Dwindling ABS yields draw thousands to SFVegas in search of new opportunities

By Max Adams

With spreads compressed across assets classes, SFVegas 2020 promises another huge year in attendance as over 8,000 structured finance market participants scour the desert for better returns in a low yield world. The annual securitization get-together in Las Vegas has become more like a mass pilgrimage in the decade since the financial crisis. Each year notches a new record in attendance, with this year's event promising to at least match 2019 numbers, according the Structured Finance Association. With 8,000 pre-registered ahead of the conference and approximately 175 sponsors packing the exhibit hall, the conference promises to be a busy affair.

Many sources speaking with GlobalCapital ahead of the event said that a frenzied search for yield has kicked off the new decade and that attendees are setting their sights on opportunities in the esoteric space, hoping to build a pipeline of deals away from the traditional flow asset classes. But this may be a tough play, as demand compresses the spreads offered for the comparatively light flow of paper from esoteric sectors.

Investors hope to strike oil in budding oil and gas ABS market

By Jennifer Kang

Oil and gas securitizations may be a win-win solution for the difficulties faced both by energy producers in search of a diversified source of funds and for investors hungry for long term, attractive returns, said speakers at SFVegas on Sunday.

The oil and gas securitization panel played to a packed house on the first day of SFVegas 2020, a telling sign of the growing curiosity around the nascent asset class. The panel featured a heavy Q&A session, with investors lobbing questions at panelists ranging from expected yields to potential risks of oil and gas ABS deals.

An oil and gas securitization is typically backed by proven developed producing (PDP) reserves, which represent the estimated remaining volume of resources expected to be extracted from an existing oil and gas well. PDP reserves do not involve any drilling, a process that typically incurs high costs and depends heavily upon oil prices. Because PDP reserve securitizations deal with existing assets with just 1%-2% margin of error on calculating the resources underground, oil

ESG proponents on the hunt for a common framework

By Paola Aurisicchio

A lack of data and a broad range of frameworks for identifying environmental, social, and governance (ESG) assets are significant hurdles standing in the way of ESG becoming a more robust asset class unto itself, said speakers at SFVegas 2020 on Sunday, urging advocates to harmonize their definitions and strategies for investing. ESG policies still lack uniformity despite becoming a priority for many in the market, agreed speakers on two panels on day one of SFVegas. The amount of data that is available is increasing, and investor appetite is a driving force behind a more standardized set of criteria. The number of frameworks currently in use, however, is staggering.

According to Nate Gabig, managing director in KPMG’s structured finance group, 274 frameworks for ESG have been developed globally by different market participants. Most of them share similar features but are still subjective in their definitions.

Along with Gabig, DWS head of credit research Matt Plomin and vice president of structured finance at DBRS Morningstar Stephanie Mah highlighted the most important phases of ESG development, particularly the definitions and criteria developed by the UN Principles for Responsible Investment.

“ESG has an impact on two thirds of institutional investors,” Mah said during the panel.

The workshops, crowded with investors, issuers, and rating agency officials, underlined the growing interest in ESG among structured finance pros.
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CONTACT OUR TEAM:

Patrick Drennan  
Director,  
Business Development  
Corporate Trust  
312-827-8518  
patrick.drennan@bnymellon.com

Jenna Gatehouse  
Vice President,  
Relationship Management  
Corporate Trust  
412-234-1007  
jenna.gatehouse@bnymellon.com

Joseph Chung  
Principal,  
Relationship Management  
Corporate Trust  
212-815-5981  
joseph.chung@bnymellon.com

*BNY Mellon Internal Reporting, as of February 10, 2020
# AGENDA

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<td>Delegate Breakfast and Exhibit Hall Opens</td>
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<td>9:00 AM</td>
<td>Opening Remarks</td>
<td>Pinyon 4-5</td>
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<td>9:10 AM</td>
<td>2020 Elections: What to expect, and what they could mean - CPE</td>
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<td>11:30 AM</td>
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<td>1:30 PM</td>
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<td>2:15 PM</td>
<td>Legacy Libor – How should a legislative approach be part of the solution?</td>
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<td>Building Industry Governance for the PLS Market - CPE, CLE Accreditation Pending</td>
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<td>CLO &amp; Leveraged Loan Market Update - CPE, CLE Accreditation Pending</td>
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<td>Where do leveraged loans and CLOs fit in today's fixed income landscape?</td>
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<td>4:15 PM</td>
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**Notes:**
- **Moderator:** Name of the moderator for each session.
- **Panelists:** List of panelists for each session.
Thousands flock to Vegas as new decade for securitization dawns

Continued from page 1

“It is difficult to get anything at scale in those asset classes,” lamented one investor on the sidelines of the conference on day one. “In the senior tranches especially, but the mezzanine notes are also very heavily bid. There just isn’t enough flow of things like solar ABS to meet the demand right now.”

With the yield curve expected to remain flat in 2020, investors say that they are looking at either lower rated tranches of larger asset classes like subprime auto, or will try to add exposure where they can in esoteric assets like whole business, equipment and solar ABS, as well as in higher yielding tranches of agency credit risk transfer securitizations.

Seven panels will discuss the various esoteric or private asset classes over the course of the SFVegas, in addition to a large track of discussions on digital securitizations and blockchain ABS on Wednesday.

The ESG patchwork

In addition to the endless hunt for yield-ier asset classes, this year’s conference promises a robust discussion of environmental, social and governance (ESG) in securitization.

Investors, bankers and issuers speaking with GlobalCapital in the weeks leading up to the conference said that the emerging world of ESG securitization is at the top of their agenda, but conversations revealed that many in the market are frustrated with the patchwork of definitions, frameworks and criteria used to designate an investment as ESG (see related story from cover).

There is no universally agreed upon principle for ESG investing in structured finance, and as it stands, there aren’t strict standards. The rating agencies have done their part to begin incorporating ESG scoring into ratings methodology. Fitch Ratings last fall rolled out its ESG criteria for investors, and ESG has been a heavily researched topic among all the ratings firms in recent months. Still, there is an enduring feel of “so what” among many in the market, and for investors, it is as yet unclear if ESG investments produce stronger returns, drum up positive PR or if they simply should be thought of as a risk mitigant.

As ever, though, a few key themes will take up the bulk of the discussion this year. Chief among them is Libor replacement, a slow and plodding development that despite being two years out, many say the market is still not adequately prepared for. The new benchmark, Sofr, is still in the process of being added to the documentation of many deals across asset classes, and there are almost no non-agency issuers that have committed to issuing deals over the new benchmark ahead of Libor’s sunset at the end of 2021.

For SFA itself, the organization is setting its sights on discussions of greater diversity and inclusion in structured finance, continuing its long running Women in Securitization initiative and expanding upon it to include a more thorough examination of diversity in the industry (see page 5 for a Q&A with SFA CEO Michael Bright). Bright, who took over the industry group following his tenure as COO of Gimnie Mae, has made of point of elevating the profile of women and people of color, illustrated by the list of keynote speakers at this year’s conference.

Keynotes remarks this year will be delivered by a range of female voices, including Democratic senator Krysten Sinema, SEC director Jessica Kane, former Democratic National Committee chair Donna Brazile and former UK Prime Minister Theresa May.

ABS pros see rare opportunity in oil and gas

Continued from page 1

and gas PDP securitizations are less risky than investors may expect, panelists said. As a result, the actual operation of the reserves is quite simple and allows for a fairly stable cash flow, said Gregory Kabance, managing director at Fitch.

Oil and gas PDP securitizations that have come to the market so far have boasted attractive returns. Raisa Energy’s non-operating interest transaction and Diversified Gas’ operating interest deal saw its investment grade tranche reach yields of the high 4%-5% range, and the non-investment grade tranches touched high single digits, said John Siris of Guggenheim. Siris was the lead banker on the Raisa and Diversified oil transactions.

Along with Guggenheim, Citi has been another early mover in the PDP securitization sector and is currently reviewing a number of opportunities, said Jazib Hasan, head of commodities structured finance and credit solutions for Citi.

“Citi has been a pioneer in the space, by bringing together its oil & gas, securitization and commodities expertise under a single umbrella,” Hasan told GlobalCapital ahead of the conference. “PDP Securitization is not a panacea for all E&P [exploration and production] companies, but has a place in the capital structure of most companies that have a high number of economically PDP wells.” Citi provides its own balance sheet as well as access to third party capital to oil and gas companies, he added.

Although there have only been two deals so far, the market can expect to see “a handful of names in the next few months,” an energy and infrastructure banker said. For example, Fitch Ratings alone is looking at rating six to seven deals in 2020, Kabance told GlobalCapital.

Oil and gas securitizations have become a novel solution for E&P companies who are losing funding from the reserve based lending market.

“This is a good product which we’re able to achieve investment grade ratings from rating agencies like Fitch,” said Siris. “It provided a lot of appeal for asset managers like insurance companies and pension funds that we sell securitized bonds to and allow these [oil and gas] companies to diversify away from the bank markets.”

Furthermore, oil and gas ABS provides attractive returns as investors continue to scramble for yield. In the beginning, the typical investor base will likely be insurance companies and high net worth individuals who are already familiar with the energy industry, said an energy and project finance lawyer familiar with the first few oil and gas securitization deals. As the deal grows bigger, there may be seven to eight investors involved in a deal.

Despite the growing interest, the market may not see another oil and gas securitization until oil prices recover, said an executive at an E&P company currently looking to issue a securitization.

“I don’t think you’re going to see ton of activity until you see commodity prices recover a little bit because you’re going to have to hedge 10 years for [a securitization] to make sense,” the executive said. “Unless you’re buying an asset tomorrow and securitizing it tomorrow, we’re at 20 year lows in gas prices, so you need a price recovery for people to say ‘now is the time to crystalize my cash flows at today’s future curve.’”

GC
Q&A with Structured Finance Association CEO Michael Bright

Q: What’s on the agenda for the Structured Finance Association in 2020? Can you touch on a few of the top items?
A: We have a great agenda on a wide range of issues. We are of course going to tackle the ones most important to our industry on a day-to-day basis. These include changes in the regulatory sphere impacting securitization in all areas, including CLOs, RMBS, credit card ABS, and others. While the news paints a picture of a dysfunctional and distracted Washington, DC, the regulators at the SEC, FDIC, OCC, FHFA, and CFPB couldn’t be more busy. The efforts to re-examine Dodd-Frank’s Ability to Repay Rules, to look at the post crisis Reg AB 2 requirements, to manage the transition away from Libor, to build a functioning ESG market in structured finance, and to ensure the sanctity of the so-called “valid when made” doctrine headline just a few of the things that kept us busy in 2019 and are sure to keep us busy in 2020.

Q: Diversity is a key initiative this year for SFA, which is illustrated by many of the keynote speakers in attendance this year. What is the state of the organization’s diversity and inclusivity initiatives and why do you think it is important to promote these?
A: SFA’s Women in Securitization – or “WiS” – initiative has been an unquestioned success. We are so proud to have had great keynotes like Janet Yellen and Arianna Huffington in the past, and we are delighted to welcome PM Theresa May, Ana Navarro, Donna Brazile, and Senator Sinema – among many other distinguished speakers – to our conference this year. It’s important to also note that across our entire agenda we are very proud to have women speaking on every panel, WiS has been a force for change in the industry, giving focus and networking opportunities to the important arena of gender diversity. But we know we cannot stop there. Racial diversity in finance is our next challenge, and we are going to be discussing this issue head-on at this year’s conference. We are honored to have outstanding speakers in this arena, especially Kama Bell, whose show on CNN – “United Shades of America” – is indescribably smart and entertaining, and, in my opinion, has taken the dialogue about race in America to a whole new and much more informed level. Demographics are changing, and Wall Street needs to change, too. Our industry has a long way to go, but we will start by having a frank dialogue on this. Our goal is nothing less than real, meaningful diversity in every e-suite and boardroom across all of financial services as soon as we can get there.

Q: Can you talk about some of the policy issues that the SFA is focused on this year? A big one must be the QM patch and some of the ideas being floated as a replacement for the rule. What is the group’s stance on that issue?
A: Absolutely, the CFPB has opened an important conversation on how to transition away from a reliance on the GSE AUS systems in determining legal safe harbor from liability in the ATR statute, and we are very engaged with them as they work through the issues. But we also feel that, if you look back at the years leading up to the financial crisis, one can make the argument that what the PLS market lacked was effective governance. In Agency MBS, we now have a stronger FHFA regulator for Fannie and Freddie, and government oversight at Ginnie Mae. But for PLS, we think the industry has a chance to really roll up its sleeves and build some effective self-governing mechanisms, and SFA is working to facilitate this dialogue for the industry. SFA can’t do it, the industry needs to do it, but we want to try to help. At the end of the day, either we do it or it will be done for us. So, we might as well try the former.

Again, while most Americans are going to be captured (or disgusted) by the daily drama of a Presidential race, we are going to stay focused on the regulations and policy debates that directly impact our industry. We think there will be plenty to go around. And did I mention that Libor is ending?...

Apart from the QM patch, what are some of the topics the SFA is promoting this year in the RMBS market? What is the group doing to help drive private label issuance?

The SEC has indicated a desire to reexamine Reg AB 2 and this could matter. The lack of public issuance is certainly a sign that Reg AB 2 requires some level of review for areas where further guidance and potential revisions are needed. As we tackle this, though, we will be working closely with our investors to make sure that at every turn their voice is a driver. We will be reviewing and providing thoughtful feedback to the SEC one field at a time. In the meantime, we hope to see 144a deals continue to grow and bring capital to bear, especially in underserved communities.

Q: What about other sectors? Do you see significant risk building in consumer segments like subprime auto or marketplace lending? There is some concern building that consumer loans are growing riskier, especially those originated by online lenders, who have been mostly untested in an economic downturn.
A: Late cycle risks are hard to identify sometimes. “Bubbles” are even harder to identify, or the Fed would have built a machine to do so long ago. Frankly, one of the most interesting questions in Washington that I’ve been asked is – how can the government continue borrow so much more every year, and still see interest rates go down? So, some think the next bubble is in sovereign debt. I’ll leave the crystal ball predictions to an economist (…or a magician…or both?) To me the key to macroprudential stability is risk management, regulatory oversight that is balanced, and transparency so investors know what they are buying. We push for all three.

Q: Can you talk about what the group is doing to promote growth in some of the esoteric ABS sectors? Many of those markets have grown considerably in recent years as yields stay low. Does the SFA have any outreach or educational programs planned? Are there any concerns that the group has about credit quality or late cycle behavior in esoterics?
A: Yes, one of our top goals with investing in our new research vertical at the end of last year is providing education to our market, DC and the media. In addition to sectors where market developments call for our attention, we are also focused on education in the lesser watched asset classes, and to that end we have planned quarterly primers for Hill staff. For example, we will be starting with a primer on Aircraft receivables in a few weeks.

ESG is something we also want to take from “esoteric” to mainstream in structured finance. We think the key to success here will be establishing standards for things like definitions and criteria. Political philosophy aside, there is no doubt that the next generation of savers wants this as a key component of their investment strategy, and so we want to help build it and make sure it works as promised. Our initial roundtable on this late last year was oversubscribed with people waiting in the hotel lobby. So we feel pretty confident that it’s something we need to be productively engaged in.
Whole biz ABS riskier than oil and gas deals, Fitch says

By Jennifer Kang

Investors hungrily eyeing two esoteric ABS subsectors — one booming, the other nascent — may want to look take a second look, as Fitch Ratings this week warns that whole business securitizations are a riskier bet than the budding oil and gas ABS sector.

On Thursday, Fitch issued a commentary comparing the operating risks between oil and gas ABS and whole business securitizations, both sectors that have entered the spotlight recently for the high yields on offer. The two have clear differences, said Fitch managing director Gregory Kabance, but are similar in that they come with operating risk as a result of their structures.

The collateral for oil and gas ABS is typically proven developed producing (PDP) reserves, which represent the estimated remaining volume of resources expected to be extracted from an existing oil and gas well.

According to Fitch, PDP reserves are a tangible asset that provide a “stable” cash flow because the rate of depletion is predictable depending on the age of the wells. On the other hand, a whole business securitization is typically backed by a single brand name or a corporate parent, making it more difficult for a backup manager to take over when the parent faces trouble.

“They both have that risk, but the point we’re trying to make is that one has an intangible asset, and the other has an intangible asset,” said Kabance. “It’s questionable whether you can put a backup manager in there to handle [a whole business securitization deal], versus in the oil sector where that has been the case. [There have been cases of] companies that defaulted and production has continued because it’s an asset that continues to have cash flow until it is deplete.”

Fitch has previously voiced concern over the “overstated” benefits of whole business securitizations, which carry investment grade ratings but are much more highly exposed to corporate risk than a traditional ABS. As implied, these deals securitize the whole business, not just a few assets.

It is a “concerning trend” that companies with below investment grade corporate ratings are able to issue investment grade ABS debt, Fitch wrote in a note published in December.

The rating agency is not alone in seeing pockets of risk within the whole business ABS sector, specifically regarding the difficulty of transitioning to a replacement operator in the event the corporate parent runs into trouble.

“It’s very easy to transfer servicing on direct receivable type transactions, like auto loans or credit card loans, but I think by the nature of whole business securitizations, it’s very difficult to replace the operator,” said an esoteric ABS lawyer. “The deal is forever going to be linked to the operator. But that being said, I think whole business deals do a good job of isolating the assets and credit risks from the corporate parent.”

However, investors are usually well aware of the idiosyncratic risks that come with each franchise ABS deal, and feel as though they are being compensated with higher yields most of the time.

“If it were all cut and dry and simple and all deals and structures were iron clad, you wouldn’t be getting 200+ or more in spreads – they’d be trading at 30 off or 50 off,” said John Lloyd, co-head of global credit research and portfolio manager at Janus Henderson. “It’s a little bit of a trade-off, but I do think at this stage, whole business structures strike a good compromise between trying to protect investors and not having the structures be too stringent that the companies can’t maneuver around the way they manage their business.”

No return seen in euro CLOs for Norinchukin

By Owen Sanderson

Even after the Japanese financial year-end at the end of March, Norinchukin Bank is unlikely to return to the European market as an anchor investor in senior CLO tranches, according to a CLO manager with knowledge of the bank’s approach.

At the beginning of 2019, the Japanese agricultural bank was one of the only senior investors in the market and was willing to buy triple-A CLO tranches at least 5bp tighter than where other investors were pricing the bonds.

However, its outsized role drew increasing scrutiny, including from the Japanese regulator, which launched an investigation into the bank’s holdings, and it stopped buying. Other Japanese banks, including Japan Post Bank, were also active but on a smaller scale than Norinchukin.

Some CLO managers and investors, though, hoped and expected Norinchukin to return in the new Japanese financial year beginning in April.

The bank, according to the manager, met with managers on its list in London last week as part of the monitoring of its portfolio, and making it clear that it will not be coming back to the primary market.

Another CLO manager blamed press attention for NoChu’s continued absence from the market.

Regulatory filings from last year show that big banks in other jurisdictions had taken up some of the slack.

JP Morgan’s 10-Q disclosures, which run to the end of September 2019, showed a big increase in its exposure to the CLO market, with $27.42bn in CLO exposures, compared with $19.61bn at the end of 2018.

Barclays’ global CLO outlook, published in December, estimated that Japanese banks hold 15% of global CLO tranches outstanding.

“We expect this trend to continue, with Japanese investors still purchasing AAA tranches, as it is hard to find relative value to replace CLOs, but to a lesser degree than in years past as headline and regulatory pressure remains high.”

The research team at Barclays, led by Geoffrey Horton, suggests that European bank demand replaced some of the Japanese bid in 2019, encouraging more broadly syndicated CLO senior bonds.

CLO senior tranches have moved tighter in euros, with the latest crop of senior notes printing at 85bp over Euribor, but still offer relative value compared with most other triple-A investments, with the Euribor floors continuing to give an extra spread kicker.

The next round of CLOs may come tighter still, as CLO liabilities start to tighten in following a wave of repricing in underlying leveraged loans.
Euro CLOs escape cov-lite stricture by borrowing from revolvers

By Owen Sanderson

Although European CLOs have a standard limit on the proportion of covenant-lite loans they buy, the definition of ‘cov-lite’ means that almost every term loan with a revolving credit facility elsewhere in the capital structure remains eligible for purchase by these vehicles.

New CLOs this year from Partners Group, Investcorp, and a deal announced on Friday for PGIM have a limit suggesting that a maximum of 30% of the portfolio can be invested in covenant-lite instruments.

Most CLOs have similar limits, placing restrictions on the proportions of second lien investments, bonds, unsecured loans, and loans rated below B3/B-. The aim is to give investors in the CLO tranches confidence that the CLO manager will stick to its investing plan and not deviate too far from the market mainstream in search of yield.

But a real limit on ‘cov-lite’ loans, at least with the definition used by most of the market, would leave managers unable to buy almost the entire market. According to Fitch Ratings’ Leveraged Loan Chartbook, more than 90% of the European leveraged loan market was covenant-lite in the nine months to September 2019, with the remainder described as ‘covenant loose’. This is a marked deterioration in investor protection. In 2013, when the European CLO market restarted post-crisis, more than 70% of deals had a full set of covenants.

Where borrowers do choose to raise money with maintenance covenants in place, this typically reflects their weakness as companies — meaning a hard limit enforced on cov-lite loans can actually push CLO managers to buy the worst-quality loans in the market.

Managers that have cov-lite limits but no revolver-based route around the limit have sought to alter deal documents as part of resetting deals, to bring them into line with market practice in new issues.

The term ‘cov-lite’, as commonly used by the market, doesn’t mean a general lack of investor protection. Rather, it specifically refers to maintenance covenants, which allow a lender to enforce security if a borrower breaches certain debt or leverage limits at any time.

Covenant-lite deals, however, only have the “incurrence covenants” seen in high yield bonds, limiting the ability of a company to take on new debt or perform certain corporate actions if debt levels are too high at that point in time.

This protects a company from the effects of declining Ebitda at a given debt level — in a deal with maintenance covenants, a rough spell in the underlying business can mean lenders take away the keys of the business, while incurrence covenants only block taking on new debt.

Inevitably, it gets more complicated — many borrowers now have extensive abilities to manipulate the calculation of Ebitda, increased flexibility to change the asset security package of lenders, and surprising levels of flexibility even when in distressed territory.

The trick with CLOs, however, is that the limit on “cov-lite” loans has an extra provision in — where this loan is pari passu and cross-defaulted with another loan that does contain maintenance covenants, such as a revolving credit facility, it doesn’t count as cov-lite.

This means that almost all of the institutionally targeted leveraged loans escape the limit. Most companies include a revolving credit facility in their financing structure, since rating agencies value the liquidity support, and because it offers useful flexibility.

“If the facility has cross-defaults to the revolver, it’s still a meaningful cap,” said a CLO lawyer. “It’s an indirect protection but it’s still a protection, and this blocks true cov-lite.”

Effectively, CLO managers holding covenant-lite term loans are outsourcing the protection of maintenance covenants to the banks that provide revolving credit facilities.

Before this 30% limitation (and the accompanying definition), the market standard was for no limitation on covenant-lite loans baked into CLO documents, reflecting the fact that cov-lite loans were relatively rare.

Panelists urge greater clarity on ESG criteria

Continued from page 1

An investor during the discussion said he was hopeful that things are developing in the right direction and found it “encouraging that corporations have sustainability reporting, banks have an ESG desk and rating agencies are getting involved. It’s too early, but a standard will solidify.” Speakers also added that ESG is particularly appealing to millennials, a growing cohort of the investor community

“As more data becomes available, the opportunity to quantify the risk will increase”

that is more likely to prioritize values of sustainable finance.

ESG has become “a main focus next to the Libor transition,” said Roelof Slump, managing director at Fitch Rating’s residential mortgage group during the second panel.

Slump showcased the ESG relevance scores for global structured finance rolled out by the rating agency last October. The scoring system is used to grade the relevance and material impact of ESG to credit profile and ratings.

“The biggest challenge,” said S&P Global Ratings director Matt Mitchell, “is to have a data center. As more data becomes available, the opportunity to quantify the risk will increase.”

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Q&A — Sunnova executive vice president and CFO Robert Lane

Residential solar ABS is expected to be in high demand in 2020 as investor interest in environmental, social, governance (ESG) factors continues to grow. Sunnova, a residential solar and battery storage provider, is among the most prolific issuers of solar ABS, as well as the also the only issuer to have tapped the securitization market so far this year. GlobalCapital’s Jennifer Kang sat down with Robert Lane, executive vice president and chief financial officer of Sunnova, to talk about how the company tackles ESG, the increasing need for energy independence and why Sunnova is choosing to reduce funding through whole loan sales and pivot more to securitization.

GlobalCapital: How does Sunnova differentiate itself among its competitors in the solar ABS space?

Robert Lane, Sunnova: Sunnova is one of the leading residential solar and storage service providers in the United States. Our goal is to provide homeowners with cleaner, more affordable and reliable solar energy solutions. As a service provider, we finance the equipment that enables service to be sold to our customers, whether that’s through a lease or a loan or power purchase agreement. Recently, we’re seeing increased demand from customers wanting to add storage to their solar system. Were also seeing the value proposition increase for customers, not just from the potential customers savings compared to utility-based retail rates, but also our offering of energy storage solutions to those customers who are looking for energy resiliency and reliability. We are here to help our customers power energy independence.

One of many things that sets Sunnova apart is our regional dealer network model. We aren’t in the construction business: we let our dealers handle customer acquisition and installation, and we focus on where we add the most value: servicing our customers across the US and its territories. Our dealer model facilitates our entry into new markets by enabling us to develop relationships with existing local businesses and leveraging their local knowledge and sourcing new sales leads. This business model allows us to avoid having to support a large in-house sales and marketing team, which reduces overhead and provides substantial operating leverage.

GlobalCapital: Have you felt that ESG has been gaining traction, and is ESG helping boost the demand for solar ABS among other “green” energy assets?

Lane, Sunnova: Absolutely. I think that’s very key. ESG awareness is increasing and we don’t believe it’s just a flash in the pan. We take ESG very seriously, and while I think everyone can look at residential solar and check the box for ‘E’, the environmental factor; recently, with the energy storage system, we’ve also seen how solar can also help check the ‘S’ sustainability box as well. After the Puerto Rico earthquake in January, we were able to keep the lights on for nearly 2,500 of our customers when the power grid went down. It’s not just Puerto Rico where unexpected grid interruption are happening. You can also look at California’s mandatory power outages which are leaving more and more families in the dark, and these power outages don’t show any signs of stopping. For us, we feel that the ‘E’ factor is what brings people to the table and the ‘S’ and ‘G’ factors are what’s keeping them there.

GlobalCapital: Is ABS an attractive source of funding for Sunnova?

Lane, Sunnova: I would say the ABS is still a very important part of our funding. We also use tax equity on our third party operator (TPO) assets. It’s a combination of that tax equity and securitizations that we intend to continue to use for our long term funding. At the same time we also use warehouse funding. We have great relationships in the banking community, especially with Credit Suisse who provides warehouse and WIP funding to our TPO and loan products. We’ll use a combination of those. Right now we do not participate in the whole loan market, but instead securitize our loans just like we do our TPO systems. And really this goes back to our whole philosophy of why we use the ABS market which is that we do want to securitize but we also want to keep residual cash flow. Our focus is to build a long term sustainable cash flow. Since we’re the last money out, we think it gives investors a great deal of faith in us. Whether it’s a warehouse facility that will temporary house assets before securitization or it’s a securitization, as long as we are holding on to residual cash flow and we’re counting on that to be able to pay our service costs, that’s how we keep skin in the game. The whole loan model, which does provide cash in to those who use it, sells all cash flows in the stack. However, that would mean then every year you’re starting off with zero cash flows instead of building a base of recurring cash flows to cover corporate costs.

GlobalCapital: Are most solar ABS issuers choosing to stay away from whole loans?

Lane, Sunnova: I’m still seeing a lot of whole loan programs. It’s about where they feel like they will find the best returns. Whole loans can be very attractive to some folks because one can originate a loan for a discount. We certainly don’t get a shortage of folks who propose to us that we do whole loan programs with them. I’m not saying we’re never going to do those programs, but at this point we think that the long term returns for shareholders are better if we securitize those loans ourselves. If you look at our last securitization deal that priced same time as a loan originator/aggregator, our terms were better because, according to the feedback we received, of the fact that we provide customer service in house and we hold our own risks.

GlobalCapital: It seems that solar ABS issuance has been dampened over the last year despite high volumes of solar loan originations. Why has this happened, and will we see lower volumes in 2020 as well?

Lane, Sunnova: As the fastest growing TPO service provider, and we sell both TPO and loans, our absence from that 144A TPO securitization was noticeable. We did smaller private securitization last year but we felt clearly that we should return to the public market, which we did this year. In 2020, I think we’ve already made clear in our prior announcements that we intend to return to the securitization market more than once this year. I would expect that as other solar service providers continue to grow that we should continue to see them come to market as well. That being said, there will continue to be a higher premium on delivering service and making sure the customer has that level of service. We think the market will continue to reward us for keeping default rates low as a result of providing excellent customer service to our customers. GC
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For questions about attending or sponsoring the event, contact:
Ashley Hofmann
T: +44 207 779 8740
E: ahofmann@globalcapital.com