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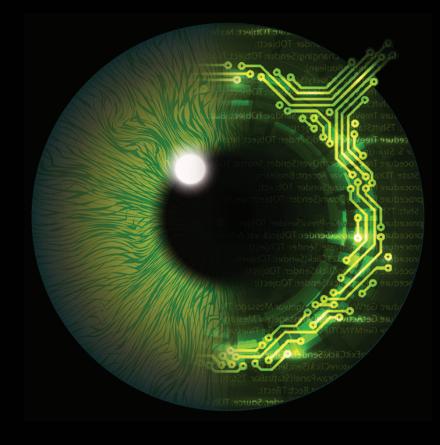
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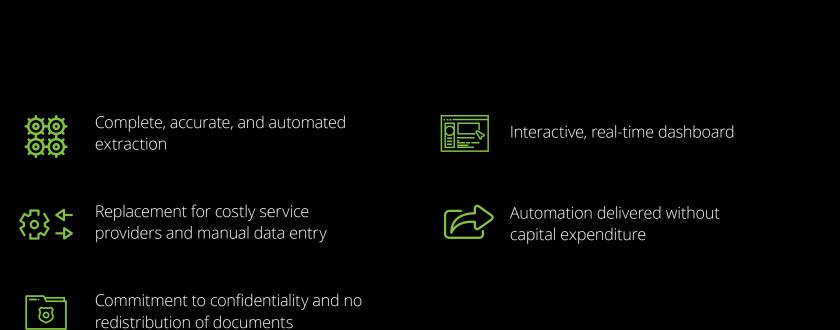
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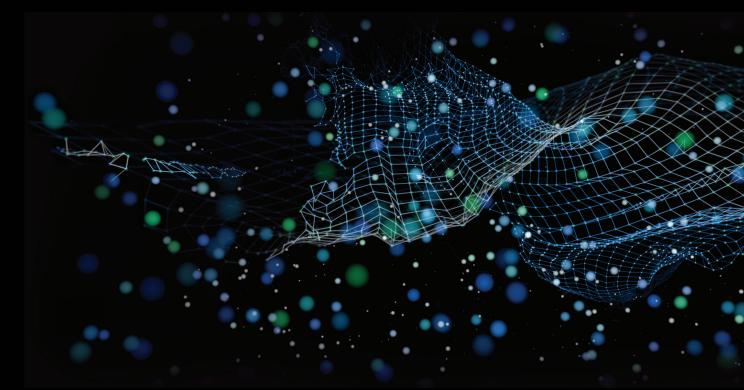
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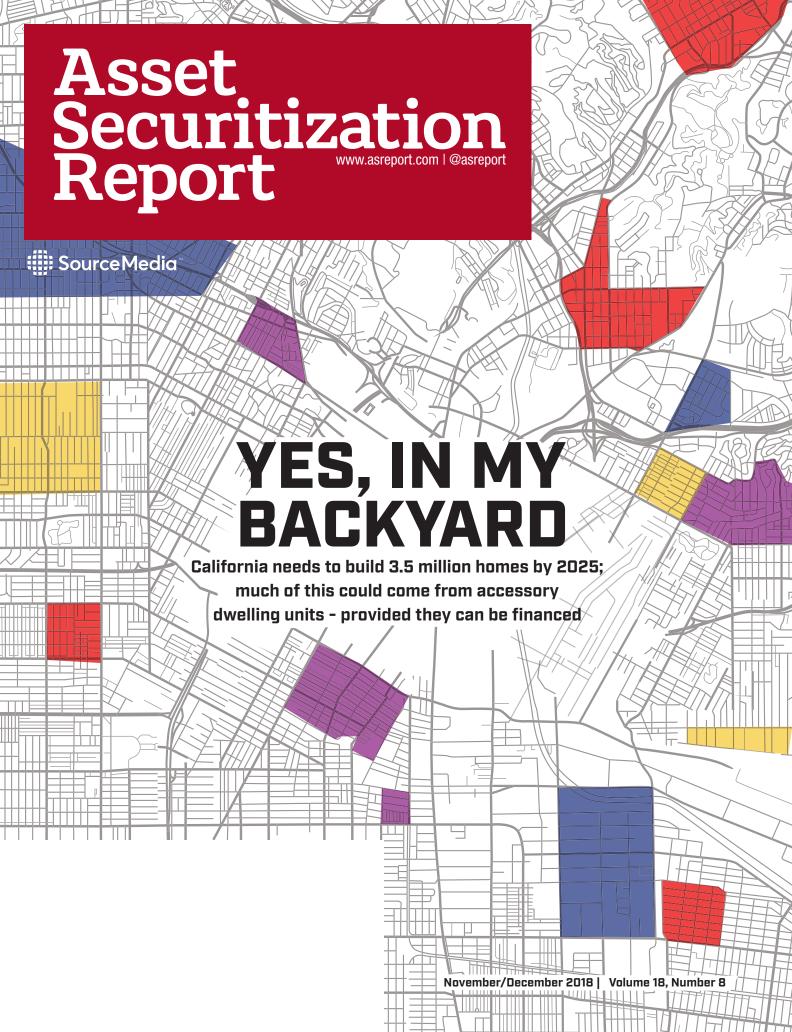
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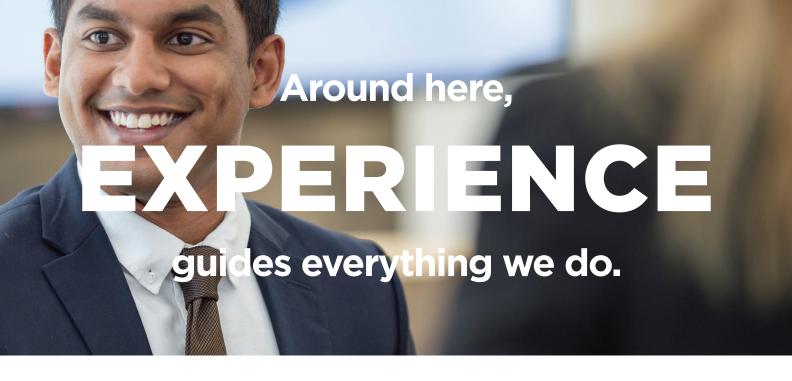
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# **Editor's Letter**

# **YIMBY**



Accessory dwelling units have enormous potential to ease the housing crunch in so many U.S. cities and towns. They are seemingly the perfect antidote to suburban sprawl, creating infill housing in backyards and converted garages. And many homeowners would be only too happy to have a flexible space that could be used to help an older parent age in place or provide rental income that allows them to keep their homes.

Yet despite government attempts to reduce barriers, a widespread surge of ADU construction has yet to materialize. A lack of dedicated financing means that most homeowners who build ADUs tap existing equity, savings or other personal resourc-

es. So they are not helping people who need affordable, flexible housing or rental income the most.

Of course, whenever banks are loathe to lend, there's an opportunity for nonbanks, whether they are specialty lenders with private equity backing or vendors offering financing to their customers. And nonbank lending eventually creates an opportunity for securitization.

Our cover story looks at the scope of the opportunity in California, one of the most crowded and least affordable housing markets in the U.S., and a couple of start-ups looking to take advantage. Neither has made anything near the volume of loans that could serve as collateral for bonds, but they represent two very different business models, one based on referrals from contractors and one that leases space for an ADU in exchange for a share of the rent. I also speak with a commercial PACE provider who thinks that there's an argument for using tax liens to finance ADUs.

— Allison Bisbey



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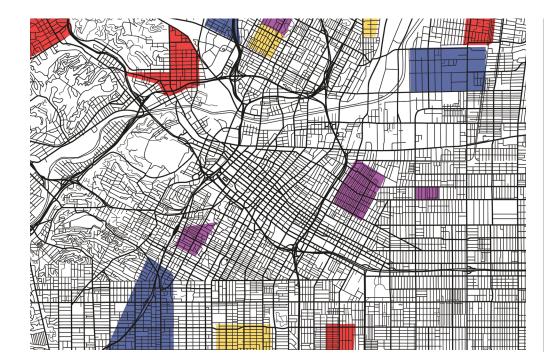
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## **Contents**



8

### Yes, In My Backyard

California needs to build some 3.5 million homes by 2025; much of this could come from accessory dwelling units - provided they can be financed

#### **Observation**

#### **6 Brokered Deposits**

Former FDIC Chairman William Isaac cautions that past abuses of deposit insurance have haunted the banking system

#### 7 Late-Cycle Behavior

Macroeconomic indicators point to another solid year for the structured finance market in 2019, but Fitch Ratings has concerns about a few sectors

#### **ABS**

#### 12 The Gloves Come Off

Come January, Navient plans to ramp up its efforts in refinance student loans as a non-compete with Sallie Mae expires

#### 13 Read the Fine Print

SoFi settled federal charges that it misled borrowers about how much they could save by refinancing their student loans

#### 14 Sam's Clubbed?

Wal-Mart's lawsuit against former credit card partner Synchrony spells trouble for the issuer's relationship with Sam's

#### 16 Sticker Shock

Rising new-car prices are boosting demand for used cars, as evidenced by rising concentrations in pools of collateral for asset-backeds

#### **CLO**

#### **18 Nudge for New Issues**

The LSTA plans to introduce delayed compensation for new-issue loan brokers who have to wait too long to take possession from agent banks

#### **MBS**

#### 20 Open Conflict

Ratings agencies are publicly sparring over the risks of a new RMBS feature that upends the traditional relationship between sub and senior bondholders

#### 22 The REIT Route

Fannie Mae VP Laurel Davis explains how changes to Connecticut Avenue Securities will widen the buyer base for the benchmark credit risk transfer program

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# **Observation**

# A Cautionary Tale on Brokered Desposits

As the FDIC considers reforms to its brokered deposit rules, the agency should recall the problems these funds caused

By William M. Isaac

A number of bankers have urged the Federal Deposit Insurance Corp. to liberalize the current rules so they might fund their banks more readily and extensively by purchasing money from deposit brokers. I would caution bankers and the FDIC to tread cautiously in this area.

Extraordinarily high interest rates during the late 1970s and early 1980s — when the prime lending rate reached a high of 21.5% — caused a massive outflow of deposits from banks and thrifts into money market funds, Treasury bills and other investments paying higher interest rates than banks and thrifts. Congress and the regulators were forced to eliminate deposit interest rates controls on banks and thrifts to prevent a meltdown of the industry due to massive deposit disintermediation.

Regrettably, deregulation of interest rates on deposits of \$100,000 and above gave rise to the practice of money brokers raising vast sums of money from individuals, businesses, and even credit unions and bundling the funds for sale to the banks and thrifts that bid the highest price, which were nearly always the banks and thrifts that had the highest risk profile.

As the bank failure rate began its dramatic rise, we found an increasing number of failed banks had large amounts of fully insured brokered funds. We felt we had to take strong actions to stop this massive abuse of the deposit insurance system, which was intended to protect relatively small, unsophisticated depositors, not institutions sweeping up billions of dollars from investors to fund the reckless

growth of high-risk banks and thrifts.

We addressed the problems on every front available to us, including publicizing the amount of brokered funds in each failed bank and naming the brokers that placed those funds. We took enforcement actions against banks making excessive use of brokered funds.

Our strongest and most controversial action was to adopt a regulation eliminating "pass-through" deposit insurance coverage on deposits by brokers. In short, we treated the broker as the depositor, not the broker's customers. This meant that if a money broker placed \$200 million in a bank, the broker was limited to \$100,000 of insurance coverage.

Our intention was to allow the free market to operate. The brokers were sophisticated firms that were perfectly capable of analyzing the condition of the banks and thrifts in which they were placing vast sums of money. They could weigh risk versus reward, unlike the smaller depositors that the FDIC was created to protect.

Money brokers contested the FDIC's new regulation through every available means, including an intense media campaign and litigation. Regrettably, the Court of Appeals for the District of Columbia sided with the money brokers and ruled that the FDIC did not have the authority to interpret its law in this manner.

The floodgates were open. Money brokers raised hundreds of billions of dollars, collecting fees from investors. They placed the money in troubled banks and thrifts, collecting placement fees. Then they asked or required the recipient banks and thrifts to purchase

junk bonds issued in corporate takeovers arranged by the money brokers and their friends.

It was the worst taxpayer scam in history, at least up to that point. We do not have accurate data because the FDIC stopped collecting the information after I left the agency at the end of 1985. But I have no doubt that the brokered deposit/junk bond scam needlessly cost taxpayers many tens of billions of dollars in the S&L fiasco.

With the deposit insurance limit now set at \$250,000, there is even less justification for schemes to further expand coverage.

It did not need to happen. We saw the problem coming, and we reacted to it quickly and strongly. We pleaded for help from Congress and got none. After taxpayers footed the \$150 billion bill for cleaning up the S&L mess, Congress finally addressed the brokered deposit issue. It restricted the use of brokered funds by banks and thrifts that fell to unsatisfactory capital levels. In other words, Congress allowed the regulators to close the barn door after the horses were gone.

I know that the usage of brokered funds has become more sophisticated and complex in the past decade or two, but surely we can find ways to substantially curtail the abuses. With the deposit insurance limit now set at \$250,000 there is even less justification to allow schemes to further expand the coverage.

William M. Isaac, a former chairman of the FDIC and Fifth Third Bancorp, is a financial consultant

# **Observation**

# Keeping a Closer Eye on Late-Cycle Behavior

We are one year deeper into an already extended credit cycle, so it's even more important to focus on market complacency

By Rui Pereira

Heading into the new year, the outlook for U.S. structured finance looks very similar to what we were seeing at around this time in 2017; stable overall with some pockets of concern.

Some notable differences as we approach 2019, however, are more peripheral in scope. The macro environment is still favorable and will continue to drive stable rating performance. That said, the fact that we are deep into an already extended credit cycle is a clear indicator that we are moving further past peak performance or past cyclical lows across sectors/asset classes. Given the old adage "bad loans are made in good times" - market complacency and late-cycle behavior among select asset classes is another risk that we're focused on heading into 2019.

The pockets of concern are largely unchanged from last year, ABS backed by subprime auto and unsecured consumer loans.. This year, however, we're adding aircraft ABS as a potential problem spot for 2019.

#### ARS

Normalization will continue for consumer bedrocks like credit cards and prime autos with performance still strong and coming in well within our expectations. Elsewhere, subprime auto and unsecured consumer loan ABS performance will remain more vulnerable to volatility due to weaker borrower profiles and acute competition. Aircraft ABS is another sector that we will actively monitor given rising asset valuations and transaction exposures to emerging market lessors, which are more exposed to both macro and local currency risks. With that said, Fitch's presence

in the subprime auto, unsecured consumer loan, and aircraft ABS is more limited due to the agency's tighter credit standards.

Fitch will continue to partcipate in the growing aircraft ABS selectively. Growth in new issuance has been quite rapid with many of the deals coming from less established originators with little to no performance history to speak of. A possible broader economic slowdown, particularly in regional or emerging markets, could reverse that trend rather quickly and result in newer originators jettisoning the space in much the same way we saw with subprime auto originators in recent years.

#### **CMBS**

The evolving face of retail has been well documented and is still problematic. We've likely seen the worst of the performance issues as it pertains to CMBS, though deals with underperforming malls may be subject to rating downgrades.

CMBS 2.0 special servicing volume will continue to increase in 2019 while delinquencies will remain steady. We are not likely to see widespread defaults on mall loans that are still performing because the properties are still cash flow positive and can cover current debt service until loan maturity. However, the first of those maturities occur in 2020 and we expect special servicers to extend loans that reach maturity, and cannot refinance, rather than foreclose on them and have the trust own the property. There's uncertainty around the depth of the market that will be available to refinance 'B' and lower quality malls at maturity – CMBS is unlikley to be a source.

#### **RMBS**

Performance remains very strong for U.S. RMBS. The potential issues we are seeing for 2019 have less to do with loan credit quality and more with new structures that provide less protection for investors. Some issuers have tested structures that distribute a greater share of cash flow to the subordinate classes (at the expense of senior classes), while others have introduced weaker rep and warranty frameworks.

The U.S. housing market is still very healthy, but price growth momentum is slowing. As interest rates rise and lenders compete for volume, the expected expansion of RMBS credit adds importance to transaction structural features. We expect the gradual recovery in new issuance to continue in 2019.

#### **CLOs**

Fitch-rated U.S. CLOs have a continued stable outlook headed into 2019, though risks are building. We've been seeing signs of late cycle behavior emerge in the form of spread compression, higher leverage and looser documentation on underlying loans. As a result, leveraged issuers experiencing stress are likely to have long runways due to looser documentation and pushed-out maturities. The leveraged loan default environment is still quite benign; Fitch's leveraraged loan default index forecast for 2019 is 1.5%, down from 2% expected for 2018. We expect performance issues to be idiosyncratic.

Rui Pereira is head of Fitch Ratings' North American Structured Finance Group

# Yes, In My Backyard

California needs to build 3.5 million homes by 2025; much of this could come from accessory dwelling units - provided they can be financed

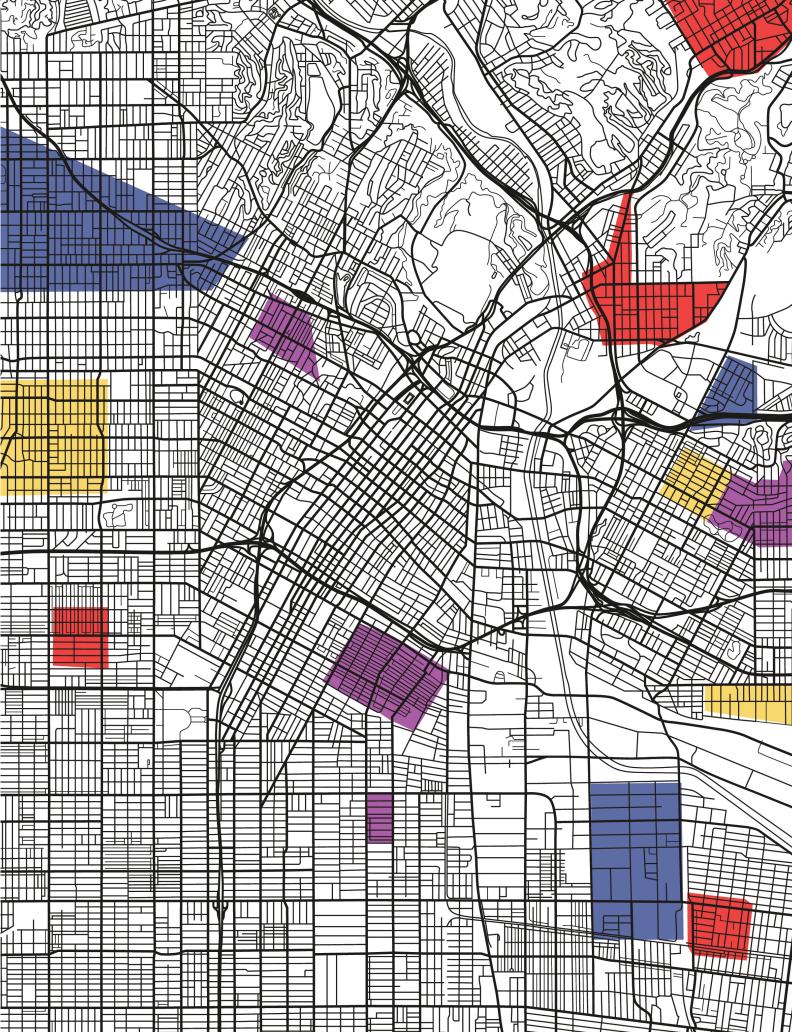
**Bv Allison Bisbev** 

It's uneconomical to build affordable homes on a large scale. So people in some of the nation's most crowded housing markets are thinking small.

Accessory dwelling units - small separate dwellings on single-family properties - are gaining increased attention as a way to quickly increase the supply of rental housing and also provide income that can keep current owners in their homes. A number of cities and states have passed legislation easing zoning and permitting regulations for homeowners who want to build infill housing in their backyards.

Yet so far, these efforts are not helping those who could benefit the most. A lack of dedicated financing means that people who build ADUs to date either have money or a lot of equity in their homes.

Portland, Oregon, is one of the most mature ADUs markets in the U.S.; the city holds regular tours for people interested in meeting the homeowners, builders, and designers who built them. Yet even here, ADUs are primarily "a luxury thing for wealthy homeowners and early adopters like architects," said Patrick Quinton, a former executive director of Portland's development commission, Prosper Portland.



Quinton co-founded a company called Dweller that builds and installs more utilitarian ADUs. For homeowners that can't get financing, Dweller offers to lease space on the property in exchange for a share of the rent. It's one of a number of startups coming up with innovative ways to finance construction.

There's clearly a need.

"We're not seeing the scale that we would expect from homeowners seeking to maximize their income," Quinton said. "We [the industry as a whole] need to get to the point where people have options to minimize the investment required to get product that's attractive and rent it out. That's where we're headed, we're just not there yet."

Portland, Seattle and Vancouver were some of the earliest cities in the U.S. and Canada to adopt zoning reforms, sometimes combined with financial incentives, resulting in a spike in construction in recent years. But many other cities and states are promoting ADUs as a way to increase the supply of affordable housing, too.

California faces a housing shortage that is projected to reach over 3.5 million units by 2025. The McKinsey Global Institute estimates that as many as 790,000 units could be created by allowing homeowners to build garage apartments, basement apartments and backyard cottages. This is a conservative estimate, because the 2016 report only examined three counties - Sacramento, San Bernardino, and Contra Costa. It notes that, in San Francisco and Los Angeles, 93% of the residential land area is dedicated to single-family housing.

McKinsey recommended changing local zoning codes to make it easier for homeowners to build ADUs. And over the past two years, there has been a lot of progress on this front, much of it at the state level. A 2016 law set state-wide standards for ADUs, preempting many local rules. Additional legislation passed

last year further reduced barriers, streamlining approval and expanding capacity for development.

"We started by looking at the principal impediments homeowners face if they decide to build," said Matt Regan, senior vice president of housing policy at the Bay Area Council, a business-sponsored, public policy advocacy group that has been working on ADUs going on four years. "The low hanging fruit are impact fees set by local jurisdictions. Some require additional off street parking, for example."

However, "permits are only half the battle," Regan said. "Homeowners in many instances don't get that far, the financial alternatives for some are lacking."

There are of course traditional methods such as cash out refinancing and home equity lines of credit. "Those work for most homeowners, particularly in the Bay Area," he said. "In this housing market, anybody who purchased a home other than in the past few years probably has equity. Home prices have risen so much they could finance an ADU just using equity. Others will use personal savings or other things. The gap lies in the communities where equity financing or cash out refinancing doesn't exist."

#### **Option 1: Borrow local**

Local and regional lenders may be more comfortable financing ADUs than larger banks. The Terner Center for Housing Innovation at UC Berkeley surveyed 414 homeowners in Portland, Seattle and Vancouver who built ADUs; the majority either borrowed against existing home equity (40%) or used cash (30%) for funding. Just 4% reported borrowing, at least in part, against the future expected value of the unbuilt ADU to help finance its construction.

Of the 91 respondents who reported getting a loan of some type and who indicated what type of institution made the loan, 60% reported borrowing either from a credit union or a local or regional bank. Only 34% reported receiving a loan from a national bank.

"This suggests that efforts to encourage or create innovative financing products to ease ADU financing might most productively focus on partnerships with locally-focused lending institutions that already understand the local real estate market in general and ADUs in particular." the report, which was published in April 2017, states.

#### **Option 2: Piggyback on PACE**

One business model for nonbank lenders is to rely on contractors to suggest their loans to homeowners, as do providers of Property Assessed Clean Energy Financing, which is used to finance energy and water efficiency projects and is repaid via an assessment on property tax bills.

Daniel Passage, a partner at Winston & Strawn and co-chair of the law firm's structured finance practice, thinks that financing for ADUs shares some characteristics with PACE that make it a compelling opportunity. "PACE is exciting to lot people because of two factors, there's compelling public interest – it encourages water, energy conservation, which are public goods – and it uses private funding," he said.

Similarly, ADUs serve a public interest, affordable housina.

Winston & Strawn has a client, Solar Capital Solutions, that recently started offering ADU loans. It was formed in the last few months, and demand for loans is already outstripping available capital. The average loan size is \$150,000 to \$200,000. The loans are often suggested to homeowners by contractors, another similarity to PACE.

The financing that Solar Capital provides is not identical to PACE; it does not have the status of a tax lien and there is no government agency involved. Like PACE, however, the interest rates are

higher than a mortgage, but not dramatically. And there's a direct benefit to the homeowners, namely rental income and higher property values.

Passage said there's already significant demand for ADU loans from banks, which can use them to comply with Community Reinvestment Act requirements. There's also demand from capital markets investors amid expectations that these eventually the loans will be bundled into collateral for bonds, similar to PACE.

Greg Saunders, CEO of CleanFund, a provider of PACE financing
for commercial property, thinks
that there's a case for using PACE
itself to finance ADUs. There's
already some latitude to use PACE
for the kinds of improvements
you'd normally make on new
construction, such as efficiency-related
measures, for ADUs, he said.

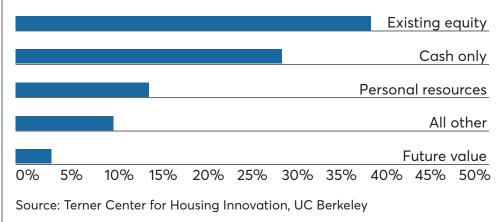
CleanFund would be interested in supporting legislation that would broaden the scope of commercial PACE to include 100% of the costs associated with constructing ADUs.. Building ADUs "is a public good, it achieves a community benefit, which is the cornerstone of PACE," Saunders said. This could be done with an amendment to existing PACE legislation that would enable all local PACE providers to automatically provide financing for ADU's.

Working with policymakers to amend PACE legislation is "a very methodical and collaborative process," however. It would require PACE providers to coordinate efforts to win over realtors and other constituents that, in the past, have opposed residential PACE. Nevertheless, PACE has become increasingly applicable to things that matter to communities, especially seismic strengthening, storm proofing, and more recently, fire proofing.

To meet the criteria for achieving a

#### Catch 22

The biggest challenge cited in a survey of homeowners in Portland, Seattle, and Vancouver who built ADUs was the lack of financing; only 4% borrowed against the future expected value of the unit to help finance its construction



community benefit, legislation might have to stipulate that an ADU is eligible for PACE financing on the condition that the ADU is immediately available for a long-term rental, for example, in order to satisfy the affordable housing needs of local communities.

#### **Option 3: Vendor financing**

Another business model is for a builder to provide financing, as Dweller does. The company retains ownership of the ADUs it finances and pays a share of the rent to the property owners each month. A property owner has the choice of identifying qualified tenants for the ADU or leaving that to Dweller. The property owner can purchase the ADU at any time, based on a declining buyout payment; at the end of a 25-year lease, the property owner will own the unit outright.

Dweller works with a factory builder, Champion Home Builders; the entire ADU is built at the company's Idaho factory, including cabinets, flooring and appliances. When the unit arrives at the site, Dweller drops it in. "We do very little onsite construction, most what happens onsite is prep and installation, pouring the foundation, hooking up to existing utilities and landscaping," Quinton said.

Each Dweller ADU is approximately 450 square feet and has a living space, a kitchen with full-size appliances, a bathroom and a bedroom.

Quinton said ground leasing has not been as tough of a sell as the founders anticipated. "There's a whole generation in their 30s and 40s now that understands that [their backyard] is an asset to be monetized. It makes complete sense for them."

To date, the company has been funding the ADUs it owns itself, though it is in the process of obtaining a bank line of credit. It's also raising equity.

While boosting property values is part of the sales pitch, Quinton said views on this are "evolving." Despite demand for properties with ADUs, "we need appraisers to build up enough experience and see enough transactions that can justify increasing property values. Then ADU lenders will follow suit."

# **ABS Report**



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# Navient Eyes End of Non-Compete with Sallie Mae

Starting next year, the servicing giant plans to go after some of SLM Corp.'s best borrowers – at least with refinance loans

By Allison Bisbey

Come January, the gloves come off.

Navient Corp. has been ramping up origination of refinance student loans even as rising interest rates reduce the potential savings for borrowers. Earnest, the online lender it acquired late in 2017, originated \$903 million of refinance loans in the third quarter, bringing year-to-date originations \$2 billion. But so far, the servicing giant's ability to expand has been limited because of a non-compete agreement with the largest private student-lender, SLM Corp., better known as Sallie Mae. Under the terms of their split in 2014,

Navient is unable to refinance either private student loans made by Sallie Mae or any federally guaranteed student loans held by Sallie Mae.

The non-compete clause expires in January, and Navient CEO Jack Remondi doesn't plan to waste any time. On a third quarter conference call Oct. 24, Remondi made it clear that he sees plenty of potential to refinance loans made or held by Sallie Mae.

"We're focused on the Sallie Mae opportunity that will be available in January," he said in response to question about competing for

refinance lending.

Sallie Mae, for its part, has repeatedly downplayed the threat from all refinance lenders, not just Navient. Senior executives have pointed out that interest margins for refinance loans are thin and eroding as lenders are forced to increase rates as their own borrowing costs rise. On Oct. 22, CEO Raymond Quinlon told analysts on the company's own third quarter earnings call that the volume of loans refinanced away from Sallie Mae had plateaued.

It will be the first largescale, dedicated player to enter the space since the financial crisis with a large servicing platform.

Quinlon also said Sallie Mae has plans to test ways to offset competition from refinance lenders next year, by offering its own borrowers either lower interest rates or lender loan terms. "We will continue to build our capability to engage in this type of fighting," he said, adding "we do think it is on its face a margin destroyer. So, our enthusiasm for this type of business is relatively low."

Navient has steadily increased rates on its refinance loans this year, and plans to continue raising them, but this has yet to affect demand, Remondi said. "Demand is principally a function of higher rates on PLUS and Grad PLUS program loans, and to a lesser extent, on some private student loans," he said on the conference call. As interest rates rise, "the savings is smaller, but it's still significant, so demand remains very robust."

The \$903 million the company originated in the third quarter was a 44% increase over the second quarter. Navient expects refinance originations for the full year to reach \$2.9 billion.

While Navient has no qualms about cherry picking Sallie Mae's existing borrowers with refinance loans, Remondi would not discuss any plans to start offering student loans to borrowers still in school. Navient is unable to do so before January, and the terms of its split from Sallie Mae prevent it from even disclosing its plans before then, he said.

That doesn't mean other people aren't talking about it. Sallie Mae is the largest private student lender, followed by Wells Fargo and Discover Financial Services; collectively they comprise 80% of the market, according to Compass Point Resarch & Trading. That dynamic could change if Navient re-enters the market next year, however.

"Navient will be the first large-scale, dedicated player to enter the space since the financial crisis with existing school relationships and a large servicing platform," Michael Tarkan, a senior research analyst at Compass Point, wrote in an Oct. 23 report. While Navient does not have to cheap funding from bank deposits, he thinks that financing through securitization would be nearly as attractive for the servicer.

Navient is also "motivated to grow as the majority of earnings still come from their run-off legacy portfolios, so they may be willing to accept lower returns vs. existing players by potentially pricing inside of the current 9%-10% yield," Tarkan noted.

In addition to making refinance loans, Navient also purchases portfolios of both federally guaranteed and private student loans. But this activity has slowed in recent quarters. Remondi said that there are simply fewer of these loans available for purchase. "We're not going to see a repeat of [loan portfolio sales] we saw in prior years," he said. **ASR** 

# FTC PUTS STUDENT LENDERS ON NOTICE, CITING MISLEADING ADS

SoFi has agreed to settle federal charges that it misled borrowers about how much they could save by refinancing their student loans. The charges were issued by the Federal Trade Commission, which warned other student lenders to steer clear of similar violations.

The commission voted 5-0 on Oct. 29 to issue the administrative complaint and accept the agreement with SoFi. The company, which agreed to stop exaggerating potential savings, was not required to pay a civil penalty.

According to the FTC, SoFi over the past two years has inflated — at times doubling — estimates of the average borrower's savings from student loan refis. The San Francisco company, which in one ad claimed that SoFi customers save an average of \$22,359, did so, in part, by excluding from its calculations borrowers who refinance their loans with longer terms and pay more over the lifetime of their loans, the agency said.

Additionally, the FTC charged SoFi with failing to tell borrowers when they would actually pay more by refinancing their loans. For instance, the company directed preapproved borrowers to a web page where they would be told how much they would save from different loan options such as variable or fixed rates; borrowers who would have paid more for a given option were told that they would break even.

In a statement, Commissioner Rohit Chopra called SoFi's advertising "deceptive." He also urged state and federal regulators to work more closely together on cases involving violations of consumer financial protections.

"Ideally, SoFi would pay civil penalties for violating the law. Due to limitations in the FTC's authority, the agency cannot seek civil penalties in matters like these," Chopra said. "However, the Consumer Financial Protection Bureau and state attorneys general would be able to seek penalties from SoFi under existing federal law."

"In future matters where we are unable to obtain monetary remedies, we should carefully consider whether partnering with other law enforcement agencies can lead to better results for consumers and deter bad actors from violating the law," Chopra said.

In addition to filing a formal complaint against SoFi, the FTC urged other student lenders in a letter to review their advertisements and remove unsubstantiated claims.

News of the settlement comes as SoFi looks to turn the corner on a rocky period. The company's current CEO, Anthony Noto, took the helm in February, following the resignation last year of founder Mike Cagney during a sexual misconduct scandal.

"We have always been committed to giving our current and prospective members clear and complete information with which to make smart financial choices, and are pleased to have this matter resolved," a spokeswoman for SoFi wrote in an email.

Under Cagney's leadership, SoFi filed an application with the Federal Deposit Insurance Corp. for a banking charter that would allow the company to accept consumer deposits. That application was later scrapped amid the scandal surrounding former CEO's resignation.

# **ABS Report**

# Synchrony Has a Lot to Lose in Fight with Walmart

The retail giant filed an \$800 million lawsuit against its former credit card partner; now analysts fear its relationship with Sam's

By Kevin Wack

When lots of money is at stake, divorce proceedings often turn ugly. Long-held grievances get a public airing, and both sides frequently suffer damage.

So it may be with the retail giant Walmart and, even more so, its longtime credit card partner, Synchrony Financial. The two firms split up in July after a 19-year relationship, setting off rancorous negotiations over the potential sale of a portfolio that consists of approximately \$10 billion in existing loans.

Then on Nov. 1 the Bentonville, Ark.-based chain sued Synchrony for at least \$800 million, prompting a volley of charges and counter-charges.

The open hostilities appear to hold more peril for Synchrony than they do for Walmart. For one, the retail behemoth has a market capitalization that is about 15 times larger than Synchrony. Perhaps more ominously, the lawsuit, filed by Walmart in U.S. District Court in Arkansas, would seem to diminish Synchrony's chances of renewing its partnership with Sam's Club, the warehouse chain owned by Walmart. That deal expires in 2021, and Synchrony has previously vowed to be aggressive in trying to renew it.

"This is likely the beginning of what could be a drawn-out litigation process," Sanjay Sakhrani, an analyst at Keefe, Bruyette & Woods, wrote in a research note.

Walmart's lawsuit alleges that Synchrony breached its contract in several significant ways, though some of the specific claims are blacked out because they include confidential business information. One claim that was made public is that Synchrony underwrote the

Walmart portfolio in a way that exposed the program to significant credit risk.

Walmart's implication seems to be that Synchrony is placing an unreasonably high valuation on loans that are likely to result in higher-than-normal losses.

If Synchrony does agree to sell the loan portfolio, Capital One, which in August became the exclusive issuer of Walmart credit cards, would be the buyer. At issue is the price tag: If Capital One refuses to pay the amount that Synchrony is seeking, then Walmart could have to make up the difference.

Moshe Orenbuch, an analyst at Credit Suisse, wrote in a research note that while Synchrony expects to get a premium for the transfer of the portfolio, Capital One has indicated that it does not want to pay a premium for a portfolio with a loss rate near 11%.

"It appears that would leave Walmart having to add the economics, and the suit certainly seems well-timed to advance their position," Orenbuch wrote.

Synchrony, which was spun off from General Electric in 2015, responded to the suit by putting at least some of the blame for the portfolio's loss rate on Walmart. The credit card issuer argued that Walmart failed to promote the cards either in its stores or online, which contributed to their performance.

"Synchrony applied the same underwriting and decision-making processes to the Walmart portfolio as it does to all portfolios," the company said in a statement. "The credit performance of the portfolio was simply driven by the credit distribution of the applicants, the relative performance of Walmart cardholders and Walmart's failure to promote the program."

Synchrony also accused Walmart of walking away from negotiations and rushing to file suit. It called the lawsuit an attempt to avoid paying the fair market value for the portfolio, as the contract between the two companies requires.

Synchrony called the lawsuit an attempt to avoid paying the fair market value for the portfolio, as the contract requires.

"While we would have preferred to resolve this matter commercially, Synchrony intends to file substantial claims that will demonstrate Walmart failed in the most basic elements of our agreement," the company stated.

Lisa Lanspery, senior vice president of public relations at Synchrony, said in an interview that Walmart is offering less money for the loan portfolio than other comparable packages have attracted over the last decade. And she stated that it is unusual for a retailer — in this case Walmart — to take such an aggressive role in negotiations between two financial institutions over the sale of a credit card portfolio. "It's always done between the two banks," she said.

When asked about Sam's Club, Lanspery said that the warehouse chain remains a valued partner of Synchrony. "We're not going to speculate on future contract negotiations, or hypothetical future contract negotiations," she added.

A Walmart spokesman declined to respond to allegations made by Synchrony. **ASR** 



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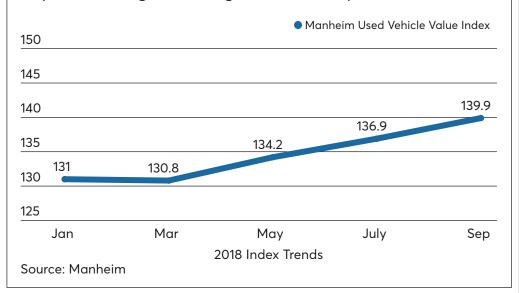
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# **ABS Report**

### **Bargain hunters**

Used car values have surged through higher demand from buyers shunning record-high new-vehicle prices



# Why More Used Cars Are Being Financed with ABS

Sales of older vehicles are on the rise and prices are headed back up, so there's more collateral and it is also performing better

By Glen Fest

Fed up with the high cost of new cars, more Americans are buying used. And increasingly, these older vehicles are being financed in the securitization market.

That's not necessarily a bad thing.

Used vehicles have historically been associated with higher risk in bonds backed by auto loans because borrowers have defaulted at higher rates and recoveries on repossessed cars have been lower.

But with average new vehicle prices topping \$36,000 and average monthly new car payments nearly \$540, more consumers with

good credit are opting instead for recentvintage used cars. And this, in turn, is boosting prices of used cars.

The combination of stronger borrowers and stronger used-car prices is encouraging lenders, and in particular subprime lenders, to increase concentrations of used-car loans in pools of collateral for deals.

"The major trend is that the used-car segment is a bigger portion of the subprime collateral pool," said Tracy Chen, the portfolio manager and head of structured credit for Brandywine Capital. And the higher prices on those vehicles "definitely makes the investor a little bit more comfortable," she said.

A main factor in that comfort is that investors can (for now) count on higher recovery rates from lease returns, or resales of vehicles taken back after borrower defaults, due to the elevated used-car prices that the market has sustained for nearly the entire year – and potentially into 2019, according to market observers.

Used cars made up 75.01% of the collateral for all subprime auto securitizations this year the highest level since 2010.

Two major indices tracking used-car pricing trends - the Mannheim Used Vehicle Value Index and the Black Book Used Vehicle Retention Index - recently hit two-year highs as many car buyers fleeing from rising newcar prices increasingly trekked to pre-owned lots.

This is resulting in some nearprime and higher subprime lenders who cater to slightly stronger borrowers adding more used vehicles to ABS collateral pools. In the third and fourth auarters. issuers including Exeter Finance, Santander Consumer USA and AmeriCredit boosted the levels of used cars in asset-backeds between 4%-10%, all without any decrease in the overall credit quality of the collateral pool. Some prime lenders, including American Honda Finance Corp., Ford Motor Credit and VW Credit, also increased used-car concentrations slightly.

The largest increase was in Santander's fourth deep

### **ABS Report**

subprime securitization of the year in September on its three-year-old Drive Automobile Receivables Trust platform (DRIVE). For the first time, Santander had a 50%/50% split on new and used cars on a DRIVE issuance, compared to the 60%/40% ratio in deals from a year ago.

According to S&P, used cars have made up 75.1% of all subprime collateral pools this year. That is the highest mark since 2010. Growing alongside used-car volume is borrower credit quality: the average subprime FICO of 586 compares to 572 in 2015, and LTVs have shrunk to 110.9% from 114.8% in 2014, according to Amy Martin, a senior director and structured finance research analyst with S&P.

Improving credit quality buoys investor confidence, as does the reduction in cumulative net losses for certain issuers since last year, thanks to growing recovery expectations on recent-vintage deals. In August, S&P revised downward loss expectations for subprime transactions for the platforms sponsored by lenders United Auto and American Credit Acceptance.

The higher average prices for used cars has been "very supportive" of auto ABS recovery rates this year for both prime and subprime securitization issuer, according to Kayvan Dariouian, a director and lead analyst on US ABS research for Deutsche Bank.

That includes outstanding ABS portfolios, which are benefiting from the conservative resale value estimates issuers placed in deals during the used-car pricing slump from 2015 to 2017, when the Black Book used-vehicle retention index "came down pretty steeply," he said.

"Now we're starting to see a pickup back where there's more gain to be had on those ABS deals where residual was more conservative," said Dariouian. "But the values have come out stronger, so we expect to see a gain on the ABS side."

Total recovery percentages for 2018 subprime deals midway through the year

was 37.05%, compared to 31.12% for 2017 vintage deals and 33.1% for 2016, according to S&P.

The strong performance of recovery rates counters the pessimistic expectations most auto ABS market analysts shared at the end of 2017. S&P felt heading into the year that used-car values would decline up to 5% as an expected record supply of off-lease vehicles (according to Edmunds.com) flooded dealer lots and auction houses – with passenger sedans suffering the most depreciation because of their ongoing decline in popularity.

But market forces brought a surprising strength to used-car prices at the start of 2018, in part due to passenger vehicle demand unmet with new-vehicle inventories.

Ford and General Motors had already adjusted to demand by curtailing passenger vehicle production for 2018 in favor of trucks and SUVS, which also contributed to fewer deep price cuts made last year to move off excess inventory of sedans.

Anil Goyal, executive vice president of operations for Black Book, a division of Hearst, said demand shifted to used sedans, and surprisingly across all types of passenger cars. Mid-size sedans are up 0.64% on the index over the past year, for example, and compact cars up 0.89% - "which is very substantial" on the Black Book index, said Goyal.

Hurricanes Harvey and Irma in the Southwest/Southeast U.S. in August and September 2017 also impacted the used-car market prices, creating a replacement demand for 700,000 vehicles destroyed in the storms. "The majority of that replacement was from used vehicles," said Goyal. "A lot of excess inventory that had been built up was pretty much set back because of that replacement activity."

Whether replacing a car out of necessity or choice, many buyers heading to dealers for the first time in a few years were in for surprise when checking out new models. Last December, Edmunds. com stated the average price of a new car was at an all-time high of \$36,848.

Used-car demand is not surprising given the obvious, said Goyal: They are excellent values.

"There's actually a supply of threeyear-old used cars of models which got refreshed and redesigned fairly well after the recession," he said. "There's fairly good product out there you can get for half the price" of a new car.

By the second quarter of 2018 dealers were seeing record numbers of used-car transactions. Certified used-car sales were over 700,000 for a quarterly period for the first time – boosted, ironically, by the off-lease supply of vehicles leased in 2015 (4 million) that were originally expected to depress used-car values, according to Edmunds.com.

It's unclear how long new-car demand will be suppressed, keeping used-car prices on an upward trend. But the threat of auto-industry tariffs imposed by the Trump administration could add to manufacturing costs of new vehicles, including those U.S. automakers produce and assemble in Mexico and Canadian plants. Under the modified North American Free Trade Agreement in August, the U.S. federal government could impose tariffs of up to 25% on imported vehicles from Canada and Mexico.

That could perhaps extend the trend of elevated used-car prices, and ongoing potential benefits to auto securitizations, as well, noted Fitch in its second-quarter auto ABS index report in August.

"With the increasing likelihood of autobased tariffs overshadowing the new vehicle market, buyers could shift toward the used market as new vehicle costs increase" by a potential \$1,000-\$4,000 on average, Fitch wrote. That could "push buyers looking for affordability to the used market and, thus, potentially benefit recovery rates and contain loss severity in auto ABS." **ASR** 

# **CLO Report**

### **Delay pay**

The LSTA is hoping to encourage faster settlement times in the allocation of primary loans by entitling buyers to compensation for late completion of trades

- Applies to loans through agent banks/affiliates
- Buyers must meet KYC vetting
- Buyers must assert readiness for settlement
- Delayed comp begins after 6 days
- Effective January 2020

Source: Loan Syndications & Trading Association

# Plan to Speed Settlement Targets New-Issue Loans

The LSTA wants to introduce "delayed compensation" for brokers who have to wait too long to take possession from agent banks

By Glen Fest

Settlement times for leveraged loans are notoriously long. Weeks can elapse between the time a buyer and seller agree on a price and the buyer takes possession of the asset and begins earning interest.

Investors who acquire loans in the secondary market (post-issuance) have long been compensated for this lag. If transactions don't settle within seven days, the buyers begin earning what the industry terms "delayed compensation" until the trade finally settles.

Not so for investors who acquire loans at issuance. If the bank that underwrites loans

takes its time allocating them, buyers – and brokers who purchase loans on behalf of clients – are out of luck. They earn no interest on the funds they have committed until the trade settles, which in some cases can take weeks due to documentation and the complexity in arranging deals with hundreds of participants.

The Loan Syndications & Trading Association plans to change that. Under a protocol to be launched a little over a year from now, in January 2020, buyers who purchase loans at issuance can also earn delayed compensation on late-settling allocations from agent banks.

The idea is not only to encourage agent banks to move a little faster in allocating loans from the primary market (which has \$1 trillion in new issuance this year), but to continue narrowing the settlement window in the \$1.12 trillion outstanding secondary loan market – through which many of these loans are "suballocated" via brokers.

The new protocol comes two years after the LSTA imposed restrictions on delayed compensation for secondary market trades.

"We have never had delayed compensation for primary [transactions]," said Ellen Hefferan, the LSTA's executive vice president of operations and accounting.

"By instituting it at this point, the idea is to once again improve settlement in the primary market which would then allow settlement in the secondary market to be assured in a timely manner as well," she said.

The trade group announced the adoption of the protocol on Oct. 29.

The LSTA will not say how long it takes to settle transactions in the primary market. But a lawyer who represents buy-side firms says client brokers and investors often complain about waiting two or three weeks for documentation needed to complete primary asset allocations.

Not only are they not earning interest during this period; they may also be digging into their own pockets to pay receiving coupons – and may be paying delayed compensation themselves to the secondary market trades they've committed to as

sellers.

"I've had clients' operations personnel complain that weeks after a credit agreement has gone effective on a primary trade they've committed to, they still haven't begun to earn accruing interest and fees," said Steve Kieselstein, a founder and managing member of the Kieselstein Law Firm, a boutique law firm specializing in syndicated loan market trading. "The argument is it's a free option for the agent/seller."

"The gripe there is that there shouldn't be an extended period of time where a buyer is conceived to legally committed to the facility and yet is not entitled to receive anything," until settlement takes place, Kieselstein added.

The new protocol comes two years after the LSTA created guidelines that tightened the delayed comp window for par secondary trades.

Before 2016, secondary loan settlement periods were governed by "no fault" guidelines that often stretched settlement times between 18-21 days after a trade agreement.

Buyers could accumulate weeks of interest without having committed capital – which critics said created an incentive for firms to slow-walk trade settlements and essentially pocket free money.

The changes did away with the nofault concept and put the onus on buyers to commit capital within five days to gain eligibility for delayed compensation.

Prior to the guidelines, secondary market trade settlement times averaged 17.7 days, according to IHS Markit data.

By the end of 2016 under the new guidelines, over 90% of par trades were settling within the seven-day window, according to LSTA data. (The guidelines exclude distressed loan assets, which often take more than 20 days to settle.)

The new-issue market rules also require buyers to commit capital. Under the protocol, delayed compensation kicks in six days after a credit agreement is fully

documented, which includes a three-day "onboarding" process to qualify buyers under the U.S. Treasury's know-your-customer (KYC) requirements.

The goal of the protocol, in essence, is to speed up settlement time in order to preclude the need for delayed compensation.

"As long as the trades settle in a timely manner, compensation will not pass since the buyers, now lenders, will earn the coupon directly," said Hefferan.

The LSTA believes that encouraging faster settlement of primary-market loan allocations will help reduce tradesettlement times in the secondary market, as well. The more quickly that banks fulfil allocations to brokers, the more quickly those fund managers can complete the sub-allocations frequently used to fill the pipeline of the secondary loan market.

The protocol calls for any secondary trade delayed comp schedule to "align" with a fund manager's delayed comp protocol, so that a manager shouldn't have to pay more in delayed comp to a secondary-market buyer than the manager received from the primary allocation

"The whole point of this," added Lee Shaiman, LSTA's executive director, "is to speed that along and make it fair to all parties so that the buyer who sets capital aside doesn't have to wait an inordinate long period of time to settle the trade and start to earn interest on the asset."

The longer-term development of the delayed compensation protocol for the primary market is due to the complexity of that segment of the market, Hefferan said.

The agent bank's allocation is constructing a lending group that finances a corporate loan, and involves setting up a syndicate of perhaps hundreds of fund managers – who in turn are setting up hundreds of other lenders into the deal through sub-allocation in the secondary

market.

"One difference in primary is the buyer tends to subdivide and suballocate into far more funds than a secondary trade," said Hefferan.

"You could have a fund manager put a primary allocation into 30 funds and not even blink."

Shaiman added that "[t]he technology has caught up to the point we can settle these trades faster and we need the behavior to equal the technology."

The LSTA has not compiled any data on average trade settlement times in the primary market, nor the number of trades completed in allocation and sub-allocations that would estimate the amount of compensation buy-side firms could earn in delayed compensation.

But with the goal of speeding settlement times, the greater likelihood is that buy-side firms won't need delayed compensation since they'll be earning directly from the coupon at a faster settlement rate.

"At the time of the primary syndication, the deal, the facilities, the contracts and the documentation must be built for the first time into the agent bank and settlement platforms," Hefferan said. "Technology improvements that have been developed over the past few years will be helpful toward implementing the protocol and thus enhancing overall market liquidity."

#### Trade volume dips in 3Q

After hitting \$183 billion in second quarter – the busiest three-month period on record – U.S. secondary loan trading volume fell 13% during the third quarter to \$162 billion, according to the LSTA's 3Q18 Trade Data Study. Year-over-year though, third quarter volumes increased 17% as S&P/LSTA Leveraged Loan Index Outstandings expanded by 16%. But to be fair, third quarter 2017 turned out to be a weak comp; it was the slowest quarter in two years. **ASR** 

# **MBS Report**

### **Expanded prime**

The loans in GFMT 2018-2 have relatively strong credit metrics compared to other nonprime pools S&P has rated; in certain aspects, it is similar to prime jumbo pools

· Avg balance: \$776.4M

WA CLTV: 69.5%

WA FICO: 754

WA DTI: 36.7%

Source: S&P Global Ratings

# Debate Over Stop-Loss Advancing Spills into Open

Rating agencies are sparring over a new feature in an RMBS that upends the relationship between senior and sub bondholders

By Allison Bisbey

Credit rating agencies are sparring over a new feature in a private-label residential mortgage securitization from Galton Funding, a unit of Mariner Investment Group, that upends the relationship between senior and subordinate bondholders.

No surprise, the debate spilled out into the public after Fitch Ratings, one of the most prolific publishers of unsolicited rating commentary, issued a report critical of the ratings of three of its rivals.

This feature, known as stop-loss advancing, limits the number of months that mortgage servicers will advance funds to bondholders

when borrowers get behind on payments. It is designed to overcome a pitfall that cost mortgage bondholders dearly after the credit crisis, when servicers advanced interest payments on distressed loans for extended periods. Servicers eventually recovered these advances from the sales proceeds of repossessed homes, reducing the funds available to repay bondholders' principal.

Galton is not alone in employing this feature; it is becoming increasingly common for servicing agreements on mortgage bonds to limit advances on interest payments to four months; after that there are fewer funds avail-

able each month to pay bondholder interest. What's unusual
about Galton's latest deal is a
related provision that determines
how the interest shortfall affects
different classes of bondholders:
It is incurred concurrently by all
classes of notes. This is achieved
by removing unpaid loan interest
from the definition of bond interest that is due to all investors.
Doing so means that unpaid loan
interest is treated as a non-credit
cost to be shared by all bond
classes.

A deal sponsored by Mariner Investment Group treats unpaid loan interest as a non-credit event, shared by all bond classes.

This is a big change. Historically, losses from unpaid loan interest on U.S. residential mortgage bonds have been allocated first to the most junior class of bondholders, and then to more senior classes.

This didn't stop three rating agencies, S&P Global Ratings, Kroll Bond Rating Agency and DBRS, from assigning triple-A ratings to the most senior tranches of securities to be issued in the \$452.7 million deal, Galton Funding Mortgage Trust 2018-2, which was offered in mid-October.

In their presale reports, all three explained that other factors, most notably the high quality of the collateral, helped offset the increased risk to senior noteholders introduced by the unusual treatment of unpaid loan interest. Essentially they believe that the risk of borrowers in the collateral pool missing more than four payments is so remote

### **MBS Report**

that senior bondholders are unlikely to be significantly impacted.

Fitch Ratings takes a different view, however. In a report published this week, it said that it would not assign ratings to any transaction with this feature.

Fitch's objections are twofold.

First, the rating agency is concerned that the structure is "inconsistent with a traditional allocation of credit risk in structured finance and results in meaningfully higher credit risk for senior classes," the report states. The rating agency believes that the triple-A ratings assigned by its peers "do not fully reflect the higher risk based on the transaction's unique definition of shortfall," and that this "reduces the clarity and consistency of ratings across transactions for investors "

Fitch is also concerned that the feature is so unusual that it may not be well understood by investors. It acknowledges that there have been other transactions with similar features. Most notably, unpaid interest related to loan modifications is typically shared across all classes of U.S. residential mortgage bondholders. But this feature has been standard for several decades in the sector and is well understood by investors, according to the rating agency.

"Conversely, the GFMT structure is uncommon and poses greater risk of misinterpretation by investors of the risks considered in the ratings," the report states.

S&P, DBRS and Kroll all agree that the unusual treatment of unpaid loan interest in Galton's deal increases the risk to senior noteholders, and all three highlight this risk in their presale reports. However, all three believe that this risk is mitigated by the high quality of the collateral, among other things.

Quincy Tang, managing director and head of U.S. RMBS at DBRS, declined to comment on Fitch's report. But in an email, he said that DBRS' disclosure on

asreport.com

the deal "notes considerable compensating factors in the GFMT 2018-2 trust, such as strong underwriting standards, prime quality collateral, 100% third-party due diligence and satisfactory loan performance of the Galton Funding conduit to

Tang also noted that the AAA ratings assigned by DBRS in this transaction have 20% credit enhancement levels.

Though many of the loans do not meet the definition of a qualified mortgage or are exempt from the rules because they finance investment properties, they have many features that are similar to prime jumbo loans, such as relatively high FICO scores (754 on a weighted average basis) and low original combined loan to values (68.8%).

In addition, a third-party due diligence provider, AMC Diligence, reviewed every single loan in the collateral pool. This is unusual, as many collateral pools only undergo a representative sampling. AMC Diligence's review encompassed regulatory compliance, underwriting compliance, property valuation and data quality, according to the presale reports.

The deal's representation and warranty framework is also unusually strong.

"New and innovative deals are a feature of the structured finance market, and our role is to bring clarity and informed insights to investors," Sujoy Saha, S&P's director, U.S. structured finance and the rating agency's lead analyst on the deal, said in an email.

"We conducted robust analysis of all aspects of the GFMT 2018-2 transaction, including the potential decline in interest paid to each class of rated certificates, and took into account the high-quality collateral in the pool," Saha said. "Our stress scenarios showed the potential risks were commensurate with our assigned ratings, as set out in our published criteria and detailed extensively in our presale report."

Kroll did not comment on Fitch's

report. However, in its own report on stoploss advancing published in February, the rating agency noted that such provisions are increasingly accompanied by a number of structural nuances.

"While stop-advance features are becoming more prevalent in RMBS 2.0, nNot all stop-advance mechanisms are created alike," Kroll's report states. "As such, they need to be evaluated and considered when performing both collateral and structural cashflow analysis."

The report further notes that, "when employing these provisions, it is our observation that sponsors strive to strike a balance between using the feature to mitigate losses and advancing timeline ambiguity while still maintaining liquidity for high investment grade."

Both Kroll and Fitch, in their respective reports, note that Redwood Trust, one of the most active issuers of residential mortgage bonds since the financial crisis, introduced a similar treatment of unpaid interest in a 2015 transaction. Like Galton's, it has an atypical definition of an interest shortfall that effectively reduces bond coupons based on unpaid interest from delinquent loans.

But unlike Galton's deal, the Redwood structure allocates the bond coupon reduction in reverse sequential order beginning with the most subordinate class.

Fitch acknowledges that the treatment of unpaid interest in Galton's deal is "transparent and direct for investors willing to closely read the transaction documents and to quantify the risk on their own." It also acknowledged that the risk is disproportionately concentrated in the interest-only classes and that, "in more moderate stress scenarios, noninterest-only classes may be unaffected by the feature."

In fact, investors in subordinate classes of bonds may favor the structure over standard structures due to the reallocation of a portion of credit risk to more senior classes, the rating agency said. ASR

# **MBS Report**

# **A Big Innovation That Was** a Long Time Coming

Laurel Davis, VP, credit risk transfer at Fannie Mae, explains why the switch to a REMIC structure for CAS is so important

By Allison Bisbey

Fannie Mae has a mandate from its regulator to offload the bulk of credit risk on residential mortgages it insures to capital markets investors. Yet participation in Fannie Mae's benchmark risk transfer program, Connecticut Avenue Securities, by an important class of investors has been limited. Real estate investment trusts have an appetite for this kind of risk, yet they must invest at least 75% of their assets in real estate. CAS, as they were originally designed, did not qualify, however. Though the performance of the bonds was linked to a reference pool of mortgages insured by Fannie Mae, they were technically general obligations of the company.

The latest CAS, which priced Nov. 7, is structured instead as a bankruptcy remote trust. Bond proceeds are deposited in investment accounts; they do not sit on Fannie Mae's balance sheet. The funds are only available to the GSE should losses on the reference pool of loans reach a predetermined level.

"This has been a huge goal for us, practically since the beginning of the program," said Laurel Davis, Fannie Mae's vice president, credit risk transfer. "It's a big innovation that has been a long time coming."

Switching to a REMIC structure accomplished something else that Davis says is important for the long-term success of the program: It eliminates the risk that Fannie Mae might not, at some point in the future, be able to make good on its obligations.

#### ASR: Why is the structure important? LAUREL DAVIS: The biggest improvement is that it allows all of the notes issued in CAS

transactions to be treated as debt for tax purposes. This is a huge difference. It helps facilitate participation by international investors and it also helps broader participation from REITs. The other benefit from a REIT perspective is that we designed the structure to meet all of the REIT good income and good asset tests, which existing CAS notes did not meet. That's an important consideration, both from a tax and from a legal perspective. We believe REITs are a natural source of capital for investing in mortgage risk. This is more of a long-term consideration, but by issuing out of a REMIC trust, we are getting rid of investor counterparty exposure to Fannie Mae. That's not an issue today, but we want the program to be sustainable in the long run, so limiting counterparty exposure is an important change.

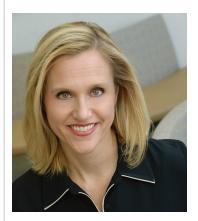
#### Why not do a REMIC in the first place?

To have started using a REMIC structure we would have needed legislation to change the REMIC rules themselves. Instead we worked to find a way to achieve this treatment through the deal structure itself. It took a while to figure out. The key was to begin to make a REMIC election on the underlying loans as we acquire and securitize them into MBS. We started doing that in May of this year. While that sounds really simple, we wanted to make sure that anything we did would keep the MBS TBA market intact.

#### Does Fannie take this election on all of the loans it acquires?

It's essentially all of the loans we acquire, or

around 99.9%. There are a handful of MBS prefixes that, in and of themselves, are not REMIC eligible ... But there is very little volume.



Laurel Davis

#### Did you attract more REITs?

We did. We expected to see participation broaden over time. I was happy that we saw new REIT money already coming in. We did an extensive roadshow and received a lot of feedback.

#### How much REIT participation has there been in the past?

For the program to date, it has been just under 5%, but it varies by class of securities. The highest participation has been in the M2 class. There has been less in the B-1 because of the tax treatment. It will be interesting to see if participation in the B-1 expands. Those bonds could be a natural fit for REITs now that they are considered debt for tax purposes. Apart from the REMIC election, we kept the structure of the deal very much the same. The classes of offered notes, cash flows, loss calculations are all consistent with prior deals. Investors value the consistency of the program, which is part of the reason why it's become so liquid. ASR



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