



Global Trends in Securitized Products

Robert McDonough and Mayra Rodríguez Valladares

Ongoing tighter credit standards for individuals and businesses -- coupled with uncertainty about the impact of financial regulation in the US, the UK, and Europe -- have kept structured product issuance at a limited level. Very tight lending requirements have prevented individuals and companies from taking advantage of historically low rates. This in turn has negatively influenced the issuance and liquidity of structured products. Regulators on both sides of the Atlantic have proposed regulations requiring issuers to retain a *first loss position interest* in new deals, which has possibly also impinged upon new issues and liquidity in the ABS market.

Regulatory Focus on Structured Products

Significant regulatory focus domestically and in Europe on structured product issuers has made market participants nervous about how new regulations could put pressure on a relatively inactive structured products market, and about the potential impact this will have on financial institutions' balance sheets.

In the US, many elements, including the Frank-Dodd bill, the FHFA, the FDIC, and the SEC are aiming to reform the structured products sector:

- The **Frank-Dodd bill** has new regulations for securitized products. The bill requires issuers of mortgage backed securities (MBSs) to *retain at least a 5% first loss position* unless the underlying loans meet standards that reduce their riskiness.
- This past July 12th, the **Federal Housing Finance Agency** ("FHFA") -- the regulator of the twelve home loan bank boards, Freddie Mac, and Fannie Mae -- announced that it sent *64 subpoenas to private label mortgage securities issuers and other entities*. If the FHFA finds that any of the mortgage securities' loans information does not match what was in marketing materials, it could force issuers to take back the securities. According to data compiled by *The Wall Street Journal*, private-label mortgage securities have been among the poorest performing mortgages¹. While they accounted for just 10% of outstanding mortgages by the end of the first quarter 2010, they represented 27% of all mortgages that were 90 days or more past due. Freddie Mac and Fannie Mae were allowed to buy AAA tranches of these securities, and -- as of the end of this May -- they had about \$255 billion worth of these tranches².
- Of concern to the market is the **FDIC's announcement** this past May, requiring ABS issuers to *retain a 5% first loss position*. The FDIC proposal would also require that issuers disclose more information about the structure of the bond as well as the credit and payment performance of its loans. The agency also seeks disclosure of compensation paid for securitizations. *The FDIC could put a final rule in place as soon as Fall 2010*. The American Securitization Forum, the Financial Services Roundtable and the Mortgage Bankers Association



have all publicly protested against this potential new rule, claiming that it will reduce liquidity in the structured products market.

- The **SEC has also proposed** that publicly registered firms retain a portion of the credit risk in their securitized issues. The agency also brought charges against Goldman Sachs in April and more recently against ICP Asset Management related to their CDO issuance practices. These charges have made market participants nervous about additional SEC actions against other issuers.

Both the **Bank of England (BOE)** and the **European Central Bank (ECB)** have introduced proposals to require more information disclosure from structured products issuers:

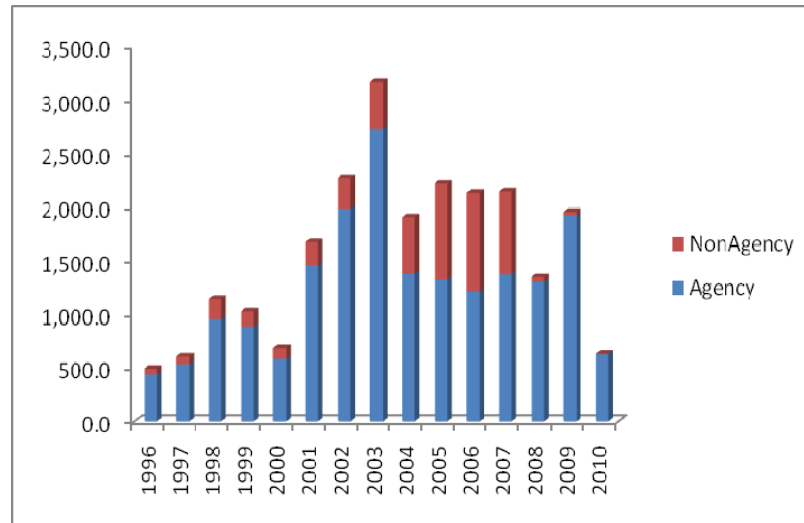
- The **ECB has recently proposed** additional transparency requirements for Eurozone banks using ABSs as collateral for short term borrowings within the Eurosystem. The proposal outlines requirements for banks to provide loan-by-loan information on the underlying assets backing the ABSs as a factor to be taken into account in the eligibility criteria. The proposed disclosure standards are intended to enhance the availability of new information to all market stakeholders, including investors, rating agencies or originators. The proposal is consistent with the regular surveillance reporting requirements that were previously implemented by the Eurosystem in February 2009 for eligible ABS.
- In March 2010 the **BOE** published a consultative paper seeking comments on proposals for liquidity insurance facilities in the U.K. banking system. The BOE provides temporary liquidity insurance to banks secured by high quality collateral through its Discount Window Facility (DWF) and Extended Collateral Long Term Repo operations. The BOE proposes to amend its eligibility criteria to provide enhanced disclosure of information for ABS. The proposed revisions would require counterparties to make publicly available loan-level data for most asset classes and key legal documents, summaries of structural features and models for each transaction. The public disclosure of this information should create greater transparency across the financial system. The proposals are scheduled to be implemented in 2011.

Issuance and Trading Trends in Structured Finance Products

RMBS

Total issuance this year in the US has been about \$630 billion, with the overwhelming majority issued by the Agencies. The private sector RMBS market could receive a significant boost if Congress reduces the maximum size of government-guaranteed Fannie and Freddie loans from the current limit of \$729,750. If this were to occur, a large amount of agency loans would have to be reclassified as jumbo credits, which when securitized would provide higher yields for investors and bigger fees for investment banks. Although it is uncertain when Congress will tackle reforming Fannie and Freddie, market participants anticipate that the agencies might reduce the loan size limit prior to any congressional resolution.

US RMBS Issuance (\$billions)

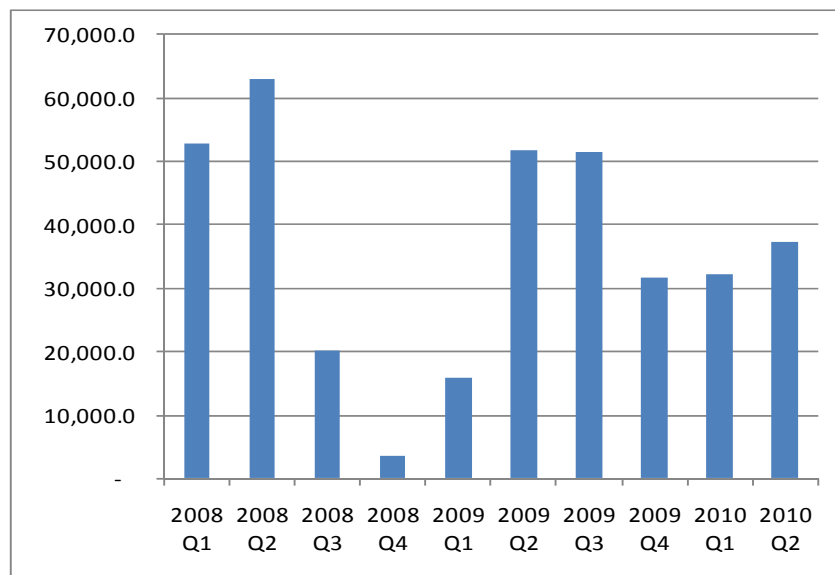


Source: SIFMA, June 2010. Note: 2010 data are until the end of May 2010.

ABS

Issuance in the auto loan ABS market has been recovering, while issuances of RMBS and CMBS have been limited compared to pre-crisis levels. Sequoia Residential Funding's \$222.4 million April RMBS Sequoia deal was notable for being the first U.S. non-Agency RMBS issue since the financial crisis began. The mortgages underlying the RMBS have an average size of \$932,699 and are adjustable loans with fixed rates for the first five years. \$175.4 million worth of loans allow borrowers to pay interest only for the first 10 years.

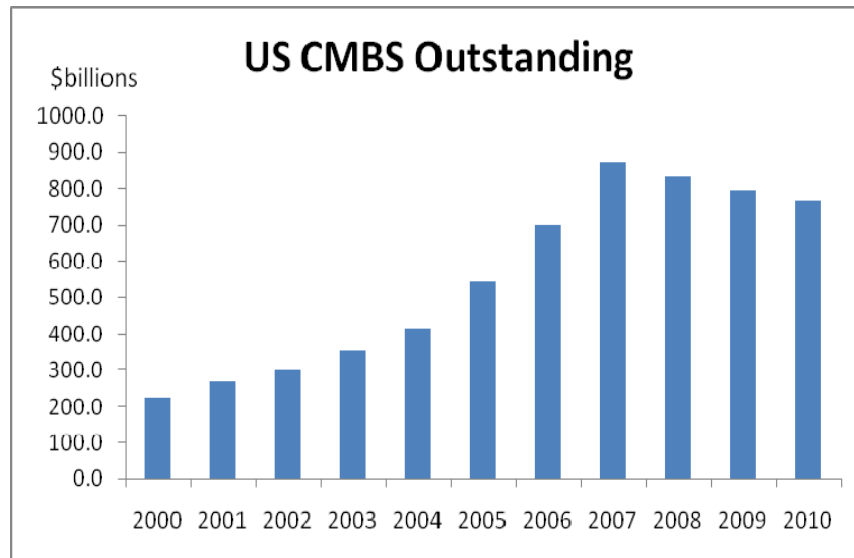
US ABS Issuance (\$billions)



Source: SIFMA, Note: 2010 data include until the end of June.

CMBS

As in the RMBS market, there has been very little issuance this year in the CMBS market. In the US, the almost \$800 billion CMBS market has been supported somewhat by a federal lending program and the improving economy. Yet, very tight underwriting requirements for commercial borrowers and declining values on office, retail and apartment buildings have kept issuances limited.



Source: SIFMA, Note: 2010 data include until the end of June.

CDOs

The Securities Industry Financial Markets Association (SIFMA) reports that new issuances of cash flow, synthetic, and market value CDOs totaled \$ 3.2 billion through the first two quarters of 2010. This is up from \$2.4 billion over the same period in 2009 but significantly down from 2007 and 2008 levels (\$345.1 billion and \$41.9 billion, respectively). In the near term, new issuances are expected to consist primarily of repackaging older issues into new structures, or new issues with low-risk collateral like sovereign debt, project finance loans, or investment-grade corporate debt.

Global Issuance

Since the July 4th holiday, trading volumes in US ABSs have risen and spreads have tightened. However, optimism about a significant amount of new issuances has been muted, particularly since US and European ABS issuances in June were the lowest amount all year.

Table 1 shows private sector structured product issuances during June 2010, in the UK, US, and continental Europe.

Table 1

Issuer	Market	Amount	Structured Product Type	Description
Dexia Bank Belgium	Europe	€6 bn(\$7.6bn)	RMBS	Penates Funding 3
DB/HSBC/RBS	Europe	€520m(\$661m)	ABS	Globaldrive AutoReceivables 2010-A
SNS	Europe	€1.6bn(\$2.03)	RMBS	Hermes XV
Bank of Scotland	UK	€1.27bn(\$1.62bn)	ABS	Penarth Master Issuer 2010-1 Credit card receivables
Tesco Property Finance 3	UK	£950.15m(1.44bn)	CMBS	Moody's, S&P and Fitch have provisionally assigned Tesco Property Finance 3 transaction A3/A-/A- ratings respectively
CarMax	US	\$650m	ABS	CarMax Auto Owner Trust 2010-2 Auto loan receivables
Sallie Mae	US	\$1.7bn	ABS	SLM Student Loan Trust 2010-C
TAL International Group	US	\$197m	ABS	TAL Advantage 2010-1, first intermodal container ABS term financing since 2007
FFELP	US	\$188m	ABS	Goal Cap Funding Student Loan 2010-1
Ally Bank	US	\$5.2bn	ABS	Ally Auto Trust 2010-2, prime auto loans
Santander Consumer	US	\$1bn	ABS	Santander Drive Auto 2010-A, non-prime auto loans
Educational Funding of the South	US	\$227.9m	ABS	Educational Funding of the South 2010-1
GE Capital	US	\$500m	ABS	GE Capital Credit Card Master Note Trust 2010-3
Silverleaf Resorts	US	\$151.5m	CMBS	Silverleaf Timeshare Loan-Backed Notes Series 2010-A
Bank of America	US	\$1.25 bn	ABS	BAAT 2010-2, prime auto loans
Hertz	US	\$184m	ABS	Hertz 2009-2, car rentals
Chrysler	US	\$90.3 m	ABS	Chrysler Financial Auto Securitization
GMACM/Ally Financial	US	\$170m	RMBS	GMACM Mortgage Loan Trust 2010-1, private placement
JPMorgan Chase	US	\$716.3m	CMBS	JP Morgan Chase Commercial Mortgage Securities Trust 2010-C1,
One Bryant Park	US	\$650m	CMBS	OBP Depositor LLC Trust, 2010-OBP, rated AAA by Fitch, S&P and Realpoint

Source: Structured Credit Investor, July 5, 2010 and IFR Markets July 2010.

Despite limited issuance, there has been increased hiring of senior structured finance specialists in anticipation of a surge in activity in European structured finance markets.

According to *The Wall Street Journal*³ (market participants anticipate that EUR1.25 trillion (\$1.55 trillion) in securitized assets will be sold this year.

Issuance in countries outside of the US and Europe has risen slightly. July has already seen significant activity in structured products issuance from Australia. Of note was Macquarie Fixed Income and Currencies' auto loan backed ABS of A\$641.7 million (US\$560.5m). The SMART Series 2010-1 U.S. Trust, denominated in USD, is the first Australian-originated auto loan securitization to be marketed to US investors. The issue was oversubscribed.

Also noteworthy, was the Emirates NBD Auto Finance yen-denominated auto loan ABS. This is the first type of transaction of this nature originating in the Middle East. Table 2 highlights some recent structured finance issuances outside of the US and Europe.

Table 2

Issuer	Country	Amount	Structured Product Type	Description
Australia Bendigo and Adelaide Bank	Australia	A\$750m (US\$639m)	RMBS	The Torrens Series 2010-2 Trust, has six tranches
MacQuarie		A\$641.7m (US\$560.5m)	ABS	SMART 2010-1 U.S. Trust, auto loans
Members Equity Bank		A\$1.04bn (US\$867m)	RMBS	SMHL Securitisation fund 2010-E. The A1 class Reg S tranche priced at 120 bp over 3-month labor. S&P and Fitch rated the tranche AAA; it has a 1.52 year weighted average life and is the only US\$ tranche of transaction.
NZF Group	New Zealand	NZ\$100m (US\$ 76m)	RMBS	NZF Mortgages Series 2010-1 Trust is the first RMBS of the group and is the first issuance from the country since 2007.
Emirates NBD Auto Finance	UAE	¥24 billion (\$271.2m)	ABS	Transaction is the Middle east's first true sale auto loan securitization. The landmark issue received a provisional rating of Aa2 from Moody's.

Sources: Structured Credit Investor and The Wall Street Journal.



Conclusion

Continued concerns of a very weak global economic recovery will keep credit and structured product issuance tight. Uncertainty about the impact of new regulations affecting the structured products market, declining retail sales and house prices, and stubbornly high unemployment rates will also continue to weigh on the primary and secondary markets for these securities. Historically low interest rates are not expected to drive deal volume because corporations are hoarding cash instead of borrowing to create new credits, whereas investors are seeking higher yields than most deal structures can offer in this credit risk-sensitive environment. Issues with non-mortgage consumer collateral -- especially auto loans -- are expected to drive any new volumes in this market; but these deals will almost certainly contain less leverage and more restrictive underwriting guidelines than similar transactions issued before the crisis.

¹ "U.S. Queries 64 Issuers of Mortgage Securities, Others," The Wall Street Journal, July 13, 2010.

² Ibid

³ "Financial News: Banks Hire For Securitisation Surge," The Wall Street Journal, 27 June 2010.