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Esoteric ABS and Innovation Roundtable

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Rise of esoteric ABS highlights innovation in securitization market

The securitization market is constantly evolving, evidenced by recent growth and development in product and technology innovation, some of which is creating new market structures. One of the most exciting areas of growth is in esoteric ABS, a decades-old market that has expanded rapidly in recent years. To discuss what's driving this growth, structural innovations, and market expectations for 2025, *GlobalCapital* convened a panel of leading experts to provide their views on the asset class and technology innovation in securitization more broadly.

GlobalCapital: The esoteric ABS market has grown tremendously over the past few years, and there's every indication that it will continue to grow strongly over the coming years. To start, given how much growth and evolution there has been in the market, how should we define esoteric ABS, and what are the main factors driving its growth?

David Natter, Dentons: To my mind, an esoteric deal is any structured transaction that is collateralised by something other than traditional assets that have defined the structured industry for the past few decades, such as mortgages, student loans, credit cards, auto loans, leases or corporate debt. This means assets like insurance premia, fees from renewable energy-related letters of credit, whole-business deals, film or entertainment receivables, franchise fees, structured settlements, IP receivables, income from fiber lines or data centres, and credit-linked notes, among others.

People have taken the technology of the structured finance business that has been used for many years now in those more traditional types of assets and applied it to all these countless new types of assets. I would view any of those less standard asset classes as esoteric.

Todd Stevens, Figure: The definition of esoteric is evolving. Many formerly esoteric asset classes are now mainstream. We are one of

those, as we are always considered kind of esoteric for the mortgage world. We had to define a structure around how things could get rated and once you securitize a number of times you start becoming mainstream. Our history is one of heavy evangelism. I would also put SRTs [significant risk transfer] in esoterics, even though they have existed for over 20 years.

Kevin Weeks, BNY: I agree with what's been said so far. I'd add that innovation in new assets has always been a driving aspect of asset-backed securitization (ABS) growth overall and many asset types that start out as esoteric turn into leading asset classes. Generally, this happens when these asset types become broadly understood, when there is a significant and regular cadence to the issuance volume, and when they become standardised. What we're talking about with credit default swaps and SRTs are great examples of that. Once new asset types become much more standardised and understood, we probably won't be calling them esoteric.

GlobalCapital: Todd, to your point, would you describe Figure as an esoteric ABS issuer?

Stevens, Figure: Yes and no. You really want to be on-the-run so everyone can just close their eyes when you issue and it's just a matter of where you clear. But that said, our whole mission is to disrupt the financial markets and

Roundtable participants

David Natter, Partner, Dentons



Todd Stevens, Chief Capital Officer, Figure



Kevin Weeks, Head of Sales and Relationship Management, Corporate Trust, BNY



Moderator: **Duncan Kerr**, Editorial Consultant, *GlobalCapital*

create a new market structure. We fundamentally believe that there is a tremendous amount of capital and borrower demand and there are these constructs in the middle which keep the borrower demand from the capital. Our goal is to try to address that market structure with innovative ways of getting to the markets. Securitization is always our preferred outlet.

GlobalCapital: In terms of transaction structures or asset class types, what's particularly fresh or new that has come to market in recent months? What

new innovations do we expect to see in the foreseeable future?

Natter, Dentons: Technologies like delayed draws and pre-fundings, mechanisms that allow issuers to do larger transactions than they might otherwise have been able to, have started to come into play in esoterics more commonly. I would anticipate that continuing because I think the market will continue to grow.

As for new asset types, many of them more generally thought of as esoterics have been around for more than a year. That said, synthetic credit-linked notes that banks are using to offset the risks on their portfolios for banking regulation reasons, have been coming more to the fore in the last year. We also saw some deals in renewable energy letters of credit, things like that, which are all quite recent.

I'd add that people are always coming up with new and more streamlined processes for managing whole-business deals. So some new technologies have come into play there to help facilitate not needing to record as many mortgages and streamlining the control party process.

Stevens, Figure: It has been a great year for the securitization market, but I think volumes can triple. How? We need some regulatory purview over who can play and how they can play in this market. On how they can play, we need to solve the ability to forward sell securities, which will bring more people into the market.

This is what we're working on at Figure. We always want to make sure our originators can originate and when they originate they have a market they can sell into. There's only one market in the world that you can do this in and that's the agency mortgage market. That's because the US government is behind it. For the non-agency market or the private origination market, what we need is a similar type of structure. How do you create that? This is what we're working on.

We're going to be launching a guarantor structure which operates like a cash window, if you will. How can we do that? First of all, it's got to be permanent capital and they always need to be bidding. How do you do that? They have to risk-manage that capital. How do you do that? You issue securitizations and you forward sell the securities; you

can do it on a funded basis, which is painful. But how can we do it on an unfunded basis? There is a ton of capital out there that would lean into this. So you're forward selling the securities, your guarantor vehicle can solve for the RoE that it needs to exist and then it forms the price it pays for loans and then buys loans and becomes that cash window.

So we need, from front to back, to start working better and think about how we can level the playing field for common issuers to do that. Taking the funding rules off a pre-funded deal and having a forward sale would introduce so much more capital into the market and that could help mitigate risk and provide so much more capital to borrowers. In that sense, you're kind of democratising the access for the borrowers. We just need structures that enable that.

Weeks, BNY: As a trustee, we don't structure deals, but we do sit in between the issuer and the investor. One thing I would say is critical is that the investors have to understand the underlying assets. They should not just buy yield or rating; they have to understand how the underlying asset performs. So that's an education journey, where issuers have to help investors understand the dynamics of what that underlying asset is and how it performs and how it would recover and how stable the cash flow is.

We mentioned a whole host of asset classes earlier. I'd add that there are one or two that first emerged over 20 years ago and are now roaring back. So, for example, it has been a hot year for music royalty securitizations. They were first done 25 years ago, but they have come roaring back as the delivery and

consumption of music and media have changed significantly over the past decade or more. As such, investors have been re-introduced to the cash flows that can come out of music securitizations.

GlobalCapital: Together with product innovation, we're also seeing innovation on the technology side. One area of development has been the use of blockchain technology. What is Figure's vision here, and how is the company using blockchain?

Stevens, Figure: We have a big vision. We think most, if not all, financial assets will trade on a blockchain rail at some point in the future, whether that's two months, two years or 10 years from now. It's just a more efficient settlement rail. T+ anything doesn't make sense on the financial markets. And the reason T+ anything exists is poor technology and there are rent seekers in the process that get paid for that T+ something.

Our goal is to have everything tokenised and traded on a blockchain rail. We know that's not happening today so we've moved upstream on our origination process. We've completely automated it with a tight rules-based engine leveraging an immense number of vendors and data sources to enable us to originate with confidence, which means we don't have any underwriters that underwrite any of our loans. That's a feature not a bug.

We have an automated rules-based system and we have a defined credit box. We have stuff that comes in at the top of the funnel and I can tell you, with a high level of predictability, what will come



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out at the bottom of the funnel every month. We’re originating 6,000 loans — \$80,000 each, about \$500m-plus a month — and I can tell you within, say, 0.5% Customer Lifetime Value (CLTV) points and three FICO points, what’s going to come out at the bottom of the funnel. We can do that very quickly.

We therefore leverage the blockchain for data and process integrity. With that process we can prove at any point exactly what we did. With that, we can obviate most of The People’s Review (TPR). TPR firms have bought into this. We think that with automation and provable processes TPR shouldn’t be necessary. We would rather the agencies just audit us like an auditor audits a public company. Put a rating on us and then give us a fast track to issue to the market.

Technology is obviously going to drive scale, but it will also drive access to capital markets. As long as you can replace trust, that is, a bank that has been around for a long time, with truth, where we can cryptographically prove exactly what we did, that will be powerful.

So we’re leveraging blockchain upstream in origination and then downstream everything will settle on a blockchain rail sometime in the future. And then midstream we’re turning on real-time servicing. Think about atomic settlement. Every time a borrower makes a payment that pays down a mortgage, we can show that in real-time.

There are a number of things throughout the process (upstream, midstream and downstream to settlement), which I think blockchain will disrupt. We’re just flying the flag and trying to change market structure one day at a time.

GlobalCapital: David and Kevin, I don’t suppose you would have examples of where blockchain is being applied in the areas you’re directly involved in. But I wonder what advanced technology you are using?

Natter, Dentons: There are two different questions embedded there. On the blockchain front, we are starting to see it used in some deals. At this point it’s more on the collateral side than it is on the security holdings side. That said, to Todd’s point, people certainly have visions of it remedying some of the issues we have had with the Depository Trust Company (DTC) regarding knowing who the ultimate beneficial holders are, getting information to them and receiving votes back from them. Blockchain certainly could be a great tool, if it were to be used in that regard.

On the advanced technology front more generally, we have not been made aware of how issuers might use things like AI for building transactions. Of course, when we are told of an anticipated structure, it could have been assisted by AI on their end since they would not have any reason to inform us about what went on under the hood. That being said, I know that some banks are starting to use AI in certain limited circumstances.

From a law firm point of view, it’s something that we could use, especially when we get in a structure for a transaction, so that we can more efficiently, quickly and cheaply go through precedent deals, finding similar prior language to use, thereby requiring less redrafting and so legal time incurred to paper the new deal.

Things along those lines are more where we are seeing it at this point.

GlobalCapital: Kevin, BNY is a big investor in advanced technologies. Can you speak to specific use cases of blockchain within the corporate trust services division?

Weeks, BNY: I’ll start by following on from what David said on AI and then I’ll come back to digital. We are using AI as a productivity enhancer. We use it to read documents, to find certain sections and aspects to help us with follow-up items, which are typically known as ticklers. But we never let the technology perform independently without human oversight and approval. We use the technology to be the maker and then there’s a human being who is always a checker and validator. We don’t let AI flow straight through and go unchecked. We just make our people more productive by using it. That’s the current focus. We want to develop and enhance that over time and be smart about how we implement it.

The second part is we’re working with a lot of the market infrastructure players to change how the bond is delivered so it’s digital. Europe is further along on this than the US; Germany, in particular, has a D7 marketplace [a digital post-trade platform from Deutsche Börse that allows market participants to issue and process securities electronically]. Europe has closed a number of different digital bonds, and we were involved in one such significant transaction last month.

In the US, we’re moving a bit slower, largely because of regulation and acceptance. Here we are doing small, closed-loop experiments to make sure that the technology will work. When everybody is ready and aligned, we will be ready and aligned to use it.

I would say one of the large frustrations generally with a digital bond and digital delivery is the issuance — the bond is sort of separated from the cash. Both are not on the blockchain and that is the key critical limiting factor. You’re doing all your issuance and activity on the chain but you’re moving money out on the traditional rails, not on the chain. When the market figures out a way to combine those two, that will probably be the turning point for our market.

GlobalCapital: Let's return specifically to the esoteric ABS market. We've been talking about its growth, evolution, and development. But what about the risks for issuers and investors?

Stevens, Figure: It's a double-edged sword. What we try to strive for is predictability and transparency. We always say we like to place trust with truth. Whenever I say truth, I mean we can prove what we've done. And so those are the benefits of our deals.

On the risk side, there are always liquidity risks. There are air gaps in the market and they can be exacerbated by people wanting to dig into the collateral more. If it's more esoteric, they might be able to rip it apart and ask more questions. So maybe the lack of standardisation in esoterics is a bit of a risk today, but in time everything is becoming more standardised and with standardisation the overall risks are reduced and liquidity increases.

Natter, Dentons: Obviously, any investment is going to have inherent risks. The only way to avoid any investment risk is to put your money under your mattress and that has risks of its own with inflation and so forth.

Esoteric asset classes are, by definition, less well-known and so to the extent you're investing, you need to understand the underlying business of the assets since it's the performance of those underlying assets that will determine the performance of your investment.

For example, if it is a music royalties securitization, music is being consumed more differently today than it ever was. In fact, it's constantly changing and evolving, and you need to understand that if you want to invest in that asset class. In whole-business deals, each one of them has an entirely separate universe of risks and concerns that are focused just on that particular business. So it's not like you can learn the mortgage business generally and then invest in residential mortgage-backed securitization (RMBS) deals; you have to understand the business of the entity that is issuing that whole-business transaction.

Overall, it can be more complex when you're dealing with these comparatively unique assets because

it is those assets that provide the risk. As attorneys, we'll structure it so that you are protected from the legal, regulatory and bankruptcy consolidation risks. We can deal with all that stuff but the remaining inherent risk in the transaction is related to those underlying assets and so you have to understand them.

That said, by isolating assets in bankruptcy-remote entities, issuers can obtain higher credit ratings for their issuance than they otherwise could. By creating a structure around the ownership of cash-yielding assets and implementing a priority order for how cash is distributed, issuers build a level of safety for investors that allows for borrowing at a reduced rate compared to a non-securitized structure. These advantages hold just as true for esoterics as for more traditional assets.

GlobalCapital: The complexity of these types of transactions must presumably make servicing them more complex. Kevin, how is BNY supporting its clients in this market and adapting its issuer services business to address issuers' evolving needs?

Weeks, BNY: That's a hallmark of the esoteric market — there's less standardisation and more complexity to the underlying asset. As such, investors have to really understand the underlying asset and its performance. Our role is to make sure that we pass through any reporting and servicer information that was defined and outlined in the deal. Essentially, what was promised to the investor is what we need to obtain and post on

our investor reporting website or distribute it as agreed.

If it was a permissioned access, if there is a final transfer, we can facilitate that. But it is up to the bank structuring the deal, the investors and the issuer to understand the information, the criteria, and what's important to create the level of transparency that's going to give comfort to the investor so that they would invest in the asset.

We tend not to prescribe what should happen, but we do make it easy for that communication to flow once the deal is up and running. We make sure that the investor gets the cash flow that was reported on those reports as well as the underlying detail at the promised level.

GlobalCapital: Touching on pricing and the premium investors can be paid for buying esoteric ABS paper, what levels are we seeing and what determines those premiums?

Stevens, Figure: There are many risk premia in the market. Investors price risk premium because either there's liquidity risk, complexity risk or something similar. For securitizations, not using certain rating agencies or only using one rating agency can cost 20bp of premium to triple-A securities. We also focus our dealers on making secondary markets for our deals to help remove some of the liquidity risk. That said, liquidity risk isn't the most prevalent risk premia today. Complexity seems to be attracting the highest risk premia.

Natter, Dentons: We are seeing more private esoteric transactions lately and there is an additional

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David Natter, Dentons



premium on these deals due to their more limited transferability. In addition, any time an asset class is more unusual and so not particularly well understood, you will have fewer investors for the reasons we discussed earlier and consequently the greater premium you're going to have to pay to sell the securities. That is just the standard supply and demand curve.

GlobalCapital: Let's move into next year and get your thoughts on what you think the esoteric ABS market is going to look like?

Weeks, BNY: Having participated in a recent round of conferences, everyone generally seems very optimistic. This has been a strong year. I think across the board everyone anticipates a stronger next year in terms of volume. Some of the feedback I hear is that there's a lot of investor demand and hunger for yield. The challenge is trying to create a sufficient set of assets and collateral pool that can deliver for investors. If you can deliver that, investor demand is certainly there.

Stevens, Figure: Given the macro backdrop, issuance is going to go

up, and more aggressive structures are going to go up. There are certainly going to be more esoteric deals. Hopefully there will also be some structural innovation in what we see, maybe some more forward sale-type deals, whether it's pre-funded, extendable or unfunded forward sales, and more hybrid products like the bitcoin mortgage. We would love to originate \$400m or \$500m of that next year. More broadly, there's a bunch of tailwinds going into 2025, which is pretty exciting.

Natter, Dentons: As Kevin noted, all the recent conferences have been very bullish on the coming year. Esoterics have grown exponentially over the past year and that will likely continue throughout 2025 during which time I am sure additional assets will be brought into the structured space.

You also have the new US administration coming into power which will lead to a change in the regulatory regime, likely creating more tailwinds for opening up new structures and asset classes.

GlobalCapital: It all sounds pretty positive. But mingled with

this optimism, what should we be cautious about next year? What risks are out there?

Natter, Dentons: The incoming administration also has other agendas besides decreasing regulations. One of those is their desire to institute additional tariffs and other policies that might cause inflationary pressures. Such inflationary pressures might then cause the US Federal Reserve to increase interest rates. Increasing interest rates can make it more difficult to put together structured products.

So there are certainly downside risks on the market in the coming year, and we do not know how all that will play out. Looking at things in the aggregate, however, a bullish point of view does seem the more justifiable, at least to my mind.

Stevens, Figure: The other risk is if the new administration doesn't pull off the regulatory de-escalation. The market is really buying into that thematic — the hope for regulatory ease. Also, and to David's point, if rates rise, that's good for our secondary business, but it does make it harder for many other esoterics. **GC**



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Q: Financial firms are making significant investments in digital technology to support their operations and clients. For BNY's corporate trust business, what is your technology investment strategy to support your structured finance debt issuer clients?

Nagel: With decades of experience and expertise across global capital markets, asset classes and transaction structures, we see firsthand how the securitization market is evolving. We are one of the leading trustees of ABS securities and have traditionally been the top provider of auto and credit card backed securities. We are also a major global trustee in the fast-growing CLO space.

ABS issuance has increased 20% in the past year to \$332bn, according to GreenStreet, and with this growth we are seeing key developments. There is a growing mix of traditional issuers and new entrants that are innovating such as fintechs. We are also seeing issuance with new and more innovative or esoteric types of underlying assets, which are backed by non-traditional asset types. According to FINSIGHT, the 'esoteric ABS market' has increased by more than 40% over the past year and includes royalties, data centers, fiber and cell towers, for example.

In response, we continue to work with clients and innovate. Some of the transactions we have been involved in include working with traditional issuer clients on mortgage insurance linked notes — credit risk transfer securitizations by mortgage insurers — and securitizations backed by new types of cash flows such as music royalties and renewable energy sources. We have also worked with new entrant fintechs on home equity line of credit (HELOC) securitizations.

Our strategy aims to ensure that our product development capabilities and technology roadmap are fully aligned with the evolving state of the market and our clients' needs.

Q: Of multiple digital investment areas, which have been a priority for your corporate trust business most recently?

Nagel: We continue to invest across the corporate trust business focused on scale, resiliency and innovation.

BNY's corporate trust business, led by Cécile Nagel, has been investing and evolving to meet the changing needs of the market and its issuer clients. Nagel talks to *GlobalCapital* about the business's strategy and strengths



Cécile Nagel

Many of our clients, and particularly large financial institutions, are growing rapidly and need to find a trusted partner that can truly enable their growth. The complexity of deal structures is also increasing.

For example, CLO servicing is inherently complex due to the active management nature of its structure and diverse loan portfolios. The sheer volume of loan data requires accurate reporting and robust systems. Similarly, ABS servicing faces new challenges due to the diversity and complexity of underlying assets. As such, we are focused on creating the digital infrastructure that allows them to readily scale. Importantly, it is underpinned by BNY's financial strength and resiliency.

Another key focus area is innovation and collaboration with fintechs and clients. We have a dedicated team focused on identifying fintech firms and industry initiatives that can enhance our strategic roadmap. We have successfully worked with AccessFintech and others on a range of initiatives such as streamlining and optimizing loan data reconciliation processes and enabling rapid ISIN issuance for clients.

Finally, capital markets continue to evolve towards increased digitization including via digitally native issued bonds aiming to provide investors with faster access to their assets through seamless settlement. We are actively involved in these efforts and proud to have been recently appointed custodian and paying agent for the European Investment Bank's

issuance of a digitally native bond on Goldman Sachs' digital assets platform.

Q: Some of the greatest interest in technology among financial institutions has been in AI. How is BNY thinking about and investing in AI?

Nagel: BNY is on a multi-year journey with AI. Recent advancements in generative AI and large language models have only reinforced our belief that this technology is transformative, reshaping both how we work and the broader financial industry.

In support of this, we have made a significant investment in this area. We are the first global bank to deploy the NVIDIA AI supercomputer. Today, we have a dedicated enterprise team that unites our AI expertise across the firm, enabling us to upskill our employees and responsibly drive adoption of AI technology at-scale.

Within corporate trust, we are dealing with vast amounts of documents and complex unstructured data. We are increasingly embedding AI into our operations for document review, data processing and reconciliation. We maintain much needed human oversight and enable more efficient and accurate anomaly detection, data driven decision making and more. We also see opportunities to develop purpose-built smart assistants for structure finance, which could further scale our ability to support clients and improve our employee experience.

Q: What is on your mind as you look ahead?

Nagel: We are steadfastly executing our current roadmap, yet simultaneously iterating and planning for the future based upon client feedback and market developments. Our goal is to ensure we're positioned to help clients achieve their financing ambitions, and our investment in technology, talent and capabilities means we are equipped to work with clients to respond and even anticipate their needs as the market continues to evolve.



Whether you're an issuer focused on new frontiers in securitization, unique credit structures or conventional debt, we're here to support you throughout the transaction lifecycle.

From trustee and agency services to trading and financing solutions, our scalable, streamlined solutions can help you benefit from a simpler, more efficient operating environment, quicker market entry and the strategic agility you need to evolve.

For more information or to contact us, please visit [BNY.com](https://www.bny.com)

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