation Bonds, I would expect the lowest interest
112 cost for the Ameren Illinois Utilities' Rate Mitigation Bonds to be achieved through
113 obtaining a triple A rating, all else equal.

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C. Timing of Principal Repayment

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Q. Generally, how is principal on the rate mitigation bonds repaid?

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A. Because the source of repayment in this instance is a charge on customers' electric bills, collections are expected to be made over time in an amount sufficient to make periodic payments of interest, principal and other ongoing costs of the Rate Mitigation Bonds on specified payment dates (e.g., semi-annually). This is different from typical utility debt, where principal is generally repaid in a single payment on a given date (although interest is normally paid at regular intervals (e.g., semi-annually) ~~through~~^{up} to and including the principal repayment date).

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Q. Are other measures of the timing of principal repayment relevant to the structuring and pricing of the rate mitigation bonds?

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A. Yes. One such measure is the expected "weighted average life" of a security, which represents the expected average time to repay principal. For a bond with a given

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137 maturity, if proportionally more principal is repaid in the later years, the weighted
138 average life will generally be longer. If proportionally more principal is repaid in the
139 earlier years, the weighted average life will generally be shorter. Rate Mitigation
140 Bonds, like most other ABS, are normally priced relative to a benchmark security
141 with a maturity date comparable to the weighted average life of the Rate Mitigation
142 Bonds. It is possible for a given offering of ABS to consist of multiple classes (or
143 tranches), each of which may be priced relative to a different benchmark depending
144 upon the weighted average life of each class.

145 **Q. Does the timing of principal repayment for the rate mitigation bonds affect the**
146 **level of the bond charge?**

147 A. Yes, to the extent that any Rate Mitigation Bond offering, in aggregate, has a shorter
148 expected final maturity date, relatively more of the principal will have to be repaid in
149 a given year on average. To the extent that a Rate Mitigation Bond offering has a
150 longer maturity, relatively less of the principal will have to be repaid in a given year
151 on average. Therefore, all other things being equal, a longer maturity will typically
152 result in smaller periodic principal payments and, therefore, a lower periodic bond
153 charge, although customers will likely be obligated to pay the bond charge for a
154 longer period of time as compared to an offering with a shorter maturity.

155 **Q. What is an optional redemption feature?**

156 A. An optional redemption feature allows the issuer of Rate Mitigation Bonds, at its
157 discretion, to redeem all or a portion of the Rate Mitigation Bonds on or after a
158 specified date prior to their repayment in full. Generally, Rate Mitigation Bonds have
159 contained a limited optional redemption feature referred to as a “clean-up call,” which

160 is customary for many asset-backed securities. The clean-up call allows the issuer to
161 redeem all outstanding bonds if the aggregate principal balance outstanding falls
162 below a specified percentage of the aggregate initial principal balance, which has
163 been 5% for previous Rate Mitigation Bond transactions.

164 **Q. Should the presence of a clean-up call impact the financing cost of the rate**
165 **mitigation bonds?**

166 A. No. Based upon current market conditions, a clean-up call should not impact the
167 financing cost of the bonds because of the limited range of circumstances under
168 which it applies.

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170 D. Type of Interest

171 **Q. Have fixed and floating interest rates been used in issuances of rate mitigation**
172 **bonds?**

173 A. Most Rate Mitigation Bonds have been issued with a fixed-rate of interest. Where
174 floating-rate Rate Mitigation Bonds have been issued, in order to eliminate the
175 potential volatility in the bond charge created by issuing floating-rate bonds, any
176 floating-rate Rate Mitigation Bond offering would normally need to include an
177 interest rate hedging arrangement.

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179 E. Liquidity of the Rate Mitigation Bonds

180 **Q. What do you mean by liquidity?**

181 A. Investors prefer (i.e., may accept a lower interest rate) to own securities that they can
182 readily sell or “liquidate” in the secondary market at a reasonable price. Securities

183 which are issued in a large aggregate principal amount will generally tend to have
184 greater liquidity because there should normally exist: (a) many other owners of the
185 same security, (b) a greater level of information about the security in the marketplace,
186 and (c) a more active secondary market for the buying and selling of such securities.

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188 F. Market Conditions and Marketing Process

189 **Q. Do market conditions play a large role in the pricing of bonds?**

190 A. Yes. Factors such as the general level of interest rates and expectations for future
191 interest rates (which may be impacted by macro-economic or political factors), the
192 existing and anticipated supply of other debt securities, and the existing and
193 anticipated demand for other debt securities may impact the price and interest rate of
194 a bond.

195 **Q. What sort of marketing is typically conducted by the underwriters?**

196 A. There are several components of the marketing process leading up to the pricing of
197 the bonds.

198 Each underwriter will typically contact members of its sales force to inform
199 them as to the specific terms of a given offering. Representatives of each underwriter
200 (including members of its sales force and individuals responsible for structuring Rate
201 Mitigation Bonds) will attempt to contact likely potential investors to inform them
202 about the specific transaction. Likely potential investors of the security will receive a
203 preliminary prospectus (a document filed with the [SEC Securities and Exchange](#)
204 [Commission \(“SEC\)](#) for the marketing of securities, or a similar document in the case
205 of a transaction that is not registered with the SEC). The underwriters (joined by

206 representatives of the issuer or its affiliates) may conduct meetings with potential
207 investors, or may make recorded presentations available over the Internet. The
208 purpose of these elements of the marketing process is to increase investor awareness
209 of the offering, so as to potentially increase the size and number of investor orders for
210 the securities.

211 The lead underwriter and issuer will later establish informal pricing
212 benchmarks for securities and investors will generally provide indications of interest
213 for the securities at the pricing levels. This is usually an evolving process as broad
214 parameters for the pricing of the securities may be established initially and, later, may
215 be refined based upon market conditions and investor feedback.

216 During this process, the underwriters will continue to receive feedback from
217 investors which will assist them in making several determinations for the offering
218 such as the maturity characteristics of the bonds. Upon finalizing the characteristics
219 of the bonds, the underwriters will formally launch the transaction and begin
220 accepting orders from investors for a given amount of bonds they are willing to
221 purchase at certain prices and interest rates. Based upon the final demand, the price
222 and interest rate will be finalized.

223 As part of this process, there are also decisions relating to the specific timing
224 of the marketing and the pricing of the bonds. For example, underwriters may
225 accelerate or delay offerings to avoid known competing supply in the marketplace or
226 anticipated announcements relating to economic news or performance (e.g.,
227 announcement of unemployment figures or actions by the Federal Reserve Bank).

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229 IV. THE PRICING AND CLOSING PROCESS FOR RATE MITIGATION BONDS

230 **Q. When are the rate mitigation bonds priced?**

231 A. The Rate Mitigation Bonds are priced (i.e., the [issue size](#), price and the interest rate
232 are determined) after the marketing process described in the previous section of my
233 testimony.

234 **Q. When the bonds are priced, does the issuer receive funds immediately?**

235 A. No. The actual sale of bonds by the issuer and receipt of net proceeds from the
236 underwriters (commonly referred to as the “closing” of a transaction) occurs a few
237 business days after the pricing of the transaction. Typically, Rate Mitigation Bond
238 transactions close approximately five business days after pricing, although this period
239 may be slightly longer to accommodate holiday periods or other circumstances.

240 **Q. Are there any conditions to closing?**

241 A. Yes. The issuer and the entity acting as seller and initial Servicer must make several
242 representations and warranties. One important condition is that all approvals to
243 undertake the proposed transaction have been obtained, including regulatory
244 approvals relating to the Bondable Property, the bond charge and the Rate Mitigation
245 Bonds. To the extent that such approvals are not obtained, the transaction will not
246 normally close (i.e., no bonds will be sold and no proceeds received). It is very
247 unusual for transactions not to close on time, and any failure to close could require a
248 re-marketing of the transaction at additional expense, including a possible increase in
249 interest cost due to the perceived uncertainty or risk [\(or increased cost due to changes](#)
250 [in market conditions\)](#).

251 There are also certain events that excuse underwriters and investors from their
252 commitments to purchase the securities. These would typically include events such
253 as material adverse changes in the issuer's financial condition and significant adverse
254 developments in the financial markets.

255 V. THE CREDIT RATING PROCESS FOR RATE MITIGATION BONDS

256 **Q. What characteristics of rate mitigation bonds do you expect the rating agencies**
257 **to consider important in establishing the credit rating of the Ameren Illinois**
258 **Utilities' proposed issuance of rate mitigation bonds?**

259 A. I expect that the rating agencies will, among other things, consider the following
260 characteristics of the Rate Mitigation Bonds: (i) bankruptcy-remoteness from the
261 seller; (ii) servicing standards; (iii) predictability and non-bypassability of the bond
262 charge; (iv) standards governing an alternative retail electric supplier (~~an~~ ARES); (v)
263 credit enhancement; and (vi) the State Pledge and other statutory safeguards.

264 **Q. On the first characteristic, please describe the importance of protecting investors**
265 **from the risk of the seller's bankruptcy.**

266 A. An important component of asset-backed securities is that the asset underlying the
267 securities (i.e., the Bondable Property) be "bankruptcy-remote" from the seller of the
268 Bondable Property (each of the Ameren Illinois Utilities, in the case of these Rate
269 Mitigation Bonds). Specifically, an asset-backed security is secured by, and payable
270 from, a cash flow stream associated with an identifiable asset, with the cash flow
271 stream expected to be sufficient to pay debt service and related costs. The ownership
272 of that asset should be transferred to a limited purpose entity, such as a limited
273 liability company, trust or special-purpose corporation, which is insulated from the

274 bankruptcy and credit risks of the seller (thereby making it possible for the Rate
275 Mitigation Bonds to achieve a higher credit rating than the seller's debt). These are
276 collectively referred to as special purpose entities ("SPEs").

277 **Q. What policies do you recommend to ensure that the SPE continues to receive its**
278 **revenues in the event of a default in payment by a servicer?**

279 A. The Illinois Commerce Commission ("ICC") should permit the SPE or the trustees or
280 representatives of the holders of Rate Mitigation Bonds, in the event of a default by
281 the seller in its servicing responsibilities, to appoint immediately a successor Servicer
282 for the Bondable Property. Such successor Servicer would promptly assume billing
283 and collecting responsibilities for the bond charge and assume all other rights and
284 obligations as though it were the Servicer at the time such Rate Mitigation Bonds
285 were issued. This should provide greater certainty that the bond charge will benefit
286 the owner of the Bondable Property, and should serve to enhance the credit quality of
287 Rate Mitigation Bonds.

288 **Q. On the second characteristic, please describe the importance of maintaining**
289 **servicing standards for the servicer.**

290 A. Rating agencies have established criteria that govern the amount of time a Servicer
291 can commingle collections from assets it services (e.g., bond charge collections) with
292 its own funds. The purpose for these criteria is to limit the potential for cash flow
293 interruption to investors in the event of a Servicer bankruptcy where collections due
294 to investors are consolidated into the Servicer's bankruptcy estate. These criteria
295 relate primarily to the Servicer's short-term and/or long-term unsecured credit ratings
296 as these ratings may provide one indication of the likelihood of bankruptcy.

297 Generally, if a Servicer has a certain minimum credit rating, the Servicer may
298 commingle collections arising from assets it services for up to one month. If such
299 ratings are not maintained, the maximum commingling period is normally limited to
300 two business days.

301 **Q. What is the importance to rating agencies of the third characteristic of**
302 **predictability and non-bypassability of the bond charge?**

303 A. The revenue stream associated with the bond charge should be secure and predictable.
304 The rating agencies, in assigning a credit rating for Rate Mitigation Bonds, will assess
305 the predictability and stability of that revenue stream even under financial stress or
306 changes in circumstances.

307 It is important that the bond charge be non-bypassable. In other words, even
308 if (i) a third party bills a customer, (ii) a customer obtains electric power and energy
309 from a provider other than the seller or (iii) a customer switches distribution services
310 to a provider other than the seller, the customer is still obligated to pay the bond
311 charge. The SPE, not the seller or any other collection agent, including an ARES,
312 must have the right to receive such bond charge.

313 **Q. How do you expect the rating agencies to assess the predictability of the revenue**
314 **stream related to the bond charge?**

315 A. In assessing the risks of Rate Mitigation Bonds, rating agencies have typically
316 reviewed an electric company's historical portfolio experience, requesting detailed
317 information on billing, accounts receivable, collections, delinquencies and
318 charge-offs attributable to customers in the seller's service territory. In general, the
319 collections ability of electric companies historically has been viewed as stable and

320 predictable by the rating agencies, due to the relatively small percentage of actual
321 charge-offs and the ability to enforce bill payment through service termination.

322 The right of an ARES to bill and collect amounts including the bond charge
323 can affect the predictability of the stream of payments. Therefore, when customers
324 choose an ARES, such ARES should be required to pay the applicable bond charge ~~to~~
325 ~~the Servicer~~ in accordance with the Servicer's regular billing cycles, regardless of
326 whether such bond charge is paid by such customers.

327 **Q. What ICC policies would enhance the predictability of the revenue stream?**

328 A. Continuation of existing electric service termination policies that permit the seller, as
329 Servicer, to terminate electric service to customers in accordance with Illinois law
330 and applicable regulations, should be maintained to minimize investors' credit risk in
331 the case of non-payment of the bond charge by individual customers (but not for
332 non-payment by an ARES of the bond charge duly paid by individual customers to
333 such ARES). These policies should apply to non-payment of the bond charge.
334 Termination policies are viewed by the rating agencies as an important tool for
335 inducing prompt payment from customers and for limiting losses from uncollectible
336 bills.

337 **Q. On the fourth characteristic, what concerns do the rating agencies have with a**
338 **third party ARES?**

339 A. When the Servicer bills and collects the bond charge from ARESs and each such
340 ARES bills and collects the bond charge from customers, the Servicer may receive
341 the bond charge collections later than it otherwise would if it were billing and
342 collecting such charge from customers directly. The greater the delay in receipt of

343 payment, the greater the potential risk of non-payment due to default or insolvency of
344 the ARES holding the funds. ARES billing and collection places increased
345 information requirements on the Servicer. It requires the Servicer to perform double
346 tracking of bond charge payments because the Servicer has the responsibility of
347 accounting for the bond charge payments due to Rate Mitigation Bond holders
348 regardless of which entity provides a customer's electric power. As a result, the
349 creditworthiness of the cash flows that constitute Bondable Property may be reduced,
350 thereby increasing risks to investors, potentially reducing the credit rating and
351 increasing the interest rate of Rate Mitigation Bonds that would be required by
352 investors. Such ARES billing and collection may also increase the bond charge as a
353 result of such interruption or delay in ARES payment.

354 **Q. What principal factors for billing, collecting and remitting the bond charge by**
355 **an ARES do the rating agencies typically consider important?**

356 A. Rating agencies have typically considered the following principal factors:

- 357 1) The extent to which a Servicer receives timely information from an ARES,
358 solely for the purposes of performing its obligations as Servicer;
- 359 2) The ARES's obligation to remit bond charge collections to the Servicer and
360 the length of time an ARES can commingle bond charge collections with its
361 own funds prior to their remittance; and
- 362 3) The procedures to transfer responsibility for billing, collecting and remitting
363 the bond charge in the event of an ARES default and the requirements placed
364 upon an ARES to reduce the risk of cash flow interruptions due to ARES
365 defaults.

366 Guidelines relating to billing, collecting and remitting the bond charge by
367 ARESs are important to the rating agencies and the absence of appropriate guidelines
368 could negatively impact the terms, and therefore the cost, of the Rate Mitigation

369 Bonds. Thus, the seller should request in its financing order that the ICC approve a
370 minimum set of policies and procedures.

371 **Q. Have similar policies and procedures been included in financing orders for other**
372 **rate mitigation bonds?**

373 A. Yes.

374 **Q. On the fifth characteristic of credit enhancement, please explain the types of**
375 **credit enhancement considered significant by rating agencies.**

376 A. Credit enhancement is often necessary in asset-backed securities transactions to
377 provide investors with added assurance that principal and interest payments will be
378 made as promised. In transactions such as the issuance of Rate Mitigation Bonds,
379 rating agencies look for various types of credit enhancement, including the right to
380 make periodic adjustments to the bond charge, a Reserve Subaccount, and a Capital
381 Subaccount.

382 **Q. Please explain the purpose of periodic adjustments to the bond charge.**

383 A. The purpose of making periodic adjustments to the bond charge is to ensure that the
384 SPE does not over- or under-collect relative to expected collections, on at least an
385 annual basis. Several factors could contribute to actual bond charge collections
386 differing from the amount expected: variability of energy usage; changes in payment
387 and charge-off patterns (including charge-offs relating to an ARES) and changes in
388 ongoing costs of the Rate Mitigation Bonds. The Servicer needs the ability to
389 periodically adjust the bond charge, up or down, by the adjustment mechanism
390 required under the enabling legislation.

391 **Q. Why should the ICC approve a mechanism for periodic adjustments to the bond**
392 **charge?**

393 A. The ICC should approve a mechanism for periodic adjustments to the bond charge, up
394 or down, as may be necessary to ensure timely recovery of fees and expenses of the
395 SPE, payments of principal of and interest on the Rate Mitigation Bonds, and the
396 funding or replenishment of the Capital Subaccount as discussed below. These
397 periodic adjustments should provide greater assurance that the aggregate bond charge
398 collections will be sufficient to satisfy debt service obligations to the Rate Mitigation
399 Bond holders and other fees and expenses of the transaction for the entire term of the
400 Rate Mitigation Bonds, in accordance with the expected amortization schedule and
401 should protect ratepayers against paying an unduly high bond charge if collections
402 significantly exceed forecasted levels. The bond charge adjustment mechanism is
403 viewed by the rating agencies as the primary form of credit enhancement and is
404 essential to achieving the highest credit ratings and minimizing the cost of other
405 credit enhancement. However, while it should significantly minimize the amount and
406 cost of other protections, it does not completely eliminate the need for other forms of
407 credit enhancement discussed below.

408 **Q. What are these other forms of credit enhancement?**

409 A. Chiefly, a Capital Subaccount and Reserve Subaccount, which are established as
410 subaccounts of the Collection Account and are intended to ensure that the SPE has
411 additional cash at all times over what is required to pay debt service in case of a
412 shortfall in expected collections.

413 **Q. Please describe the capital subaccount.**

414 A. The funds in the Capital Subaccount also protect against the risk of insufficient
415 collections due to variability of energy usage, changes in payment and charge-off
416 patterns (including ARES defaults) and changes in ongoing costs of the Rate
417 Mitigation Bonds. The Capital Subaccount is normally funded up front upon
418 issuance of the bonds and any funds therein will be available to cover shortfalls in the
419 payment of fees, expenses, principal and interest on the Rate Mitigation Bonds on any
420 payment date. The amount of such Capital Subaccount will be determined by the
421 seller (with input from the rating agencies or tax authorities) prior to the time of Rate
422 Mitigation Bond pricing. The bond charge will be calculated in a manner intended to
423 replenish the Capital Subaccount to the extent amounts have been withdrawn.

424 **Q. Please describe the reserve subaccount.**

425 A. Bond charge collections and investment earnings thereon may exceed amounts
426 payable as (a) fees and expenses of the SPE, (b) payments of principal of and interest
427 on the Rate Mitigation Bonds, and (c) allocations to the Capital Subaccount. Such
428 excess amounts will be deposited in the Reserve Subaccount to be held for the benefit
429 of investors and will be taken into account in calculating adjustments to the bond
430 charge such that amounts in the Reserve Subaccount shall be expected to be zero at
431 the end of the period for which the bond charge was adjusted.

432 **Q. On the sixth characteristic important to rating agencies, please describe the state**
433 **pledge and other statutory safeguards that are a factor in supporting the credit**
434 **rating of the rate mitigation bonds.**

435 A. The Ameren Illinois Utilities' ability to obtain a high credit rating on the Rate
436 Mitigation Bonds may be impaired if the financing order issued by the ICC does not

437 contain a recitation of applicable statutory safeguards in addition to the required
438 findings and ordering provisions. Detailed recitations have been included in other
439 securitization orders. For this reason, I have been informed that the draft financing
440 orders (the Financing Orders), that the Ameren Illinois Utilities will request that the
441 ICC enter, will include language which tracks the relevant provisions of the enabling
442 legislation. These provisions include the pledge by the State, the irrevocability of the
443 Bondable Property and the Financing Orders, and the statutory lien placed on the
444 Bondable Property.

445 Regarding the first of these provisions, it is important that the Financing
446 Orders affirm the State's pledge, that it will not take or permit any action that would
447 impair the value of Bondable Property, or reduce, impair, or adjust the bond charge to
448 be imposed, collected, and remitted to financing parties, except for the true-up
449 procedures permitted by the enabling legislation, until the principal, interest and
450 premium, and any other charges incurred and contracts to be performed in connection
451 with the related Rate Mitigation Bonds have been paid and performed in full.
452 Affirmation of this pledge should further the predictability and stability of the
453 revenue stream, thereby helping to support the credit rating of the Rate Mitigation
454 Bonds.

455 Regarding the second of these provisions, it is important that the Financing
456 Orders, together with the bond charge authorized in the Financing Orders, be
457 irrevocable and not subject to reduction, impairment, or adjustment by further action
458 of the ICC except for the true-up procedures permitted by the enabling legislation,
459 and that the Rate Mitigation Bonds, when issued, will be entitled to all of the

460 statutory benefits and protections of the Financing Orders without further action or
461 review by the ICC.

462 Third, it is important that the Financing Orders provide for the creation of a
463 first priority lien on the Bondable Property which, in accordance with the enabling
464 legislation, will attach automatically upon the issuance of the Rate Mitigation Bonds
465 and be continuously perfected as against any and all subsequent judicial or lien
466 creditors upon filing of appropriate notice with the ICC or the Secretary of State. If a
467 default or termination occurs under the Rate Mitigation Bonds, on application by or
468 on behalf of the financing parties, a court of appropriate jurisdiction should be
469 empowered to order the sequestration and payment to them of revenues arising from
470 the bond charge.

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472 **Q. Does that conclude your testimony?**

473 A. Yes.

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