Risk retention win could be tip of the iceberg for regulatory loosening

Max Adams

The Loan Syndication & Trading Association’s win over federal regulators exempting CLO managers from risk retention could be just the beginning for the loosening of regulatory reform, said market pros speaking on day two of SFIG Vegas.

“I expect we’re going to see more chipping away at the regulation that’s in place,” said Lea Overby, managing director and head of CMBS research at Morningstar Credit Ratings. “We believe risk retention is a good thing but we see that we are entering a period where we may struggle to reach a

Citi eyeing ‘Marcus-style’ online consumer lending

Sasha Padbidri

Citi is eyeing the launch of an online consumer lending service similar to Goldman Sachs’ Marcus platform, according to sources speaking with GlobalCapital at the SFIG Vegas conference.

Executives at Citi are already in discussions about launching the product, according to the people, though the bank has yet to settle on a name or a formal timeline.

“There’s been real talk about this from people at Citi,” said one of the sources familiar with the discussions. “It would be interesting to see how they go about doing this because there is the potential for this to get messy if it’s not executed properly, given Citi’s lending business,” he added.

Citi already has a personal loan business which offers fixed-rate loans ranging from $2,000 to $50,000 that borrowers are able to repay over the course of 12, 24, 36, 48 or 60 months.

In ABS, the bank has arranged several marketplace lending securitizations, including Lending Club’s CLUB deals and Marlette Funding’s MFT transactions.

Citi also sponsored the CHAI shelf, in which it bought and securitized loans originated through the Prosper platform. The formal partnership between the two firms ended in April 2016.

A move into

Rating agencies turn to industry veterans to tackle CLO deluge

David Bell

In a booming CLO market, managers have found a new bottleneck in the deal pipeline – squeezing their transactions in with rating agencies that are swamped with deals. The agencies are calling on veterans of the CDO market to help take on the challenge.

“The biggest challenge in the last six months has been the rating agencies,” said one CLO equity investor. “They’re just completely buried, and deals are being delayed.”

Volumes in the new issue market alone have ramped up the pressures on rating agency capacity, after volumes almost doubled to around $118bn last year.

But combined with refinancing and reset transactions, last year’s $245bn of deals was the busiest year on record for the CLO market, according to Rishad Ahluwalia, managing director at JP Morgan, speaking on a panel discussion at SFIG Vegas on Monday.

The growing prevalence for managers to opt for reset transactions, over simpler refinancing, has put increased strain on rating agency resources. Refi transactions boomed in 2016 and 2017 as managers took advantage of the Crescent no-action letter, allowing them to refi deals without needing to stump up risk retention capital.

But most eligible deals have now been refinanced in this way, leading managers to focus on more substantial reset deals, piling on additional work for the rating agencies.

“This time last year it was all about refis, now it’s mostly resets,” said Eric Hudson, senior director in structured finance at S&P Global Ratings. “It’s almost doubling the work load, with new issue

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Pictures

Shots from
day two

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AGENDA

8:30 AM
Delegate Registration and Breakfast

9:00 AM
Keynote Speaker Fireside Chat with Comptroller Otting, OCC
- Richard Johns, Executive Director, SFIG (Moderator)

9:40 AM
Keynote Speaker
- Steven Levitt, Economics Professor; Co-Author, UNIVERSITY OF CHICAGO; FREAKONOMICS

10:20 AM
Refreshment Break

10:35 AM
Keynote Speaker
- Dana Wade, Office of Housing’s General Deputy Assistant Secretary, FEDERAL HOUSING ADMINISTRATION

11:10 AM
Filling the Generation Gaps – Comparing Solutions to Age Old Problems: What Would A Millennial Do?

11:50 AM
Women in Securitization
- An assessment of progress made since the beginning of SFIG’s WiS initiative
- Where does the momentum currently sit?
- What are the qualitative impacts that initiatives like WiS have on organizations?
- Where do we go from here?
- How do we measure our progress along the way?

12:30 PM
Delegate Luncheon
- Commence Concurrent Tracks A, B, C, D

1:30 PM
TRACK A Market Best Practices in Reporting and Disclosure in MPL, RMBS and 144A Markets
- SFIG’s MPL best practices initiative
- RMBS 3.0
- 144A: What happens if the SEC does not do something? What could the industry do?

1:30 PM
TRACK B Investing Down Under: The Aussie ABS/ RMBS Market
- Economic and collateral performance trends
- Participation of global investors in the Aussie ABS market
- Outlook for Aussie RMBS and ABS in 2018

1:30 PM
TRACK C CLO Manager Roundtable: Credit Selection and Risk Retention Implementation
- What were the various strategies developed for smaller managers without the ability to finance via their balance sheet or private equity? How did they fare?
- What are the implications of the Court of Appeals ruling? Does everything change immediately? Will we see deconsolidation or the reemergence of smaller managers?
- Will the global CLO market become fractured in the context of European risk retention rules remaining in place?

1:30 PM
TRACK D State of GSE Reform: Discussion of Current Reform Models in Play and Their Relative Merits
- What are the areas of commonality among plans?
- What are the leading plan prospects?
- What are the hurdles to implementing commonly recommended changes?

2:20 PM
TRACK A Unsecured Consumer ABS Issuer Roundtable: SLABS, Credit Cards and MPLs
- Overall performance trends in these asset classes
- Online versus offline: Is there a material difference in the performance of the loans?
- Mainstreet vs. Online lenders vs. Bank lenders

2:20 PM
TRACK B China: Considerations for Foreign Investors and Key Market Developments
- Appetite for Chinese securitization market by foreign investors
- Recent loosening of foreign investment restrictions
- Challenges as a foreign investor in China’s domestic securitization
- What are the channels they invest in local market?
- The case for deepening local currency markets: experience from other markets
- Local currency ABS investments

2:20 PM
TRACK C The CLO Equity Investor Roundtable
- Has the investors’ view of the managers changed in light of Risk Retention implementation and credit volatility in the past year?
- Outlook for refinancing activity
- What offers better value these days: USD equity vs Euro equity?
- Where is CLO arbitrage going amid an interest rate hike?

2:20 PM
TRACK D The Credit Risk Transfer Market: An Overview and Update on Developments and Issuance Outlook
- How have the Mortgage credit markets changed in response to CRT and what continued adoptions do we expect to see?
- Are the GSEs considering expanding the assets covered in risk transfer transactions?
- What can the PLS market learn from CRT and vice versa, respectively.
- How can risk transfer programs be leveraged to deliver on affordable housing goals?

3:10 PM
Refreshment Break

3:30 PM
TRACK A Engine Check: Auto ABS Sector
- Liquidiy - issuance and spread performance
- Impact of regulatory changes and outlook
- Mortgage Registry
- Smart Contracts

3:30 PM
TRACK B Blockchain in Practice: A Series of Case Studies (Continued)
20-minutes each:
- Smart Contracts
- Mortgage Registry
- TBA

4:20 PM
TRACK C CMBS Perspectives on Dealing with Risk Management
- What are we seeing in terms of risk retention vehicles: structures and investors
- Update on the Q-CRE

4:20 PM
TRACK D An Update on the Single Security Common Securitization Platform
- Program features
- TBA securities labeling conventions
- Exchanging Gold securities for UMBS
- Portfolio management considerations

5:10 PM
TRACK A 2018 Leadership Outlook for Marketplace Lending: The Marketplace Lenders’ Roundtable
- Where are we in the recovery process? Current landscape of marketplace lending: assets funded, key players, underwriting standards and lending volume
- Future for marketplace: entering a new phase of growth? How will the industry evolve and mature?
- What further healing does the industry need?

5:10 PM
TRACK B Blockchain in Practice: A Series of Case Studies (Continued)
20-minutes each:
- Smart Contracts
- Mortgage Registry
- Disclosure

5:10 PM
TRACK C Canadian Update on Cross Border Investment Developments
- Where are investors seeing relative value across the Canadian ABS landscape?
- Areas of concern for US investors?
- Due diligence requirements
- Private versus public issuance appetite

5:10 PM
TRACK D Diversity in Finance

6:00 PM
Day Three of SFIG Vegas Concludes and Delegate Networking Reception Commences
CLO managers jump the gun on risk retention rollback

David Bell

Even before the potential rollback of risk retention rules has been confirmed, CLO managers have been rushing to include language in new deals that allows them to take advantage of a repeal, according to lawyers working on the deals.

The federal agencies that lost the case against the Loans Syndication and Trading Association on February 9 have until April 2 to appeal the decision. If no appeal comes forward by that date, CLO managers will no longer be required to hold risk retention notes of the deal.

Some managers are making sure they are in a position to take advantage of that in deals that are already being marketed, before there is any certainty over the ruling.

Transactions are being marketed at the SPIG Vegas event that include language saying the manager will not hold a 5% vertical strip of the deal, in the event CLO risk retention is no longer in place after April 3. The closing date of such deals is after that date, according to a lawyer working on one of them.

In that instance, the manager has previously locked in vertical strip financing through arranging banks. With the new deal, instead of committing to paying for financing, the manager has lined up conditional external financing – which would not be used if risk retention no longer exists.

In the event that the rule is still in place, the size of the deal would be increased by 5% and the manager would buy it using this third party financing.

Speakers on a CLO panel on day two of the SPIG Vegas event warned that the industry should not take risk retention rollback as a foregone conclusion. One panelist pointed out there was still a possibility that federal agencies could appeal the decision.

A second lawyer told GlobalCapital that there were other potential impacts over the risk retention rule that had not been fully considered by the industry yet.

One is the practice of rolling the assets from old CLOs into new structures – the “call and roll” trade. This has become increasingly popular, given the scarcity and high cost of sourcing loan assets.

Speaking on one of the CLO panels on Tuesday, Loris Nazarian, executive director at Morgan Stanley, said the market could expect to see managers look to use this method more, particularly with transactions that were refinanced under the Crescent no-action letter, which prevents further refinancing.

“A lot of CLOs that were done in the early period of the Crescent letter will likely be called. New issue deals can be seeded with those portfolios, which would accelerate ramping on new issues.”

But the lawyer suggested that, among other aspects of risk retention rollback that are still to be fully considered, there could be questions over whether this call and roll practice would allow certain deals to qualify for a risk retention exemption. This is because the ruling applies only to “open market CLOs” where the assets are sourced externally.

“If they have a substantial equity interest in the old deal, it could look more like a balance sheet transfer,” she said.

The new issue market has slowed in recent weeks, particularly for deals from managers that ordinarily turn to external financing for vertical strips. But for large managers that have set up capitalised vehicles with external money, the market is wide open, according to sources.

“There’s so much demand for paper, and I think the larger managers will still come in for a tight print,” said the first lawyer.

Citi eyeing online consumer lending

Continued from page 1

online lending by Citi would be the latest example of banks wading into territory claimed by market disruptors like SoFi and Prosper. It also points to a trend of big banks throwing more weight into consumer-focused businesses.

Goldman Sachs’ Marcus, which originates no-fee, fixed-rate personal loans up to $40,000, was launched in October 2016. The product was part of Goldman’s foray into consumer banking that also included the launch of Goldman Sachs Bank. In April 2016, Goldman acquired the online deposit platform of GE Capital Bank, and took on $16bn in deposits.

Another source also familiar with the plans attributed Marcus’s success to its parent bank keeping the Goldman business separate from Marcus.

“The reason why Marcus works is because Goldman Sachs is very insistent on keeping the divisions separate. Also the clients that Goldman traditionally cater to versus Marcus are quite different, whereas Citi already has history as a personal lender,” he said.

A spokesperson for Citi declined to comment on plans for the online lending business.
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Risk retention exemption could spill over to other ABS

Continued from page 1

happy medium between what we have now and what things could look like in a few years.”

Overby said that as far as CMBS is concerned, risk retention has strengthened the market, with many risk factors in CMBS conduit pools declining since implementation. Weighted average loan to value ratios, for instance, are down to around 58%, from 66% pre-risk retention, according to Overby.

Although the LSTA and CLO managers cheered the February 9 ruling by the District of Columbia Court of Appeals as a win for the market, not all structured finance players have been keen to see the rule scrapped. Some fear that doing away with it will open the door to some of the excesses that brought on the financial crisis.

“We don’t want to see managers swinging for the fences and taking as much risk as they can. In our view, this is a net negative, and we’re concerned it could spread to other asset classes. We think skin in the game is an important part of the puzzle,” said MetLife managing director Scott Waterstredt. “We see it as potentially loosening something that protected from the excesses of the past.”

Regulators have 45 days from the ruling to appeal the court’s decision, but the speakers said that the market should not expect that to happen given the priorities of the administration.

“My gut reaction from this administration is that they are absolutely not going to appeal,” said SFIG’s Kristin Eagan. “I don’t think there is any appetite to appeal and I don’t think key regulators at these agencies would think appealing is a valuable use of government resources.”

In fact, the future could hold even more loosening of financial regulations. Eagan pointed to two Treasury reports from last year as a potential roadmap for what further easing of risk retention could look like for other asset classes.

In June and October, the Treasury hinted at its attitudes toward risk retention, singling out private label RMBS and suggesting a repeal and revise of the rule as it relates to the asset class. In the October report, the Treasury came out even stronger against the rule, and recommended that the five year hold period be reviewed. It also said that risk retention should ultimately be regulated by one agency, rather than the six that are in charge of it now. This would be a welcome relief for issuers who have complained bitterly about the difficulties in obtaining guidance on compliance from a patchwork of federal regulatory bodies.

“So if risk retention is something regulators will consider revising, the Treasury report will be one of the first places they go,” said Eagan.

She cautioned, however, that market players should not hope for a wholesale repeal from Congress, stating that the best bet is for regulators to go back in and rework the rule rather than hoping for it to be re-legislated.

Solar market eyes self-sponsored structures

Sasha Padbidri

Solar securitization experts on a panel at the SFIG Vegas 2018 conference on Monday observed that they are beginning to see ‘more and more similarities’ between the solar market and marketplace lending ABS, with some market participants starting to see the benefits of self-sponsored securitizations.

The panelists said that the self-sponsored securitization deal format, which has been adopted by larger players in the marketplace lending industry, mainly SoFi, Prosper and Lending Club, could benefit the solar securitization market and boost liquidity for the growing asset class.

Eric Neglia, senior director at Kroll Bond Rating Agency, indicated that the adoption of the self-sponsored deal format would be welcomed by investors and rating agencies, and give issuers control over their securitization programs.

“We’ve seen this happen in the unsecured consumer and marketplace lending space. Platforms will sell loans to whole loan investors – they hold that on their balance sheet for a little bit and then bring it back into a securitization. We’re comfortable with that, investors are comfortable with that...lenders have more control over the securitization process, credit enhancement structure and the cadence. It provides diversity of funding sources and more control over the securitization program,” Neglia told a crowded room of attendees.

Deal flow for solar securitizations was thin in the early days of the market, following SolarCity’s watershed deal in 2013.

In the last two years, a combination of growing investor familiarity with the asset class and low yields in elsewhere led to a spike in deal volume, with the number of solar securitizations jumping from $321m in 2016 to $1.4bn in 2017.

Though there have been no deals so far in 2018, the panelists indicated that issuers would tap the market as investor demand for higher yielding bonds continues.

Katya Baron, managing director at Mosaic, which originates home solar panel loans, described the investor reception for the firm’s October 2017 deal as a “food fight for bonds”.

“We saw 5x oversubscription on the seniors and 12x oversubscription on the subordinated notes. It shows that there’s strong interest in a green bond product that’s backed by high quality secured consumer loans,” said Baron.

Mosaic has already adopted a hybrid approach to funding its originations, using both warehousing and securitization, in addition to whole loan sales.

Panelists also acknowledged that the solar securitization industry is developing and still lacks historical data, meaning that market participants have to rely on proxy data to model curves and loss assumptions.

“We at Goldman are buying loans from Mosaic, and provide warehouse facilities for them. We’ve also been an underwriter on transactions,” said Katrina Niehaus, managing director at Goldman Sachs, referring to a purchase agreement made in September 2017 in which GS Bank agreed to purchase $300m in home solar loans originated by Mosaic.

“The main thing is that industry is still developing so we’ve been working with Kroll to figure out the capital structure and get data on prepay and defaults,” said Niehaus.
Regulation cuts may not boost dealer balance sheets

Owen Sanderson

Cuts to trading capital requirements for securitizations would be welcomed by dealers, but are unlikely to result in major boosts to balance sheet commitments, according to securitization pros at SFIG Vegas 2018 on Monday.

“I don’t agree that an easing of bank capital regulation will increase banks’ appetite to hold more bonds,” said Matt Mcqueen, head of securitized credit trading at Bank of America Merrill Lynch, speaking on the traders’ panel at SFIG Vegas on Monday. “At the end of the day we buy bonds from clients because they want to sell them, and because we think we can sell them on at a higher price,” he added.

He continued: “If capital regulation eases up, that’ll be good, but we’re not going to triple our balance sheet to earn more carry. Some people might, but it won’t end well for them”.

Mcqueen argued that the structure of the market is fundamentally different from the pre-crisis era, with more active trading accounts – and therefore greater price volatility than before. The pre-2007 market featured heavy demand from banks and SIVs which tended to sit on triple-A assets rather than trade them, resulting in lower levels of price volatility. Dealers were also more willing to hold large portfolios of trading assets, he said, as they expected price moves to be contained.

The US Treasury published a paper in October outlining its thoughts on how to regulate capital markets, including securitized products.

The paper recommended rationalising securitization capital treatment so that the market was not disadvantaged compared with other ways of holding the same economic risk, and noted several problems with the existing capital treatment of securitizations.

It also came out strongly against the Basel Committee’s Fundamental Review of the Trading Book (FRTB) treatment of securitization, noting: “The implied capital required under FRTB would make secondary market activity uneconomic for many banks, thereby hindering ABS liquidity...Such requirements would act as a disincentive for banks to participate in secondary market trading for securitized products, thereby reducing liquidity vital to the success of this market.”

The proposals in the paper have been seen by the securitization industry, as well as the broader banking and capital markets community, as moderate and thoughtful, and there is widespread hope that they will be adopted.

But an SFIG Vegas panel earlier on Monday noted that there’s still a long way to go on the regulatory front. One panellist working at a buyside firm, who was speaking off the record, noted that the Treasury has relatively limited authority to actually implement many of its recommended changes.

Bank capital issues are in the hands of the Federal Reserve, the FDIC, the OCC and other bodies, while capital markets and securitization issues touch the jurisdictions of the SEC, the CFTC and CFPB, none of which can be directly compelled by the Treasury without Congress passing legislation, he said.

“There has been lots of debate and discussion about what the Treasury paper means,” said the buy-side panellist. “But we need legislation to move the regulatory effort forward. The regulatory organizations are responsive and sympathetic to the Treasury’s views but may be unwilling to move on their own.”

CLO pipeline clogged as rating agencies struggle with workload

Continued from page 1

and reset deals,” he said.

“Resets are trying to mirror new issue deals, in terms of updating the indentures. It’s a pretty significant review. There’s a lot more work being thrust upon rating agencies in general,” he said.

The additional reset volumes are particularly complicated due to the number of moving parts that need to fall in place, particularly when the deal can only be reset on a specific payment date.

“In some older CLOs, changes to indentures need to be finalised 15 business days before the reset date,” said one lawyer on the sidelines of the conference. “If arranging banks aren’t wise to that, deals can lose their slot with the rating agencies and move to the back of the queue. I’ve seen deals delayed for several weeks because of this,” said another lawyer speaking on the sidelines of the conference.

“It’s not just the volume that is causing a backlog for rating agencies, said Jian Hu, managing director of structured finance at Moody’s Investors Service. He said that increasingly complex and aggressive terms are being introduced in reset deals, many of which are new to the market and require lengthy analysis.

“This is taking up additional time. Many of these changes come to us at the last minute,” he said.

“In the early CLO 2.0 era it would take two to three weeks to rate a deal. Now it takes six to eight weeks, from the date we get a good set of documents. We want to make sure the product remains robust. The rating performance of CLOs has been strong, and it’s our goal to ensure this continues,” he said.

Managing this overwhelming amount of deal volume has been tricky. The head of structured finance at one rating agency said at the conference that it was difficult to ramp up hiring during busy periods, because of the cyclical nature of the CLO market.

“If the market falls away – what are those new hires going to do, work in the canteen?” he said.

Both Moody’s and S&P Global Ratings said that they have turned to veterans of the CLO market, who may have subsequently moved to other asset classes within the business, in order to help process the flood of deals. Many were involved in the pre-crisis CDO market. Both agencies said they have also made additional hires and ramped up training programs to help bring new and junior staff up to speed.

S&P said it is also drawing on its European structured credit team to help meet demand for US ratings.

The lawyer said that the strain on rating agencies, as well as other service providers in the market, was likely to get worse as a result of the potential roll back of risk retention rules – probably increasing the number of managers in the market, and therefore competition for resources.

“We’ve been talking to some funds that have been out of the CLO market for ten years, and they’re now saying – let’s get started again,” said the lawyer.

Rolling back risk retention would make it easier for managers to reset more of their existing deals, an attractive trade because of the difficulty of sourcing attractive assets in an expensive leveraged loan market.

“It takes down some of the barriers to refi and reset deals. Managers have had to be choosy on how they deploy risk retention capital, and they may have held off for economic reasons,” said Jacob Wentworth, vice president and corporate counsel at PGIM Fixed Income, speaking on a CLO panel at the conference.
MPL ABS set to grow in 2018, but credit cracks begin to show

Sasha Padbidri

The online lending sector is anticipating a swell in deal volume this year, but market participants speaking with GlobalCapital are raising the alarm on increasing consumer leverage and deteriorating loan quality.

A key factor behind the predicted surge in deal volume is the use of the self-sponsored deal format by Marlette Funding, SoFi, LendingClub and Prosper. The model has been touted by many in the industry as a “win-win” situation for both issuers and investors, and was a big driver of liquidity in the sector in 2017.

“Over the past year, there has been an increase in the number of marketplace platforms who are sponsoring their own securitization programs. The platforms want to control the process to ensure consistency, to manage the timing of coming to market and to avoid having competing deals coming out at one time,” said Rosemary Kelley, senior manager and co-head of ABS at Kroll Bond Rating Agency.

According to data from PeerIQ, cumulative online lending ABS issuance as of the fourth quarter of 2017 stood at $28.2bn across 106 transactions, with 2018 issuance projected to grow by 30% to $18bn.

Valerie Kay, head of the institutional investor group at LendingClub, indicated that more online lenders could issue self-sponsored deals this year. Last year, LendingClub issued a total of four self-sponsored securitizations from its prime and non-prime shelves, which were heavily oversubscribed by investors.

“We believe there will continue to be an increase in self-sponsored securitizations as these types of deals promote liquidity, velocity and standardization, and are keys to success and access to the capital markets. It is important to develop a strong brand and control your brand and your reputation in order to achieve a broad distribution among investors,” she said.

In January, GlobalCapital reported that Credibly, an online small business lender, was looking to roll out a debut self-sponsored securitization either later this year or in early 2019 as it gains critical mass, but that means the company also had to put restrictions on its whole loan buyers to prevent them from doing third-party securitizations.

CRACKS IN CONSUMER CREDIT

Although loan performance is still stronger than pre-crisis levels, market participants have pointed out that overall loss rates on recent loan vintages have been increasing, with the late 2015 and 2016 loan vintages being flagged as the worst performing cohort.

“We’re seeing a moderate increase in year-over-year vintage loss across the same cohorts, in part due to the current consumer credit environment,” said Eric Neglia, senior director at Kroll.

“However, we believe these increases remain within Kroll’s expectations and that outstanding deals have the appropriate credit enhancement and structures to support the ratings. In 2018, Kroll expects loan volume will continue to increase and there will be greater competition as other platforms look to gain market share,” Neglia added.

LendingClub’s Kay noted that some of the problems are left over from the financial crisis, and indicated that the company has already responded to the credit deterioration by tightening credit boxes.

“This quarter we continued to see a similar trend as we have for the past two years: credit performance across the industry and on the platform is returning to long-term averages. This dynamic is a result of the 2008 financial crisis. From 2009 to 2014, credit supply was tight, so consumer loans experienced better-than-average loss rates,” she said.

“Since then, credit supply has increased, and the industry has seen a return to long-term average delinquency rates and higher losses in higher risk populations. We see sizeable opportunities for investors in consumer credit, supported by strong borrower profiles on the platform and solid economic fundamentals,” she added.

LendingClub has a loan grading system where each consumer loan is assigned a grade ranging from ‘A’ to ‘G’, reflecting the borrower’s credit report. In November 2017, the company announced that it had stopped selling ‘F’ and ‘G’ grade loans to investors.

Brian Korn, partner at Manatt, Phelps & Phillips, added that investors need to do their due diligence to check the quality of the loans being sold.

“I think investors need to do their homework and ensure that they’re not being sold ‘A’ grade loans which may have been jammed with loans from people who are not ‘A’ level borrowers. As long as platforms stay true to their underwriting models, nothing bad should happen, but if you have marginal borrowers who are able to get past some of these barriers, then that’s where you’re going to have problems,” he said.

REGS, COMPETITION AT THE FOREFRONT

As online lending and the broader fintech industry matures, several regulatory developments are being closely watched by the market.
European banks could be hamstrung by extraterritorial CLO rules

Owen Sanderson

New securitization rules could put EU-domiciled banks at a competitive disadvantage arranging US CLOs, if EU risk retention rules are applied in their planned form. Market participants raised the issue at a public hearing earlier this month, but regulators refused to be drawn on whether they would try to cure the problem in the final version of the rules.

The European Banking Authority held a bumper day of securitization public hearings on February 19, with sessions in the morning on disclosures and notifications of “simple transparent and standardised” (STS) status, and afternoon sessions on risk retention and asset homogeneity.

The EBA was working with the European Securities and Markets Authority on the morning sessions, since these touch on public notifications and market transparency, as well as bank prudential standards. Market participants welcomed the co-operation between the regulators as a step towards a more integrated European regulatory environment — but that doesn’t extend to the US.

Until recently, that has been a minor annoyance — both the EU and the US required risk retention in securitisations, and there were plenty of structures that allowed deals to comply with both sets of rules. In genuinely transatlantic markets such as CLOs, deals were often “dual-compliant”.

But on February 9, the District of Columbia Court of Appeals ruled that CLO managers should be exempt from risk retention rules. There is a 45 day appeal process, but already commentators are arguing that dual-compliant deals could disappear from the market, with the marginal European buyer not worth the effort of meeting risk retention.

“We expect the US CLO market to become more domestically focused, much like other retention-free asset securitisations (qualifying residential or commercial mortgages, for example),” said a report from Integer Advisors, a boutique securitization research firm.

“At this stage it is inconceivable to us that European regulators will consider any equally liberal retention regime for European CLO managers in the foreseeable future, and so this divergence in regulations will ultimately affect cross-border CLO market liquidity.”

HURTING COMPETITION

But the risk retention rules could also hurt competition in the market for arranging, trading and investing in purely US deals, once Europe’s new Capital Requirements Regulation lands.

This applies from January 2019, and applies to all the provisions of risk retention, credit granting and due diligence right across the subsidiaries of CRR-regulated institutions.

Because the new version of the EU risk retention rules applies to arrangers, not just to investors, this could prevent subsidiaries of EU banks from actively working to arrange, invest in and trade deals without risk retention.

PGIM pushes for tighter terms on CLO Libor replacement

Owen Sanderson

PGIM’s Ronni Neeman, vice president, structured products, said that his institution was pushing CLO managers to put firmer terms on replacing Libor in their deal documents, cutting down on manager discretion — which could be used to lock in low fixed interest rates if the benchmark is longer published after 2021.

Unlike other securitization asset classes, the actively managed nature of CLOs gives more options for coping with the potential end of Libor — managers are involved for the life of a deal — but this also creates more opportunities for conflict over deal terms, especially if the manager also holds equity in the deal.

Since July 2017, when the UK Financial Conduct Authority said it would no longer compel banks to submit Libor rates, some deals have given managers the choice over whether to switch to whichever new benchmark is adopted as a market standard, or whether to stick with Libor.

Such deals often also include language requiring, in the absence of a Libor rate, that calculation agents or other deal parties to call banks and ask for their borrowing rates — or use the last available Libor rate. This would effectively switch CLO debt tranches to fixed rate.

As the underlying leveraged loans will still be floating rate, this would deliver outsize returns to the equity in a rising interest rate environment.

“A lot of managers may be incentivised to take no action if Libor ceases to exist and there’s a new reference rate,” said Neeman, speaking at the ‘Bye-BOR’ panel on Libor replacement at the SFIG Vegas conference on Monday.

“It’s clear that there’s an interest in the preservation of Libor”, and urged market participants, as well as bank clients, to express their desire to keep the rate to the submitting banks.

Wells Engeldow, vice president and deputy general counsel at Fannie Mae, said that a system where Libor co-existed with a replacement rate could be bad for consumers, especially if Libor became more volatile because fewer banks were submitting rates.

“I’m concerned about the borrowers, because they can’t get out there and hedge, they probably don’t understand what’s Libor, what’s SOFR,” said Engeldow. “You could be on a Libor rate mortgage or credit card or auto loan and your neighbour could be on SOFR and you could be living a very volatile life.”

SOFR, the secured overnight financing rate, which has been chosen as a replacement by the Alternative Reference Rates Committee is based on hundreds of billions of daily transactions in Treasury repo. The rate will start to be published this year, but will not be usable as a term rate until active derivatives markets develop — and it remains to be seen how stable and liquid those markets will be.
Connecticut Avenue Securities: The benchmark for mortgage credit risk

Laurel Davis is Fannie Mae’s Vice President for Credit Risk Transfer, where she is responsible for developing and executing strategies to transfer credit risk to the capital markets and private investors. This includes leading Fannie Mae’s benchmark Connecticut Avenue Securities program since its inception.

Q: Fannie Mae calls credit risk sharing, and CAS, a key part of its business model. What’s your main focus when developing the program?

A: Connecticut Avenue Securities™, or CAS, is our flagship single-family mortgage credit risk sharing program that began in 2013. We’ve been consistent issuers in the market since that time. We continue to strive to build the premier credit risk sharing program in the single-family residential market, focusing on industry-leading credit risk management, investor transparency, increasing the liquidity of our CAS securities by working to expand the investor base, and by being responsive to investor feedback.

These principles drive how we manage the overall program. Investor response to CAS has been overwhelmingly positive, as seen in the amount of risk we’ve transferred. It really proves that the program has been an ongoing success that reduces taxpayer risk and strengthens the U.S. housing finance system. In 2017, we hit a major milestone in credit risk transfer, transferring a portion of the credit risk on single-family mortgages with an unpaid principal balance of $1.2 trillion at the time of the transactions. Under the CAS program, we have now issued approximately $30 billion in securities since the program began.

Q: What were some of the key evolutions in 2017?

A: By design, and to promote consistency for our investors, the CAS program has remained quite predictable. Our evolutions in 2017 have focused on providing transparency that investors desire to monitor their investments in the program. This includes building on our unique analytical tool, Data Dynamics® that we launched in 2016.

For a bit of background, Fannie Mae publishes quarterly loan-level data on over 36 million loans to help investors model potential performance of the types of loans that are referenced in our CAS program. Data Dynamics, unique to Fannie Mae, allows investors to quickly analyze trends in this historical performance dataset, analyze monthly performance of both CAS deals and our Credit Insurance Risk Transfer™ (CIRT™) transactions, and drill into interesting cohorts of data such as geographic breakdowns and rolling performance. Data Dynamics is free for market participants, and it’s flexible. One of the best parts of the tool is that we continue to make enhancements as we receive feedback from investors. Just in the past few months, we added forbearance data, hurricane data, and drillable geography features, quickly providing transparency to our investors in light of recent hurricane events in the U.S. In 2018, we will continue to enhance Data Dynamics based on investor feedback.

In addition to Data Dynamics, we continue to enhance our credit risk transfer disclosures to align with the investor feedback we receive. We’ve provided additional disclosure throughout the year, and in 2017 added a one-click download functionality giving investors the option of downloading loan-level deal performance data more quickly than was available in the past, easing the user experience. We continuously look for ways to provide investors with greater transparency into the data as well as ways to ease the use of the dataset.
Data Dynamics

Q: What can investors expect for 2018? How will Fannie Mae look to grow the investor base?

A: We’ve had great success in adding new investors to the CAS program. One of our key objectives for 2018 is to continue to expand our investor base. We believe a deep and diverse investor base is critical to maintaining the liquidity of our CAS securities. Investors are not just investing in an abstract pool of loans, they are investing in our abilities as the largest, leading residential mortgage credit risk manager in the industry - they look to us as a partner. With that, we need to make sure we are providing the greatest possible transparency into our credit risk management tools and help investors understand how these tools improve loan quality and reduce risk. We spend a lot of time with investors, both domestically and internationally, sharing our credit risk management toolkit and soliciting feedback on how to continue to enhance the CAS program.

This past year, we introduced an exciting new proposal for CAS. In May, we pioneered a proposal that would allow us to structure future CAS offerings as notes issued by trusts that qualify as REMICs. The new structure will allow us to expand the potential investor base for CAS securities, making the program more attractive to REITs and non-U.S. investors. Currently, REITs for example, make up less than 5% of the investor base at issuance, yet we believe that they are a natural source of funding for mortgage credit risk, so their participation in the program can increase. We’re looking forward to rolling out this innovation later in 2018.

Q: Can you talk about secondary market liquidity? What is Fannie Mae doing to make sure CAS bonds are a liquid, accessible way for investors to gain mortgage market exposure?

A: Improving CAS liquidity has been a key focus of the program since its inception in 2013, and we have seen great success in this area. I’m proud to say that in 2017, CAS was the most liquid RMBS in the market, with $26 billion of CAS bonds trading in secondary markets. We successfully brought seven benchmark size deals to market in 2017, seeing new investors participate in each deal.

Our efforts in increasing transparency add to the improved liquidity. Our goal is to come to market as a consistent issuer. We provide a calendar at the beginning of the year that lays out all of our potential issuance slots so investors can anticipate new issue supply. We issue in a systematic way through benchmark sized securities, which helps to facilitate liquidity in secondary trading. We ensure our structures remain fairly consistent, with newer deals looking similar to our past vintages, making it easier for investors to analyze deals across time. In addition, we’ve been very pleased by the strong support CAS has received from the dealer community with multiple dealers providing pricing across the entire CAS universe throughout each trading day.

Q: What about mortgage and housing market developments within Fannie Mae? How are they relevant to the company and to the industry?

A: The mortgage origination process is time consuming, complex, manual, and still too paper intensive. The process is ripe for digital transformation. As the largest residential credit risk manager in the market, Fannie Mae is in a unique position to lead that transformation, focusing on data over documents. Our goal is to deliver a simple, certain, and dynamic experience to our lender, servicer, and investor partners.

We have introduced a stream of innovative solutions that will help our business partners take on their most important business challenges, enabling us to improve the mortgage origination process while offering Day 1 CertaintyTM to our lender customers. With Day 1 Certainty, we deliver key innovations through tools like Desktop Underwriter® (DU®), the industry’s most widely used automated underwriting tool. DU now enables electronic validation of income, assets, and employment by relying on source data, moving away from the current paper intensive process to make the process simpler, cheaper, and faster while mitigating manual errors and potential fraud. Investors are also familiar with Collateral Underwriter®, our proprietary appraisal risk assessment tool that helps drive higher quality appraisals resulting in greater certainty on property value. These are just two examples of the innovations that the market will continue to see from Fannie Mae.

Our processes and tools are a part of a larger company strategy to continuously deliver innovations that benefit lenders, servicers, and investors. You’ll continue to see a stream of solutions from Fannie Mae that help to create a mortgage process that is faster and easier, producing greater certainty and a housing finance system that is stronger, safer, and smarter as we strive to be America’s most valued housing partner™.
ABS East 2018 will take place September 16-18 in Miami Beach, FL. Serving as one of the most important structured finance industry conferences, the 2018 gathering anticipates a delegation of over 4,000 structured finance professionals, which includes more than 2,000 attendees representing a diverse cross section of issuers and investors in the ABS market.

Now in its 24th year, the program continues to evolve in order to offer the structured finance enhanced educational and networking opportunities:

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- ABS East Gives Back: Charity Event
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For more information on ABS East Speaking or Sponsor Opportunities, the ABS Industry Awards of Excellence, Charity Efforts or the Securitization Seminars contact Christopher Keeping on +1 (212) 901-0533 or ckeeping@imn.org
Quick break for a shoe shine

Status Check on Regulatory Reform

The exhibit hall fills up on day two

Cortland®

Deutsche Bank and Cadwalader host the 6th Annual Red Rocks Run

Crowds gather in the halls on day two

John Orchard, Euromoney Institutional Investor

Richard Johns, SFIG

Timothy Bowler, ICE Benchmark Administration

Speakers on the Bye-bor panel address the crowd

Fitch’s Doug Murray

Delegates mingle between sessions

Howard Kaplan, Deloitte & Touche LLP

Brian Quintenz of the CFTC delivers his keynote

A live demo at the Solve Advisors booth

Quick break for a shoe shine

The exhibit hall fills up on day two
Cortland®

PLS RMBS Issuance Outlook

A Tuesday panel on risk retention reform

Cadwalader’s Neil Weidner

Amit Roy moderating Leveraged Loan and CLO Market Fundamentals

Panelists talk RPLs and NPLs

CLO experts give their thoughts on risk retention

Meredith Coffey of the LSTA

The outlook for liquidity and capital reform

Housing finance players on mortgage market reform

Speakers talk ABS and disaster relief

Andy Davidson moderating on day two

Catching up in the exhibit hall

ABS pros on the move

The Aria Resort & Casino
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We look forward to seeing you on Wednesday, May 30.

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