Asset Securitization Report

www.asreport.com | @asreport

SourceMedia

LEASE RESISTANCE

Beyond the length of time planes are grounded, investor exposure to Boeing Max is determined by the type of deal, timing of deliveries and the strength of lessees

April 2019
Volume 19, Number 3

Triple Net, Not Triple A

The global grounding of Boeing's 737 Max jets illustrates why rating agencies do not assign their highest ratings to structured financing of aircraft leases, whether EETCs or asset-backeds: There are simply too many exogenous risks.

The Max is the fourth generation of the world's best-selling commercial aircraft, first introduced in 1967. Yet it was involved in two crashes within the past five months that killed 364 people. Numerous investigations are under way, including ones looking at how U.S. flight regulators came to certify the airplane. In the meantime, airlines are rerouting other kinds of aircraft and canceling flights while the manufacturer works on a software fix for a stabilization system believed to have pitched the nose of the aircraft downward.

There are plenty of protections for the capital market investors that have stepped in to finance aircraft as the industry expanded over the past few decades. The leases are triple net; not only are the lessees responsible for maintenance, repairs and insurance; they also have to keep making lease payments regardless of any difficulties they may encounter. Payments to lessors, and capital markets investors, are protected for the full term of the lease.

Still, the financial health of a lessor is an important credit consideration, and the grounding of the Max jets is costing airlines plenty of money. In the most extreme scenario, it could affect their ability to make timely lease payments on all kinds of aircraft. While this risk is still fairly remote, it may be giving airlines some leverage to negotiate compensation with Boeing and some leeway from lessors, as Glen Fest explains in our cover story.

Glen also takes an early look at the final version of Japan's new risk retention rules, which allow the nation's banks to avoid a higher risk weighting on their holdings of U.S. CLOs, so long as managers can demonstrated that their deals were not "inappropriately formed." Stay tuned for a closer look at just how burdensome this might be.

And Kate Berry has a pair of articles on the potential scope of consumer protection laws in the U.S. The CFPB's rollback of underwriting requirements for small-dollar lenders could redefine a legal doctrine that governs other companies. But even as the agency pulls back, a key California lawmaker is exploring how to create a state-level CFPB that could take the lead.

There's also a roundup of coverage from SFIG's annual conference in Las Vegas, where housing reform and replacing Libor were key themes.

— Allison Bisbey

Asset Securitization Report

One State Street Plaza, 27th Floor, New York, NY 10004

Editorial
Editor in Chief: Allison Bisbey
allison.bisbey@sourcemedia.com; 212.803.8271

Senior Editor: Glen Fest
glen.fest@SourceMedia.com; 817.847.8041

Art Director: Neesha Haughton
neesha.haughton@sourcemedia.com; 212.803.8815

Contributors
Kate Berry, Kevin Wack

Group Editorial Director, Banking & Capital Markets
Richard Melville
richard.melville@sourcemedia.com; 212.803.8679

Executive Director, Content Operations and Creative Services: Michael Chu
michael.chu@sourcemedia.com; 212.803.8313

Publishing
VP Capital Markets Division: Harry Nikpour
212.803.8638

SVP, Head of Media Sales: Dennis Strong
212.803.8372

Associate Publisher: Louis Fugazy
212.803.8773

Marketing
Marketing Manager: Leatha Jones
212.803.8374

SourceMedia™

Chief Executive Officer: Gemma Postlethwaite

Chief Financial Officer: Sean Kron

EVP & Chief Content Officer: David Longobardi

Chief Strategy Officer: Jeff Mancini

Chief Data Officer: Christian Ward

SVP, Conferences & Events: John DelMauro

VP, People & Culture: Lee Gavin

Contents

ABS Vegas

ABS

CLO

MBS

Subscription Information: help@sourcemedia.com | 212.803.8500; Bulk subscription | US/Canada $2,995 | Annual Rate (8 issues) International $3,035

Asset Securitization Report - (ISSN # 1547-3422) Vol. 19, No. 3, is published 8 times a year by SourceMedia, One State Street Plaza, 27th Floor, New York, NY 10004. Postmaster: Send address changes to Asset Securitization Report, SourceMedia, One State Street Plaza, New York, NY 10004. For subscriptions, renewals, address changes and delivery service issues contact our Customer Service department at (212) 803-8500 or email: help@sourcemedia.com. All rights reserved. Photocopy permission is available solely through SourceMedia, One State Street Plaza, 27th Floor, New York, NY 10004. For more information about Licensing and Reuse of Content: Contact our official partner, Wrights Media, about available usages, license and reprint fees, and award seal artwork at sourcemedia@wrightsmedia.com or (877) 652-5295 for more information. Please note that Wright's Media is the only authorized company that we've partnered with for SourceMedia materials. No data herein is or should be construed to be a recommendation for the purchase, retention or sale of securities, or to provide investment advice of the companies mentioned or advertised. SourceMedia, its subsidiaries and its employees may, from time to time, purchase, own, or sell securities or other investment products of the companies discussed or advertised in this publication.

LEASE RESISTANCE

Beyond the length of time planes are grounded, investor exposure to Boeing Max is determined by the type of deal, timing of deliveries and the strength of lessees

By Glen Fest

Leasing has fueled the takeoff of the airline industry over the last 50 years, helping carriers around the world meet rising demand for travel and upgrade their fleets to become more fuel efficient. Planes are expensive; leasing gives airlines, particularly smaller carriers or those looking to expand quickly, an attractive alternative to making big, up-front investments.

Events like the grounding of the Boeing Max put some stress on this business model. The financial burden falls almost exclusively on the airlines, so much so that some weaker airlines could eventually face financial difficulties because of liabilities to lessors. In the most extreme scenario, this could affect their ability to make timely lease payments on other kinds of aircraft – including some that have been securitized.

Aircraft operating leases are typically what are known as "hell or high water" leases, meaning that lease payments must continue irrespective of any difficulties the lessee may encounter. So the aircraft lessors' revenues are protected for the full term of the lease, generally up to 12 years. While hell or high water leases cannot be canceled, if an aircraft is


N494AP

grounded for a prolonged period—typically more than six months—the airline is obligated to pay the a sum intended to make the lessor whole, usually within 120 days. Only when the lessor receives full payment is the lease is terminated.

Airlines have an "unconditional obligation" to continue lease payments on Max aircraft during the grounding, DBRS analyst David Laterza said on a webinar held in March. He said this obligation could pressure a carrier's financial performance, resulting in "potential credit issues for the lessors including rising delinquencies or deferred lease payments."

While airlines typically carry insurance-loss coverage for third-party liability claims or damage as part of a leasing arrangement, Kroll Bond Rating Agency does not believe the grounding would qualify as a claim. "Therefore, airlines with exposure to 737 Max aircraft could face earnings pressure, which is potentially credit negative depending on the extent of their exposure," it stated in a report published the same month.

Even if this risk is remote, and there are still relatively few Max aircraft on lease, the prospect of making lease payments on planes that they cannot fly over an extended period of time is creating tension between lessors and lessees, market observers say.

Phil Seymour, chief executive of the International Bureau of Aviation, a U.K. consultancy, thinks that airlines are likely to be negotiating for some leeway from leasing companies in the event of a prolonged grounding. "Obviously, lessors already have equipment placed with airlines, and those airlines will be requesting some sort of alleviation of not having to pay the lease rentals even though technically and legally they will still be liable for those lease payments," he said. "I suspect there are conversations going on amongst airlines and lessors and correspondingly with Boeing over those commitments."

Buy or lease, the grounding of Boeing's 737 Max passenger planes has unquestionably been a costly exercise for airlines. Each day that their Max fleets are parked, airlines are losing $150,000 in direct costs per plane, according to the IBA. That tally includes expenses for storing the jets at major airports, paying for staffing costs for idled Max-trained flight crews, and re-routing and/or compensating passengers for routes changed or canceled.

Then there's the cost of financing the jets. At an average monthly cost of $360,000, airlines leasing a next-generation Max 8 plane must shell out $12,000 a day, according to the IBA.

Fortunately there are still relatively few Max aircraft on lease, let alone in a securitization. A total of 37 737 Max aircraft, 34 of which have been delivered, are currently in five outstanding enhanced equipment trust certificates, or EETCs, a kind of sale-and-leaseback arrangement, according to Deutsche Bank. However, EETC investors are pretty well insulated from the impact of the grounding of these planes. In a March 12 report, Douglas Runte, an aircraft debt analyst and managing director at the bank, said these deals have several indenture provisions that insulate investors from the financial impact of regulatory action.

For aircraft already delivered, EETC indenture language requires principal and interest payments to continue for outstanding EETC issues "regardless of the operating status of the aircraft" or until a loss is declared, when a par call on the notes would occur, Deutsche Bank's report states.

EETC agreements also establish the steps for an airline to return a plane deemed not flightworthy, usually a six-month time frame during which EETC payments also continue. (Airlines can delay this return schedule up to two years if it's working toward introducing the plane into service).

An airplane returned to a manufacturer would be followed by a pro rata call of the EETC deal at par to refund certificate investors, the report states.

Even for the 4,596 of Max jets on back order awaiting delivery, regulatory and transactional protections will also limit exposure for airlines and aircraft lease/EETC investors in the event of a long-term grounding or an actual ban of the jet. It is "inconceivable that an airline would accept delivery of an aircraft that could not be flown," the report states. "In the event that scheduled delivery had to be delayed, the indenture provisions allow for some period of time between the original expected delivery date of the aircraft and when it is ultimately delivered."

Carriers' first recourse is likely to seek compensation from Boeing. Industry observers believe airlines received reimbursements from Boeing over the five-month grounding of approximately 50 787 Dreamliner series in 2013 due to a series of electrical problems related to on-board lithium-ion batteries. (None of the Dreamliner incidents included fatalities, but one of the events was an in-flight fire that forced an emergency landing for an All Nippon Airways flight in Japan.). Details on these types of undisclosed arrangements are usually held tightly to the vest by the airline and the manufacturer, however.

Aircraft lessors have taken delivery of 67 737 Max planes, according to Boeing sales date, but none to date have been financed in the asset-backed market. That's to be expected, according to Deutsche Bank, since this model has only been delivered since 2017. "The typical aircraft ABS collateral pool consists of aircraft that are not newly delivered (and quite old)," the bank stated in a March report.

Kroll, DBRS and Fitch Ratings all confirmed that they do not currently rate any bonds backed by leases on 737 Max.

Even so, airlines that fly 737 Max them are included in ABS pools, though rating agencies are downplaying this risk, for now. "Smaller and financially weaker airlines with large exposure to Max aircraft could face disruption issues, including lost revenue and costs associated with sourcing replacement aircraft," Fitch stated in a March 21 report. "These disruptions may worsen depending on the length of the grounding."

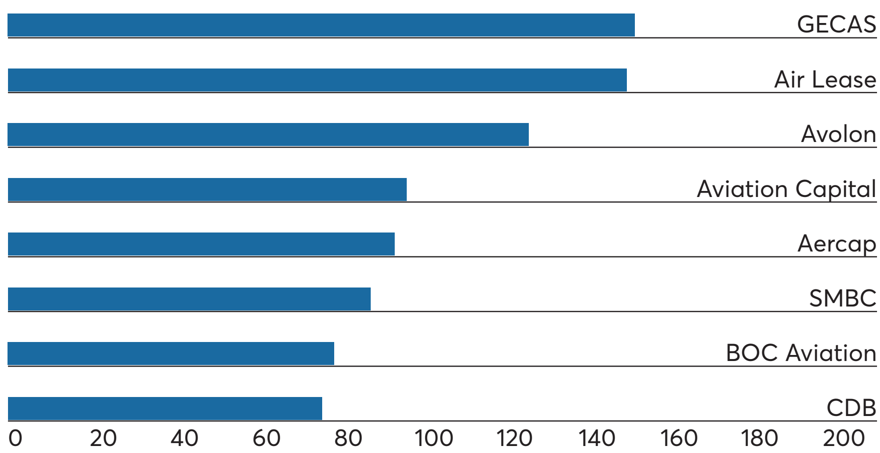
Still, Fitch believes the risk of this causing airline defaults in ABS pools is limited. "In general, among the airlines flying the Max, those with the greatest exposure are larger and more financially stable," the report states. "Further, we expect these airlines to pursue compensation from Boeing to offset costs incurred."

In fact, the grounding of Boeing Max could result in higher valuations for alternate narrow-body models, at least temporarily, as airlines seek replacement aircraft. ABS pools rated by Fitch contain high concentrations (typically 60%-100%) of Airbus current engine option and Boeing next generation narrow-body aircraft. "If findings of ongoing investigations result in a prolonged grounding of Max aircraft, ABS transactions with near-term maturity or off lease narrow-body aircraft may benefit as on-lease aircraft are likely to be extended and off-lease aircraft placed quickly at favorable lease rates," the report states. "This would help minimize downtime and costs while supporting ABS lease cash flows."

For lessors themselves, the primary risk is from the halting of new deliveries. Of the nearly 5,000 MAX on back-order, 1,000 are on order from leasing companies such as Avolon Aerospace, which is awaiting 102 MAX planes, and Air Lease Corp., which has 92 MAX planes on the way. Lessors cannot collect lease payments on planes that have not been delivered. And the longer they wait, the more revenue they forfeit on planes they have ordered but cannot put to work. Seymour said aircraft lessors have been counting the lost revenue ever since global aviation regulators grounded the Boeing MAX on March 10. "If there are lessors out there thinking they would be [placing] 10 MAX 8s in this quarter, and they can't deliver those, they can't earn that $300,000 to $360,000 a month," per plane, he said

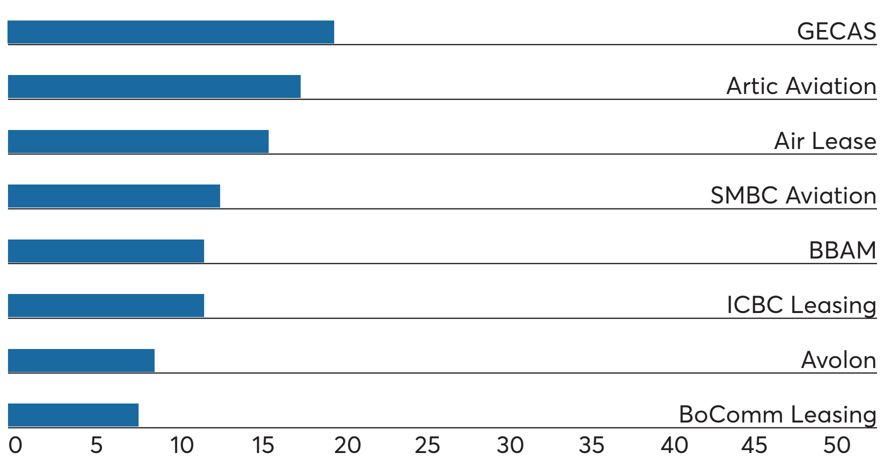
Nevertheless Seymour believes that lessors are much better protected than the airlines themselves. The grounding "will be inconvenient, and maybe there's a few hundred thousand dollars' worth of costs toward them, but it's not going to be tens of millions they've got to find in cash," he said. **ASR**

737 Max Ordered by Lessors



Source: FlightGlobal, Kroll Bond Rating Agency

737 Max Placed by Lessors



Source: FlightGlobal, KBRA

Zero Guarantee Has Consequences

Removing the implicit guarantee for Freddie Mac's unsecured debt would have consequences for the housing finance system, according to CEO Don Layton.

Speaking at SFIG Vegas, Layton said that Freddie, along with Fannie Mae, relies on unsecured debt to fund its purchases of delinquent loans out of pools of collateral for mortgage bonds. Loans that are subsequently modified stay on Freddie's balance sheet, rather than in a securitization trust.

The two GSEs could not continue to do this if they had to issue unsecured debt without the implicit guarantee because their funding costs would rise.

Layton, who took the helm in 2012 after Freddie was put in conservatorship, said that the company had previously used unlimited access to unsecured borrowing inappropriately, to build an investment portfolio that was larger than the balance sheet of the Federal Reserve. At the peak, Freddie and Fannie each held some $800 billion of mortgage bonds, most of it discretionary. The GSEs "profited from money that was very cheap and it wasn't what they were there for," Layton said.

In reaction, some people in policy circles are pushing to restrict the implicit guarantee to the mortgage bonds that the GSE issues.

"Let's go through what that means," the CEO said. "We could use mortgages as collateral for borrowing, but it would be a lot more expensive. Could we buy back all of the loans that are 120 days delinquent? No way. This is a government-sized program."

Freddie has now run down its investment portfolio to the point it is only used to run the guarantee business. If the GSE loses the implicit guarantee for its unsecured debt, "things will change," he said. "People should

Don Layton

understand that. Zero as a policy reaction has consequences that I don't think the system would like. A lot of MBS investors don't want to hear you won't buy a mortgage out of [a trust]. It will change prepayment speeds."

Layton stopped short of endorsing any specific policy. "My job is to tell them what those consequences would be and let them deal with it," he said. **ASR**

CRT Could Be Used to Adjust G-fees

Tapping the capital markets for reinsurance does more for mortgage insurers than just reduce their exposure to a downturn in the housing market.

It also provides them with information about how others view this credit risk. One day, this information could be used to adjust premiums.

Arch Capital Group, the largest private mortgage insurer, comes to market twice a year with notes whose performance is linked to insurance policies underwritten over the previous six months. Pricing of these notes provides information about investors views of credit risk that flows back to Arch's premium pricing team.

"To date, there have not been any actual adjustments on the front end, [credit risk transfer] execution has been good," Jim Bennison, executive vice president for capital markets, said.

"But at some point that will likely change as we go through a normal housing cycle," he added.

Bennison noted that the private mortgage insurance industry traditionally used a fairly flat premium that was cross-subsidized; borrowers paid the same rate, regardless of credit quality.

The financial crisis demonstrated that this credit risk had been underpriced, as many private mortgage insurers sustained losses. Arch moved to risk-based pricing in 2009.

Similarly, the capital market transactions that Fannie Mae and Freddie Mac use to offload credit risk provide information about how the market views the guarantee fees, or g-fees, that the two companies charge lenders.

"There's no current linkage, but the FHFA does monitor CRT execution," said Mike Reynolds, vice president for credit risk transfer at Freddie, referring to the Federal Housing Finance Agency.

Reynolds noted that pricing of Freddie's benchmark Structured Agency Credit Risk program is becoming more transparent as the company has been offloading the riskiest tranches of securities issued in these deals. And with over 200 investors, the market for GSE credit risk transfer is very robust, he said. "At a minimum, it's very informative to the FHFA." **ASR**

Complexity Clouds Blockchain's Utility

The first step toward getting a handle on blockchain technology is not to get bogged down in how it works.

Think instead of what it can do, experts say.

"When you look at these technologies, don't start from the ground up, thinking, 'Oh my god, these distributed ledgers, how does all that work?'" said Lewis Cohen, a co-founder of startup legal outfit DLx Law.

Instead, "Start from the top down; what are we trying to achieve here and are these blockchains a tool set that will allow us to doing something much, much more effectively," he said. "When you start looking at it that way, you're going to come back and participate and be much more engaged."

Cohen, whose practice involves companies involved in blockchain and other "disruptive" technologies, is among experts who espouse the longstanding promise of blockchain, such as automating the collection and distribution of current immutable data between parties through a single, non-centralized secured source.

Bernadette Kogler, co-founder and chief executive of RiskSpan, noted multiple applications to mortgage markets – from automating the slow and methodical due diligence work on compliance regulation to redistributing credit risk on government-backed mortgage guarantees without a Freddie Mac or Fannie Mae in the picture. "What does the GSE world look like when you think about redistribution of credit risk, with blockchain you can see a world where there are multiple entities [tied in] that can provide a government and pay that g-fee," Kogler said.

Blockchain, or distributed ledger technology, is envisioned as a means to create a single, secured source of data and information that creates an immutable audit trail of transactions and data between parties, which improved efficiency by eliminating lag times in settlement and payments. It already has already been used in securitization.

In April 2017, a group of 19 institutions participated in a demonstration of a leveraged-loan syndication through a blockchain transaction on a private platform, from Synaps Loans LLC, which involved over 100 participants at 19 banks.

In November, BBVA completed the first-ever leveraged loan syndication in Spain using its homegrown distributed ledger technology. **ASR**

GM Financial's Role Expanding

GM Financial's role as a captive lender has grown considerably in the eight years since it was acquired by General Motors. Now the Fort Worth, Texas, lender is ready to go along for the ride as its parent expands into electric cars and managed fleets of driverless and ride-sharing vehicle fleets.

CEO Dan Berce said all three programs are central to GM's long-term corporate mission of achieving "zero crashes, zero emissions and zero congestion," or "zero/zero/zero." GM Financial has a key role to play, Berce said..

The finance company is already underwriting and managing leases for GM electric cars in China. The lender is also buying and managing fleets for GM's Maven ride-sharing program launched in 2016 in a handful of U.S. and international urban markets, and plans to do the same when GM introduced driverless car fleets later this year through its Cruise Automation division. For now, this financing is being kept on balance sheet, however.

"Mainstream adoption is many years off, but GM's Cruise unit is gearing up to have an autonomous fleet in operation in 2019," Berce said. The plan is to finance operations similar to its support for the Maven program, "and do some management activities as well."

GM Financial's role in the zero/zero/zero initiatives is another example of the finance company's strengthening ties with the automaker since it was acquired by GM in 2010. Berce has headed the firm since 2005, when it operated as the independent subprime lender Americredit Corp.

It took GM Financial nearly eight years to capture the financing business for more than 50% of the automaker's annual vehicle sales last year. "Our [original] vison wasn't what GM Financial turned out to be today," Berce said. "Our vision was what we referred to as a strategy of 'captive-lite.'

Within a year of being taken over, GM Financial opened financing platforms for leasing, dealer inventory and real-estate financing, and by 2013 closed on the acquisition of former GM captive finance partner Ally Bank's international operations. It also built out six platforms for loans, leases and dealer floorplan securitization.

"By 2014, our strategy was to become a full captive," Berce said. **ASR**

Look for More Managed CRE CLOs

Expect even more actively managed CRE CLOs to be issued this year as investors get more comfortable with the idea of managers using proceeds from the repayment of collateral to acquire new bridge loan.

Kunal Singh, a managing director at J.P. Morgan, notes that the volume of actively managed commercial real estate collateralized loan obligations exceeded the volume of static deals issued last year; he expects the proportion of actively managed deals to be even higher this year, perhaps as high as 75%.

Unlike longer term commercial real estate loans, bridge loans can be repaid early. And when one of the loans in a CRE CLO prepays, the economics of the deal quickly deteriorate unless the manager can replace it.

"The reason that actively managed CRE CLOs have gained popularity with managers is that it is a true replica of a balance sheet repo," Singh said. "When a loan pays off" in a repo, "I don't reduce the advance rate" — the amount that can be borrowed against — "on the remaining loans," he said.

Similarly, if a large loan in a CRE CLO pays off early in the life of the deal, reducing the amount of interest earned each month, there may not be enough funds to pay the CRE CLO note holders and all of the other fixed costs associated with the deal, many of which are "front-loaded," occurring early in the life of the deal.

While static CRE CLOs are similar in many ways to CMBS, actively managed deals "take a while to be understood and accepted" by investors, according to Steven Kolyer, a partner at Sidley Austin. They have various features designed to offset the risk that the composition of the pool will change over time, potentially resulting in a deterioration in credit metrics. For example, any new asset that is purchased is subject to numerous criteria.

In addition, any assets purchased after the close of a deal are subject confirmation by a rating agency that it is still comfortable rating the deal. Daniel Chambers, a managing director at Fitch Ratings, said this means that Fitch must be comfortable that losses would be no worse than they would be without the new loan. If Fitch feels losses would be higher, it may not rerate the deal, though it is open to discussing other changes to the deal that could offset the risk of the new loan. "It's a higher-touch asset," he said. **ASR**

Legislative Fix for Libor?

Replacing Libor as the benchmark for outstanding securities is so challenging that an industry working group may ask the New York legislature to lend a hand, said David Bowman, special adviser to the Federal Reserve Board of Governors.

Since most U.S. securities transactions are subject to New York law, it could be expedient to pass legislation defining the London interbank offered rate as the secured overnight financing rate plus a spread, Bowman said.

This would obviate the need to amend documents governing $1.1 billion of leveraged loans and $800 billion of collateralized loan obligations, most of which never anticipated that Libor might cease to be published.

Loans and other floating-rate instruments typically require 100% of investors to sign off on material amendments.

But identifying investors is a challenge because financial assets are held "in street name" by a brokerage firm, bank or dealer on behalf of a purchaser, obscuring their true ownership.

Many existing floating-rate instruments will begin to pay a fixed rate of interest in the event Libor is no longer published after the end of 2021, when current contributors are free to abandon the benchmark. Other notes have no permanent contractual provisions.

"We" — the Alternative Reference Rates Committee — "could go to the legislature and say, 'It's pretty clear that issuers did not intend for these to convert to fixed-rate instruments, and did not envision a permanent stop to Libor,' " Bowman said.

"We need to make sure that the legal arguments are sound" before doing so, he added. And if ARRC it does take that step, "we hope to have wide and vocal support from this industry."

Libor is also used as a reference rate for residential mortgages and other kinds of floating-rate consumer loans, including student loans and auto loans. Bowman said replacing the benchmark for these products must be handled differently, and ARRC will be consulting with the Consumer Financial Protection Bureau and consumer interest groups.

"Any solution for consumers needs to be fair and transparent and in no way harm those consumers," he said. **ASR**

C-PACE Targets Larger Projects

CleanFund and other providers of Property Assessed Clean Energy financing for commercial building are increasingly focusing on larger projects.

While this should boost underwriting volume over time, it may have slowed the growth of the industry in the short term, according to CEO Greg Saunders.

Saunders said that the sponsors of larger commercial developments are starting to see all kinds of advantages to PACE, which creates a lien on a property that is senior to a first mortgage and is repaid alongside property taxes.

It is generally less expensive than some other means of financing energy and water efficiency improvements, such as mezzanine financing.

Local governments are also becoming more supportive, according to Saunders. They realize that they need to offer "policy accommodations" that help offset the added cost of elevated standards for energy efficiency for both new construction and existing buildings.

CleanFund has provided quotes for PACE financing as large as $350 million on a multibillion-dollar developments.

"We see larger PACE financing happening at the expense of smaller projects, those of $500,000, partly because of the cost and time involved in getting commercial mortgage lenders to consent," Saunders said.

So far, CleanFund hasn't financed anything nearly as large as $350 million; most of the deals listed on its website are in the $1 million to $5 million range.

And the largest financing listed on its website is a $40 million funding of seismic upgrades for the Seton Medical Center in Daly City, California. CleanFund provided half of the funding; the other half was provided by Petros PACE Finance.

There is a downside to pursuing larger projects, however. "We were a little disappointed" with industrywide volume last year, Saunders said. "It was only $20 million greater, on reported basis, than the prior year, but in 2017" volume rose 100% over 2016, he said.

The CEO noted that financing for larger projects is more complicated, and so requires more lead time, than does financing smaller projects.

"We took our eyes off the ball for some origination," he said.

ASR

The Handset Rush that Never Was

When Verizon issued its debut handset securitization in 2016, it generated some buzz. There were expectations that other U.S. carriers would follow suit, resulting in a new asset class with significant size. Yet three years later, Sprint, T-Mobile and AT&T have yet to securitize device plan purchase agreements, despite the potential benefits.

"Across the industry, there are other priorities," said Chris Jonas, the direct of ABS banking for Bank of America Merrill Lynch. "Some of the carriers are focused on managing their debt load, so it probably is incongruent to say we're going to add a new debt product as part of the process."

He added, "You have carriers that are focused on M&A priorities right now. It's hard to incorporate a new very public piece of the capital structure to do term ABS."

Two of those carriers, T-Mobile and Sprint, have in the past expressed interest in using term ABS as a cheaper alternative to bank funding. But last year the carriers formally filed plans for a $26 billion merger that's under regulatory review with the Federal Communications Commission.

Since 2012 wireless carriers have been weaning customers off of subsidized phone-contract plans in favor of device-payment installment plans providing zero-percent financing or leasing of phones, usually over a period of two years with no down payment.

This ties up a significant amount of capital, however. Bundling device payments into collateral for bonds frees capital up, and the financing can be matched to the term of the payment plans. DBRS and Moody's have both speculated that the big four carriers could issue approximately $40 billion a year (in 2015 figures).

But establishing a handset securitization platform is no piece of cake, said Jonas. While Verizon has proven their utility, "any issuer knows it takes a lot to get to point A to point B," he said. "So I would say you have to figure out where are the corporate priorities." Upper management must sign off, carriers must work out arrangements with ratings agencies, and the finance and legal teams must learn the due diligence process "soup to nuts," Jonas said. "And servicing afterwards is a process that is probably overlooked." **ASR**

Bloomberg News

Why CFPB's Payday Revamp Is Such a Big Deal

The rollback of underwriting requirements for small-dollar lenders could redefine a legal doctrine that governs other companies.

By Kate Berry

The Consumer Financial Protection Bureau's overhaul of its payday lending rule rolls back a key policy of the prior Obama-appointed leadership. But some observers say the move goes beyond any single regulation.

In proposing to unwind the rule, the CFPB appears to rely on a legal doctrine regarding "unfair, deceptive or abusive acts or practices." A UDAAP is prohibited under the Dodd-Frank Act, but the CFPB can determine what types of conduct meet that designation.

By softening its view toward payday lenders, some experts say the CFPB is also clarifying what constitutes a UDAAP. Such a move, long sought by the financial services industry, could have wide-ranging effects on how the bureau enforces rules at companies other than payday lenders.

"A major concern of businesses subject to UDAAP is that it's ill-defined and is extraordinarily expansive," said Nick Gess, of counsel at Morgan, Lewis & Bockius. "The proposal is a clear indication" of how CFPB Director Kathy Kraninger views UDAAP "and how it could be applied in any matter that comes before her."

The bureau had cited UDAAP in the original 2017 rule, which required payday lenders to verify borrowers' repayment ability. The agency had said then that high-cost, small-dollar loans were both "unfair" and "abusive."

But under Kraninger, the agency rescinded that finding and proposed that the underwriting requirement be eliminated.

"A deeper and more rigorous analysis of the unfairness and abusive standards is a refreshing change," said Jenny Lee, a partner at Arent Fox and a former CFPB enforcement attorney.

"A deeper and more rigorous analysis of the unfairness and abusive standards is a refreshing change."

Some see the move as more generally narrowing the agency's reach.

"They are putting on the record a narrower interpretation of UDAAP, and are making a second argument — that the bureau misapplied the law the first time around," said Casey Jennings, an attorney at Seward & Kissel and a former CFPB attorney, who worked on the 2017 payday rule.

A prohibition on "unfair" and "deceptive" conduct predates Dodd-Frank. But the 2010 law added "abusive" and gave the CFPB authority both to issue enforcement actions for UDAAP violations and to write rules defining the standard. Kraninger's February proposal on payday lending devotes more than 30 pages to the legal findings.

UDAAP has long been a pain point for banks and other financial firms because violators can be fined up to $1 million a day.

Kraninger's proposal argued that former CFPB Director Richard Cordray's interpretation of UDAAP was "problematic," because it relied on "insufficiently robust" evidence.

Cordray's rule found that consumers did not understand the risks of short-term, small-dollar loans. It also found that repeated rollovers of payday loans forced many borrowers into a cycle of debt. As a result, the final 2017 payday rule determined that small-dollar loans are both unfair and abusive unless a lender can determine a borrower's ability to repay a loan.

But lenders argue that Cordray's payday rule failed to take into account consumer choice, and that borrowers of high-interest loans pay annual interest rates of 300% to 500% because they need money in an emergency.

"The elephant in the room in UDAAP cases is whether the likelihood of harm can be reasonably avoided for the consumer," Lee said. "This new approach in the new proposal opens a door to challenge the policy assumption that consumers that choose these products are not allowed to make that choice."

Kraninger's proposal delves into whether Cordray's proposal met the legal criteria to determine whether short-term loans are "unfair" — one, that a consumer could not reasonably avoid an injury from the product and, two, if substantial injury is not outweighed by "countervailing benefits" to consumers.

Determining what is abusive is a tougher standard because little case law exists.

Dodd-Frank defined four different categories of abusiveness using broad language to determine whether a consumer lacked an understanding of the costs and risks of a product, and if the lender took "unreasonable advantage" of the consumer.

Last year, then-acting CFPB Director Mick Mulvaney said the bureau planned a rulemaking to define what types of practices qualify as "abusive" to provide more clarity to industry.

"The CFPB has to talk about abusive in this proposal because they don't want to be inconsistent if they move forward with a further rule on abusiveness," Cordray said in an interview. "It was something Republicans in Congress were hot about early on because they feared the bureau would throw the term around loosely and be too aggressive with it."

Cordray said that he used the term "abusive" sparingly in enforcement actions. However, one example where that standard was used was the $100 million fine against Wells Fargo for opening unauthorized checking and credit card accounts, which the bureau determined was both unfair and abusive.

He said he was disappointed with Kraninger's proposal and the arguments about UDAAP.

"They are trying to suggest that the term abusive in the statute should be read to mirror the term unfair, which on its face is an unusual reading, since Congress added [abusive as] a third term," Cordray said.

Kraninger is looking to garner support for the bureau's proposal by soliciting other regulators to file comments backing the rescission of tough underwriting requirements for small-dollar lenders, lawyers said.

In the short term, financial firms could cite Kraninger's proposal to counter actions filed by state or other federal regulators.

Gess at Morgan Lewis said that if a company is litigating a UDAAP case outside of the payday rule, the company could point to Kraninger's proposal as precedent to push back against an enforcement action.

Cordray said there is still a long fight ahead over the CFPB's payday rule.

"It's going to be a legal battle and it may be up to several courts to decide," he said. "One of the things a court will have to consider is how thorough is the support for the rule and for the proposed rescission." **ASR**

Calif Lawmaker Mulls State CFPB

A California lawmaker is in the "early stages" of exploring how to create a state-level Consumer Financial Protection Bureau.

Assemblywoman Monique Limon, D-Santa Barbara, said March 27 that California needs more consumer protection, either through the creation of a new agency similar to the federal CFPB, or by increasing the enforcement budget of the state's Department of Business Oversight.

"We are working to really rethink what a state CFPB would do," said Limon, who chairs the Assembly Banking and Finance Committee. "We see the presence of predatory lending products in auto loans, payday loans, cash-advance and small-business loans."

Limon held a press conference at the state capitol with former CFPB Director Richard Cordray to build support for more consumer protection legislation. She is backing a student loan borrower "bill of rights" and last month introduced a bill that would cap interest rates at 36% for consumer loans of between $2,500 to $10,000.

Under California law, the interest rate on consumer installment loans of under $2,500 is capped at 30%. But above the $2,500 threshold, the state has no rate cap. Golden State lawmakers have repeatedly defeated legislation that would close the loophole by capping rates at 36% for larger consumer loans.

Cordray said California needs to take the lead because the CFPB has pulled back on overall enforcement, with actions have plummeted 80% in the past year. "If the system is not preventing massive problems and exploitation, even the people that are most careful can be hurt," he said. **ASR**

James Gutierrez, left, founded Oportun Financial in 2005 and left in 2012. Oportun is now run by Paul Vazquez, right.

Silicon Valley Lenders' Rivalry Turns Personal

Seven years after James Gutierrez left Oportun Financial and started a competitor, the acrimony is coming into public view

By Kevin Wack

Bad breakups happen all the time in hyper-competitive Silicon Valley. But the drama between one consumer lending startup and its ousted founder, who now runs one of the firm's top competitors, has turned especially ugly.

In a recently filed lawsuit, James Gutierrez accused Oportun Financial and its venture-capital industry backers of subjecting him to verbal abuse, discriminating against him on the basis of race and fostering a hostile work environment.

Gutierrez founded the company in 2005 and left in 2012.

Oportun hit back this week with allegations that Gutierrez misappropriated corporate funds during his tenure, and also abused his position as CEO to use company employees as personal chauffeurs and to help plan his wedding.

The court papers suggest a fierce rivalry between two companies that tout themselves as providing a more consumer-friendly alternative to payday loans.

Gutierrez is currently the CEO of San Francisco-based Aura, which, like his former company, offers installment loans and caters to immigrant customers.

His old firm and his new one also squabbled recently in the California Legislature over a proposed tweak in the state's consumer lending rules that had big implications for Aura.

Disputed departure

Oportun, which denied Gutierrez's court allegations in a document filed March 11, said through a spokesman that it does not comment on pending litigation.

Gutierrez declined to answer questions on the record, but did provide a lengthy written statement.

Gutierrez' old and new firms also squabbled recently in the California legislature over consumer lending rules with implications for Aura.

He is seeking at least $225,000 from Redwood City, Calif.-based Oportun as compensation for attorney's fees that he incurred during an earlier lawsuit, arguing that the costs are covered by an indemnification agreement he had with the company.

"Oportun's allegations in their response are entirely unfounded," Gutierrez said in the statement.

Gutierrez was a student at Stanford University's Graduate School of Business when he started Oportun, which was originally called Progreso Financiero.

Oportun stated in its recent court filing that Gutierrez was terminated in part because of his ineffectiveness as CEO. The company also said that its business performance has improved significantly as a result of its decision in 2012 to find a new CEO.

"While Mr. Gutierrez, as one of the co-founders, can be credited with having a good idea that led to the founding of Oportun, his shortcomings as CEO eventually became clear to the board," the filing states.

"One of Mr. Gutierrez's primary responsibilities as CEO was to raise equity from external sources at the levels necessary to maintain Oportun's market position and growth projections. Mr. Gutierrez was ultimately unsuccessful in these efforts, thereby focusing Oportun to seek inside financing to continue operations."

Oportun raised $100 million in venture capital and $250 million in debt during Gutierrez's tenure as CEO, he said in his statement to American Banker.

He added that he left company because he and the board no longer saw eye-to-eye.

"As a young, Latino CEO, building a fintech startup in Silicon Valley was no easy task. There was skepticism about our business model, the communities we were trying to help, and the culture we were trying to build," Gutierrez said.

(Oportun is a U.S. Treasury-certified community development financial institution, or CDFI, with a primary mission to lend and invest in low income and underserved communities.)

"Even in this environment, we were able to take a good idea, and build a business around it that is successful to this day."

Since Gutierrez' departure, Oportun has frequently turned to the asset-backed sector to financing lending, with 12 securitizations since 2013, according to Kroll Bond Rating Agency. In 2018 alone, Oportun sponsored four transactions totaling $863 million.

The allleged 'Rambo' incident

In his lawsuit, filed in San Francisco County Superior Court, Gutierrez alleged that Oportun board members had animus for him as a Latino, and he suggested that racial discrimination was a factor in his firing.

Oportun noted in its response that the CEO the company hired immediately after Gutierrez's termination, Raul Vazquez, is also Latino. The firm said that it prides itself on diversity and inclusion, both in terms of the customers it serves and the people it employs.

"The success of Oportun's Latino leaders — including Mr. Gutierrez's successor Mr. Vazquez, who still runs the company today, almost seven years later — confirms the absurdity of Mr. Gutierrez's accusations of discrimination," the company stated in its court filing.

Gutierrez's lawsuit includes one particularly vivid allegation. During a business meeting, David Strohm, an Oportun board member who is a partner at the venture capital firm Greylock Partners, thrust a large knife into a table while yelling and cursing at Gutierrez, according to the complaint.

The knife was described in the lawsuit as a "Rambo" knife — a reference to the weapon brandished by Sylvester Stallone's character in the eponymous films.

Opportun denied in court papers that any such incident ever occurred. A Greylock spokeswoman declined to comment.

Oportun also went on offense, alleging in its court filing that Gutierrez failed to reimburse the company for personal expenses. Gutierrez has called that story false and defamatory.

Gutierrez is seeking reimbursement for attorney's fees that he incurred during class-action litigation brought by Oportun shareholders in 2015.

That lawsuit alleged that Oportun's directors breached their fiduciary duties by orchestrating several rounds of financing — both during and after Gutierrez's tenure as CEO — in which common shareholders were virtually wiped out.

The class-action lawsuit settled last year for approximately $8.5 million, according to Gutierrez. While he was not directly a beneficiary of the settlement, trusts in his name were, as were some of his family members.

During the 2015 lawsuit, Gutierrez was compelled to turn over documents and sit for four days of depositions, which he says led to substantial legal bills. Oportun maintains that those expenses are not covered by his indemnification agreement because they were incurred in furtherance of his interests as a participant in a recovery from the class-action suit.

From court to the legislature

The fight between Oportun and Aura, which until recently was known as Insikt, extends beyond the courts.

While Oportun has approximately 300 retail locations in 12 states, Aura has chosen not to operate its own stores. Instead, the latter company offers loans through a network of retail partners, including the money transmission chain DolEx.

By not opening its own retail locations, Aura has been able to control its expenses. But the decision also subjects the company to a different regulatory framework in California — a key market, since it is home to nearly one-quarter of all immigrants living in the United States — than the one under which Oportun operates.

Aura makes loans in California under a pilot program that until recently had a $2,500 cap on loan sizes. Last year, the company successfully lobbied lawmakers in Sacramento to raise the cap to $7,500. The change in state law was widely seen as benefiting a single company: Aura.

The legislative change was opposed by Oportun, which was already allowed to make loans of more than $2,500 under a different statute.

In comments last year, Oportun stated that the existing restraints under state law on the use of so-called finders — which is how Aura's retail partners are classified — were probably not stringent enough. "We do not want to see that compounded or made worse," Oportun stated. **ASR**

U.S. CLOs Get a Pass from Japanese Risk Retention

Managers will have to jump through some hoops if Japanese banks are to avoid a higher risk weighting on their holdings

By Glen Fest

CLOs managers can avoid Japan's new "skin in the game" rules, though they will have to jump through some hoops.

It remains to be seen how much of a burden this will be.

A final risk retention rule published by the Japanese Financial Services Agency on March 15 has a carve-out for U.S. collateralized loan obligations; it applies solely to CLOs backed by broadly syndicated loans acquired in the open market. In this respect, it is similar to the exemption that such CLOs enjoy in the U.S.

Under the rule first proposed in December, the JFA will require banks to hold more capital on asset-backed holdings that don't meet the risk retention standard. Most U.S. CLOs currently being issued would fall short of that requirement due to the repeal of U.S. risk-retention rules for CLOs last year; so the proposal created great concern in the U.S. CLO industry since Japanese banks are big buyers of the AAA-rated tranches of U.S. CLOs.

In order to avoid triggering higher risk weighting for securities issued by CLOs whose managers do not hold on to 5% of the economic risk in their deals, Japanese banks must ensure that these deals are "not inappropriately formed." According to law firm Dechert, those due diligence exercises include confirmation of "reasonable standards" for the acquisition and replacement of loans by managers, and risk analysis that potentially involve stress tests conducted by the investor that the pool of assets remain sound under JFSA standards.

The final rules apply to deals issued after March 31. Deals issued before that date are grandfathered.

Elliot Ganz, general counsel and chief of staff for the Loan Syndications and Trading Association, said the final rule does not spell out clear pathways to judge loans as appropriately underwritten. "There is a fair amount of uncertainty about what that means and what they need to do to establish that."

Also unknown is how much more compliance preparation activity this will mean for U.S. managers of open-market CLOs. "I think it will be more of a burden," added Ganz. "If you ask me for [information on] five loans, that's one thing. If you ask me for 25 loans, that's five times more work."

Still, the final rule is "largely positive" for CLO managers, according to Wells Fargo. In a report published shortly after the final rule was released, the bank noted that without the carve-out U.S. CLOs would have had to change their strategy once again.

However, structured finance analyst David Preston also cautioned in the report that "Japanese financial institutions will increase their due diligence in CLO transactions, leading to more disclosures/paperwork for U.S. managers."

Wells estimates that Japanese banks own 20% to 25% of the outstanding AAA tranches of U.S. CLOs. (Law firm Milbank, Tweed, Hadley & McCloy estimates that Japanese banks buy 50%-70% of new AAA-rated tranches annually).

in a report issued March 18, law firm Dechert wrote that it also sees more due diligence by Japanese investors "not only with respect to the loans in the CLO at the time the Japanese investors acquire their CLO notes, but also with respect to the credit underwriting and servicing practices of the collateral manager and the stress testing and structuring of the CLO."

The final rule also clarified that Japanese banks will be subject to higher capital requirements for U.S. CLOs backed by loans to small and medium-sized companies that don't comply with risk retention, according to Ganz. Managers of these deals generally use them to securitize loans that they originated themselves and hold on their balance sheets. This is less of a concern, however, since managers of so-called middle-market CLOs generally retain a large economic interest in their deals.

Japanese banks' due diligence efforts could create more disclosure/paperwork burdens for U.S. CLO managers

The LSTA has been in talks with Japanese regulators since before the Dec. 28 proposal was first issued, lobbying for the exemption and clarifications to the statute. In January, the trade group filed a comment letter with the JFSA taking the position that broadly syndicated loan CLOs should be exempt because they are not securitizations as defined by the JFSA.

The LSTA asserted that since CLO managers do not underwrite the loans they acquire in the open market, their portfolios do not constitute a collection of originations – or "original assets" – by the sponsor. Without "original assets," there is no securitization, which, in turn, means no securitization exposure for CLO investors. **ASR**

IMN
Information Management Network

The 8th Annual
INVESTORS' CONFERENCE ON CLOs & LEVERAGED LOANS

May 20-21, 2019 | New York, NY

550+ CLO MANAGERS, INVESTORS & MORE ALREADY CONFIRMED!

Featured Keynote Speaker:

David Bowman
Special Adviser to the Board
Federal Reserve System

Lead Sponsors:

Bank of America Merrill Lynch
Deloitte.
Moody's
S&P Global Ratings
Wells Fargo

Partner Sponsors:

Clifford Chance
Credit Suisse
FitchRatings
Goldman Sachs
J.P.Morgan
Morgan Lewis
pwc

Patron Sponsors:

Allen & Overy
BNY Mellon
Dechert LLP
EY Building a better working world
Jefferies
KPMG
Mayer • Brown
Morningstar
Natixis Beyond Banking
Paul Hastings
usbank.
Winston & Strawn LLP

Associate Sponsors:

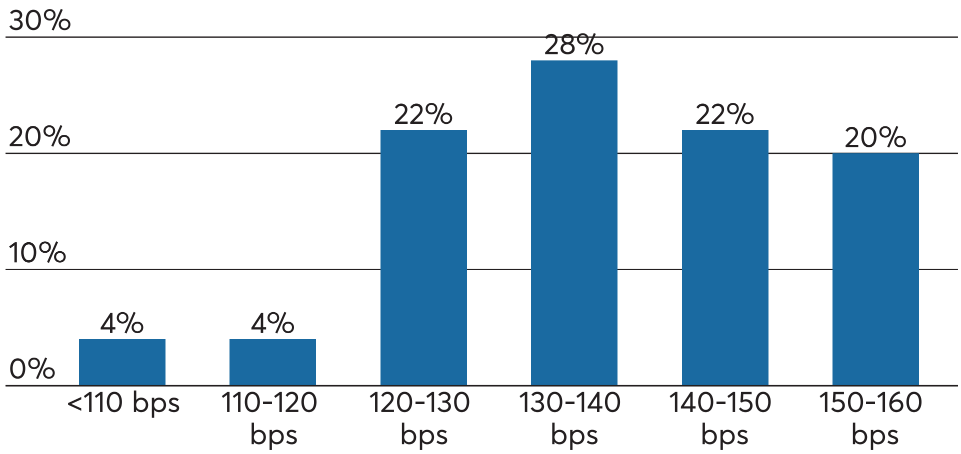
Cortland* Part of Alter Domus Group
DBRS Insight beyond the rating
Katten KattenMuchinRosenman LLP
KBRA Kroll Bond Rating Agency
MUFG
Seward & Kissel LLP
Sky Road
Wilmington Trust

Exhibitor Sponsors:

ClearStructure Financial Technology
Crestbridge
Intex
Locke Lord
NetRoadshow
Perkins Coie Counsel to Great Companies
Refinitiv
Trepp
Walkers

www.imn.org/clo - For sponsorship opportunities, contact Chris Keeping at 212-901-0533 or ckeeping@imn.org

Where AAA Spreads Will End Year



Source: JPMorgan survey of CLO AAA/equity investors March 14-19

Why CLO Managers Are Issuing Shorter Deals

Investors will accept lower spreads in exchange for tying their money up for less time; managers may be hoping to refinance

By Glen Fest

After a shaky start to the year, CLO issuance is now running slighlty ahead of the pace as the record issuance of 2018. The nearly $11.5 billion in new deals in February brought year-to-date volume to $38.5 billion, compared to the $30.25 billion in deals issued in the first three months of 2018.

But spreads on securities issued by collateralized loan obligations remained flat or slightly widened across the capital stack during the month, according to Wells Fargo market research. The average spread on AAA rated CLO securities issued in February was 133 basis points over Libor; that was 12 basis points wider than the 121 basis points average reported by Refinitiv for December, but still well wide of 98.14 basis points in March 2018.

A number of CLO managers have responded by issuing deals with unusually short life spans – as short as one year, compared with a more typical four- or five-year reinvestment period before amortization – in order to reduce their funding costs.

On Feb. 13, Voya Asset Management issued the $399 million CLO with a one-year reinvestment period, in exchange for which investors accepted a spread of just 117 basis points over Libor.

The same day, BlackRock Financial Management printed a $500 million CLO that has a reinvestment period of three years and can be called, or repaid early, as soon as one year after issuance. (The collateral for the deal also has maximum weighted average life of seven years, compared with an average maximum WAL of 8.5 years for CLOs rated by Fitch Ratings in the fourth quarter.) The spread on the senior notes is 128 basis points on the triple-A rnotes.

"If you were an AAA investor [last year], you were running in place a lot ... you don't have that right now."

Market difficulties "always lead to some sort of innovation," said John Nagykery, a team lead for CLOs at Morningstar Credit Ratings said at SFIG Vegas. In addition to shorter reinvestment periods, Nagykery said Morningstar has received inquiries on other "bespoke" structures including principal protected notes, collateralized fund obligations, and CLOs that use both loans and bonds as collateral.

There are a number of factors impacting CLO spreads. CLOs and other floating-rate assets have lost some of their allure with investors now that the Federal Reserve appears to have stopped raising interest rates. This makes fixed-rate investments relatively more attractive.

There may also be residual concerns about the riskiness of leveraged loans, as regulators continue to harp. Former Federal Reserve chair Janet Yellen, who spoke in a closed session at the same industry conference, expressed her concerns that leveraged loans have been weakened by "egregious underwriting deficiencies" and that lenders' weaker covenant restrictions on corporate borrowers, could be a cause of another economic downturn, according to participants.

It's also possible that some Japanese investors, who are big buyers of the senior tranches of securities issued by CLOs, were sitting on the sidelines until Japan's Financial Services Agency finalized proposed rules that could impose onerous capital burdens on holdings of CLOs whose managers don't retain skin in the game of their deals. While regulators chose to exempt CLOs when the rule was finalized in March, there was initial concern the rules could have had a dramatic impact on the U.S. market.

And as CLO spreads continued to widen, refinancing activity has slowed, which in turn conributed to the early-year slowdown in new issuance, according to Gretchen Lam, a senior portfolio manager for Conning's Octagon Credit Investors. Last year, investors had to replace holdings in $83.8 billion in CLO securities that were refinanced or resets, which involve managers transferring collateral for existing deals to new deals with longer terms. "If you were an investor in AAAs [last year], you were running in place a lot" selling and buying CLO paper, said Lam. But "you don't have that right now."

Whatever the reason, it's unattractive for many managers to issue new deals with CLO spreads at current levels. The collateral for new deals is typically assembled over a period of weeks or months using what is known as a "warehouse" line of credit. When the loan market tanked late last year, a number of managers were in the process of warehousing loans; the violent selloff in November and December left them holding assets worth less than what they paid for them.

And since prices of CLO securities have also fallen, it's less attractive to "term out" this warehouse financing by selling the loans to a securitization trust. The bonds that would be issued to finance the purchase of the loans might not fetch enough to recoup a CLO manager's original acquisition costs. Even in some cases where managers could recoup their initial investments in the loans, the yield on the assets might not be sufficient to adequately compensate holders of the riskier tranches of notes to be issued.

"Any new CLO warehouse is thirsty [for loans] at these low prices, but existing warehouses that were pretty fully ramped [before the loan selloff] might not necessarily have the ability to (execute a deal). Their portfolios are slightly under water," said Kevin Kendra, a managing director at Fitch Ratings. "There's still strong investor demand for the asset class at the top of the capital structure; the hard part now is reconciling the equity part of equation."

Structuring a CLO with a shorter life span is one way for CLO managers to lower their funding costs, if investors are willing to accept narrower spreads in exchange for getting their principal back sooner. And shorter noncall periods give them the opportunity to refinance should market conditions improve.

PGIM Fixed Income was another issuer to sponsor a short-term new-issue CLO, when it closed a $428.8 million portfolio on its Dryden platform in January with a six-month optional redemption date and one-year reinvestment period. Assurant CLO Management also priced the $450 million Assurant CLO IV with a three-year reinvestment/one-year noncall window.

Other CLO managers appear to be taking a wait-and-see approach, holding out for better market conditions, something that is possible because warehouse lines typically have legal maturities of one or two years. DBRS, which rates some CLO warehouse lines, noted that CLO warehouses typically have six- to nine-month durations, and so these are going out to nine to 12 months. "Rated warehouse terms aren't necessarily extending, but we see actual warehouse durations stretch longer," said Jerry Van Koolbergen, a managing director and structured credit analyst with DBRS.

Smaller CLO managers who are underwater on warehouse lines may have an even harder time securitizing because investors are currently demanding additional compensation from them than they are for CLO securities issued by larger, more established managers. The triple-A rated tranches of CLOs from smaller and newer managers issued in February has spreads in the high-140/mid-150 basis point range, compared to established managers who are pricing deals at 133-136 basis points, according to Wells Fargo.

Take Los Angeles-based TCW Asset Management, on Feb. 13, the manager priced its fifth transaction – and the first in two years – the $403 million TWI CLO 2019-1 AMR: the deal has a two-year reinvestment period and is noncallable for one year, yet the triple-A rated senior tranche still pays a hefty 144 basis points over Libor. Moreover, this rate steps up at the end of its noncall period and reinvestment period.

AIG, which returned to the CLO market after a decade-long hiatus, issued its first deal of 2019 with a spread of 142 basis points. That was well wide of the 132 basis point spread over Libor it gained for its debut deal that priced only two months prior.

A potential driver for more short-duration CLOs in the coming quarters is investor preference. In a March survey of CLO AAA-securities investors, a plurality of 44% indicated they preferred deals of reinvestment periods of under three years in the current market environment. Only 22% indicated they would rather buy into deals with the more standard four- and five-year reinvestment periods, according to JPMorgan. **ASR**

Bloomberg News

SCOTUS Foreclosure Ruling a Win for Lenders

Tthe court placed new limits on the ability of consumers to sue law firms that handle foreclosures on behalf of mortgage servicers

By Kevin Wack

The Supreme Court placed new limits Mqrch 20 on the potential legal exposure faced by law firms that handle foreclosures on behalf of banks. The 9-0 ruling is likely to reduce the costs that mortgage servicers incur when foreclosing on borrowers who live in states that do not require judicial proceedings to take possession of a home. It also figures to make it somewhat harder for distressed homeowners in those same states to stave off foreclosure.

Still, the mortgage industry's win was not as sweeping as it might have been, since the justices made clear that they are not giving blanket immunity from federal debt-collection rules to law firms that represent banks in foreclosures.

The case was brought by Dennis Obduskey, a Colorado man who defaulted on a $330,000 mortgage around 2009. Wells Fargo, the creditor, hired McCarthy & Holthus in 2014 to act as its agent in carrying out a nonjudicial foreclosure. After being contacted by the law firm, Obduskey responded with a letter invoking the Fair Debt Collection Practices Act, which states that if a consumer disputes the amount of money owed, a debt collector must stop collection until it has sent verification of the debt to the borrower. The law firm allegedly moved ahead with the foreclosure without taking that step.

The case hinged on whether McCarthy & Holthus fits the law's definition of a debt collector. The Supreme Court concluded that it does not, as long as the law firm is taking steps required by state law to carry out a nonjudicial foreclosure. But the court's opinion, written by Justice Stephen Breyer, also suggested that law firms could still be sued if they try to collect money that the borrower owes, as opposed to merely taking steps that are mandatory prior to foreclosure.

Justice Sonia Sotomayor wrote a concurring opinion in which she noted that Congress can clarify the law if the court is interpreting it incorrectly.

The court's unanimous opinion drew praise from the Mortgage Bankers Association, which had filed a brief in support of the law firm's position.

The ruling will result in smaller legal bills for the mortgage industry, said Matt Podmenik, general counsel at McCarthy & Holthus. "Had the Supreme Court ruled the other way," he said, "you'd have to litigate these cases further and longer."

Christopher Willis, a partner at Ballard Spahr. said that banks now face a trade-off. If they assign more responsibilities to the law firms, they may be able to recover more money from delinquent homeowners, but they also face the prospect of higher legal costs.. If they limit the duties they give to law firms to steps that are required by the states, the reverse figures to be true. **ASR**