Nomura Fixed Income Research

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Report from Paradise Island: Coverage of Selected Sessions of ABS East 2002

7 October 2002

Several key themes emerged at last week's asset securitization conference in the Bahamas. First, securitization professionals are coming to grips with the weak performance in several sectors: CDOs, manufactured housing ABS, franchise loan ABS, and aircraft ABS. For most securitization professionals, the performance experienced in those sectors would have been unthinkable just a few years ago. Second, the evolving landscape in the legal, regulatory and accounting areas is creating profound challenges for certain types of securitizations. Off-balance sheet accounting practices are in the public spotlight, as is the issue of predatory lending. Third, the condition of the U.S. economy poses potential threats to the sectors that have been relatively free of problems so far. A "housing bubble" could test the protections in sub-mortgage ABS. Sharp movements in interest rates – either up or down – could precipitate equally tough challenges.

The following summaries reflect remarks of the panelists who participated in selected sessions at the recent asset securitization conference sponsored by Information Management Network. For the most part, the summaries have been drawn from notes taken during the sessions by Nomura employees. The summaries have not been reviewed or approved by the panelists. While we have tried to capture panelists' remarks accurately, we apologize in advance for any inaccuracies and omissions. In addition, we wish to acknowledge the excellent work of the conference organizer in hosting the conference.

The summaries below do not necessarily reflect the views of Nomura Securities International or any of its subsidiaries or affiliates.

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Please refer to important disclosures at the end of this report.

Wednesday, 2 October 2002

8:30 AM – Securitization Post-Enron, WorldCom & Other Corporate Scandals: Impact on the Future Outlook for the Global ABS Markets

U.S. structured finance issuance grew in 2002 relative to 2001. ABS issuance grew, except for the MH sector. Against this backdrop, we observe ominous press headlines about securitization.

What is "ugly" in the securitization industry right now? Enron, WorldCom, Tyco, and others brought an unnecessary and negative focus on securitization.[1] The focus came from entities that cannot be controlled, such as FASB and the SEC. However, there are longer-term implications that will come from potential changes to the legal, regulatory, and accounting framework. Now it seems that the greatest impact is in the ABCP conduit sector. The leveling-off of issuance in that area is constraining demand for term ABS. Much of what will happen in the short run ultimately would have happened anyway in the long run (with respect to legal and accounting standards), but recent events are forcing evolution to occur rapidly.

The Sarbanes-Oxley Act[2] is very damaging legislation. It imposes standards that will be difficult to meet.

There is a real crisis of confidence. The regulatory actions taken to address problems such as fraud and corporate misconduct are not the right actions. What really needs to be done is to create more oversight (by auditors and regulators) of the ***internal workings*** of companies. Companies that are formed by mergers and combinations may have weak internal controls because of a failure to properly meld diverse systems and procedures.

A potentially damaging impact of today's intense scrutiny on securitization is that it may quash the creativity that has helped the market to reach its present size.

Investors hold the key to preventing abuses in the securitization market. Investors must demand better disclosure. That will compel issuers to deliver better disclosure and will help rating agencies and auditors do their jobs better.

The motivation to commit fraud is always greater than the ability to detect it. In the securitization market, there must be better accountability – stricter accountability. After Enron, Moody's examined a large sample of companies and found that more than 85% had covenants in their loan agreements and bonds tied to their corporate ratings. However, fewer than a quarter of those corporations had disclosed the rating triggers in their SEC filings.

The Durbin-Delahunt bill,[3] which would have amended the bankruptcy code in very damaging ways, was well-intentioned but arguably reflected a misunderstanding of how securitization works. The bill would have allowed a bankruptcy court to recharacterize virtually all asset sales as secured loans that do not remove the subject assets from a debtor's bankruptcy estate. The offending portions of the bill have been removed in its latest versions, but it is possible that the troubling provisions will resurface next year.

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[1] *See* Nomura Securities*, Tale of Two Cities: U.S. Fixed Income Research Mid-Year Review* at 15 (July 2002) (background on the accounting /disclosure fall-out following Enron's collapse).

[2] Pub. L. No. 107-204, 116 Stat. 745 (2002).

[3] Employee Abuse Prevention Act of 2002, H.R. 5221, 107th Cong., 2d Sess. (2002), S. 2798, 107th Cong., 2d Sess. (2002).

The EU has issued a "market abuse directive" relating to insider trading and market manipulation. The directive extends culpability and liability to a firm whose employee violates insider trading and market manipulation rules. This brings European standards closer to those of the U.S.

The FASB consolidation project prompted one major corporation that uses ABCP to amplify its disclosures about how it uses securitization. If FASB standards mandate consolidation of securitization SPEs, the cost ultimately will be passed along to consumers seeking credit. For this issuer, one of the big questions under the Sarbanes-Oxley Act is determining who should sign the servicer certification required to be filed with the SEC.

<u>Predatory Lending</u>:[4] There is a bill circulating in the House that would strengthen HOEPA[5] and which would preempt state predatory lending laws. New York City has passed an ordinance[6] – which is now awaiting the mayor's signature – which would limit the ability of companies that have engaged in predatory lending to do business with the City. Another recent predatory lending development is the new OTS regulation[7] that curtails the application of the AMTPA[8] to preempt state rules on prepayment penalties and late fees.

<u>NextCard</u>:[9] The FDIC's actions in shutting down the NextCard credit card trusts reflected a lack of concern for others' pain. It also illustrates that the concept of "bankruptcy remoteness" arguably has been oversold. The NextCard case makes investors wary of deals from regulated entities. In contrast to other kinds of situations, the interests of ABS holders were not aligned with the interests of depositors or the FDIC. NextCard also illustrated general paralysis among investors because the deals required unanimous consent of all security holders in order to change the cash flow waterfalls. Holders of triple-A-rated securities tend not to be willing to give up anything (arguably this position is reasonable). Trustees are not sufficiently compensated to devote substantial time or resources to work on problems that develop in securitizations. A possible fix is to create a reserve fund to cover the expenses of addressing such situations and which, if unused, would flow through to the residual interest of a deal. Governance became an important issue.

<u>Housing Bubble</u>?: The housing market is a daily topic on CNBC. This is a good thing because CNBC was the biggest cheerleader for the stock market when it was overheated. On the other hand, it is a bad thing that Chairman Greenspan has been proclaiming that there is not a housing bubble while acknowledging that certain areas are inflated. The housing market is very sensitive to movements in interests rates. If home price appreciation levels-off, cash-out refinancings will slow down or stop. The way to play in the present environment is to focus on well-established issuers, to trade up in credit, and to prefer deals backed by primary residences.

If there is a housing bubble, it is important for investors to focus on who is servicing the loans backing their securities and to make sure that the servicer has the capacity to handle increases in delinquencies.

Even without a national bubble, regional bubbles can produce trouble for deals.

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[4] *See* Nomura Securities, *Tale of Two Cities: U.S. Fixed Income Research Mid-Year Review* at 26 (July 2002) (background on predatory lending developments).

[5] 15 U.S.C. § 1639, Home Ownership and Equity Protection Act of 1994 (contained in Riegle Community Development and Regulatory Improvement Act of 1994 §§ 151-58, Pub. L. 103-325, 108 Stat. 2160).

[6] Council of the City of New York, Int. 67A (25 Sep. 2002), *available at* http://www.council.nyc.ny.us/textfiles/Int%200067-2002A.htm.

[7] Office of Thrift Supervision, *Alternative Mortgage Transaction Parity Act; Preemption*, Release No. 2002-43, 67 Fed. Reg. 60542 (26 Sep. 2002)

[8] Alternative Mortgage Transaction Parity Act, 12 U.S.C. § 3801 *et seq.*

[9] *See* Nomura Securities, *Tale of Two Cities: U.S. Fixed Income Research Mid-Year Review* at 58 (July 2002) (background on the NextCard situation).

Auto ABS: Zero percent financing earlier in the year produced a spike in prepayments. However, because not all borrowers can qualify for 0%, those financing terms have not created *additional* credit problems. Just the same, losses and delinquencies have risen in general.

Monoline vs. Multi-line Insurance: The market is distinguishing more strongly between deals supported by monoline insurance and those that rely on insurance policies from multi-line insurance companies. The interests of monoline insurers generally are aligned with investors' interests.

CDO Credit Volatility: Half of all securitization downgrades have been in the CDO sector. Investors' perception of the deals has changed and investors now focus more closely on the identity of a deal's servicer and on the servicer's track record. Liquidity for CDOs has waned over the past six to nine months. There arguably are six causes for the volatility: (1) corporate credit trends, (2) applying the law of large numbers to small pools, (3) high leverage amplifying the volatility of the underlying credits, (4) moral hazard, (5) differences between the credit quality of bonds and the credit quality of loans, (6) high leverage amplifying the impact of management quality. The securitization industry needs to be a lot more humble about "models" and "methodologies." Securitization professionals need to be more focused on the fundamentals of corporate credit. There is a rift between deals backed by large corporate credits and those backed by consumer credits.

Franchise ABS: Small issuers were given access to credit too easily. There was too much focus on "franchise value" as opposed to the true value of the related real estate.

Aircraft ABS: EETCs[10] have held up pretty well following 9/11. Synthetic balance sheet deals have good structure and diversity. The lease portfolio deals are the ones that have experienced the most trouble. Those deals supply financing for weaker lessees and highlight the difficulties of re-leasing older, less-desirable aircraft.

Growth: The key drivers of growth in the securitization market over the past year have been: (1) low interest rates, (2) tight corporate spreads, which shift investor demand to products other than corporate bonds, and (3) growing investor demand (investors seeking stable returns). Projected ABS issuance next year in Europe will be $165 billion in Europe for next year. European public sector entities accounted for much of the activity over the past year. Despite the banking crisis in Japan, there is a well-developed yen-denominated securitization market and deals are getting done. In Korea, deals happen but they often rely on insurance.

9:45 AM – Market Trends Developments & Future Outlook for the U.S. ABS Market

Economy: NBER[11] reports that the recession, which started in March 2001, may not actually have ended. The market for office real estate has been weak in many regions. The office market and the warehouse market will closely track GDP. The residential housing market has been strong. However, foreclosure rates are at record highs. In the corporate market, the strong are getting stronger and the weak are getting weaker. The manufacturing sector is weak, but it always seems to pull through. The transportation sector is struggling. The middle market is struggling — bankruptcies are at very high levels. Small leasing companies are becoming insolvent. Consumer bankruptcies are at record levels but the rate of increase has leveled out. Wholesale car prices are down 10% to 20% from a year ago. Consumer auto delinquencies are down for prime-quality (>680 FICO score) consumers and about level for sub-prime consumers. Real estate prices have remained generally stable, except for towns that have had major corporate lay-offs. Loans secured by properties in "urban fringe" areas have been particularly sensitive to changes in employment. The U.S. economy definitely is going into a slowdown for the fourth quarter of 2002 and the first quarter of 2003; it may not be an actual "negative growth" scenario but it will be slow growth at best.

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[10] Enhanced equipment trust certificates.

[11] National Bureau of Economic Research (www.nber.org).

Whether or not there actually is a double-dip recession, at best there will be weak growth for 2002 as a whole, and moderate growth for 2003. Given the stream of bad events – 9/11 followed by accounting scandals followed by the prospect of war – the economy has not really done that poorly. There is evidence that consumer confidence is improving, that inventories are improving, and that technology sales are set to grow. On the other hand, oil prices could jump if there is war in Iraq. The Federal Reserve could ease interest rates or keep them where they are for up to nine months before they tighten credit.

Another point of view is that corporate governance issues and the prospect of war with Iraq will weigh *very* heavily on the market. Consumers arguably have been driving the level of activity in the securitization market with mortgage loan refinancings. If that stops, the securitization sector (and perhaps the whole economy) could hurt.

The unemployment rate, the growth of disposable income, and the refinancing boom arguably support the view that that the economy is doing well. However, the loss of personal wealth in 401(k) plans, combined with poor corporate profits, supports the opposite conclusion. Together with the debt loads that consumers now bear, it seems that the true condition of consumers and of the economy, as a whole, is weak. Consumer spending possibly will run out of steam in the fourth quarter, especially if war with Iraq produces an oil shock.

Over the past year, fixed-income investors' risk appetite has abated. The troubles in the corporate bond market were a benefit to the ABS market. Spread widening in both high-grade and high-yield corporate markets have made ABS a safe harbor in a stormy sea.

<u>Prime vs. Sub-prime</u>: If Wall Street had not been bidding for whole loans over the past year, liquidity in the home equity sector would have been constrained. Wall Street provided strong bids for newly originated sub-prime mortgage loans. However, from an investor perspective, the appetite for subordinate bonds backed by pools of sub-prime mortgage loans is now muted. Problems come from (1) bad underwriting, (2) bad structure, and (3) bad business models. An investor should focus on an originator's business model to determine whether it needs "everything to go right" to work. It is better to find an originator that has embraced a strategy that provides a margin for error. Sub-prime mortgages are fundamentally a good asset class and investors should continue to consider sub-prime mortgage ABS. However, not all the triple-B-rated securities are created equal. Investors need to make sure that pricing of a security provides fair compensation for its risk. Tiering will become more pronounced in the sub-prime mortgage sector. Some of the spread widening in the sub-prime mortgage ABS sector has been beneficial in that it has brought new investors to the sector. Investors are becoming more savvy. Investors in sub-prime mortgage ABS have started listening to the teleconferences directed to equity investors.

<u>CDOs</u>: Investor demand for CDOs has dropped. Some investors are taking a broader view of credit markets, beyond the confines of securitization. In that broader context, we arguably now are witnessing a 2-standard deviation event (in terms of corporate bond defaults). Against that backdrop, the troubles of the CDO sector are not surprising. Even so, the experience of the CDO sector reveals that some structural changes need to happen. Investors are also reconsidering the role of CDOs in their whole portfolio. That is, investors are more aware that CDOs often represent an exposure to the corporate sector that is simply repackaged in derivative form. High-yield default rates reached an all time high in 2001. More new CDOs are being backed by ABS than by high-yield corporate debt. ABS CDOs have performed much better than those backed by corporate debt. One ABS CDO even was upgraded during the year. However, most of the ABS CDOs have not been outstanding for long enough to have experienced downgrades. Nonetheless, signs of stress are beginning to appear in ABS CDOs that have invested in franchise loan ABS and aircraft ABS.

<u>Conseco</u>: Conseco's demise will have major implications. How will Conseco's MH pools get serviced if Conseco disappears? The present servicing fee probably is insufficient to attract a capable replacement servicer. However, raising the servicing fee could be difficult because it would require consent from all investors. One reason why Conseco's servicing operation was built on a decentralized basis is the servicer's need to be in touch with local markets.

SPE Consolidation; FASB: Assuming that FASB requires consolidation of securitization SPEs, could the term ABS market absorb the financing activity now done through the ABCP market? One view is that the term market could absorb some of the activity but not nearly all of it. Some financings through ABCP programs are priced too tightly to move to the term market.

SPE consolidation could injure or kill the SIVs, which would curtail demand for term ABS.

Some ABCP financings possibly could convert to private placement term ABS, but not to public deals. The pricing would have to be wider than for public deals, which might not satisfy issuers' expectations. Consolidation would not entirely kill the ABCP sector because some new players (non-banks) are creating new conduits to exploit the regulatory environment.

1:45 PM – Prepayment, Default & Credit Performance Considerations for Mortgage-Related ABS

SUB-PRIME MORTGAGE LOANS

Credit: Losses and delinquencies have been acceptable in the sub-prime mortgage sector. However, the housing market has been very strong. This raises the question of whether the sector's strong performance has been (artificially) buoyed by home price appreciation. As home price appreciation slows, the market should expect to see an up-tick in losses and delinquencies on pools of sub-prime mortgage loans.

The high level of cash-out refinancings over the past two years has helped consumers handle financial stress coming from their other debt obligations (*e.g.* credit cards and auto loans). If home price appreciation stops, consumers will not be able to resort to cash-out refinancings as a tool for avoiding defaults.

FICO score[12] is the most important determinant of whether a performing loan becomes a non-performing loan. Loan-to-value ratio (LTV) is the next most important variable. In addition, recent payment history is a strong indicator. Once a loan is delinquent by 120 days, the current LTV (*i.e.*, the LTV calculated with the current value of the home at the time the loan is delinquent) becomes the strongest determinant of whether it will ultimately cure or become a default.

Another view is that lenders' own credit grading systems are actually more predictive than FICO scores because they are based on more data (*e.g.* a borrower's income and assets). Also, even before a loan becomes delinquent, current LTV is a more powerful predictor of future performance than original LTV.

Macroeconomic variables exert the strongest influence on losses and delinquencies. One study found that a one percentage point increase in the unemployment rate produced a 23% increase in default rates. This impact greatly outweighs the effect of variations in FICO scores from deal to deal. An even greater macroeconomic factor is home price fluctuations. Although there has never been a nationwide decline in home prices, home price declines in particular localities have occurred and allow measurements of effect. Fluctuations in home prices can have a much larger impact than small variations in original LTVs among different deals.

Likewise, occupancy status has a material effect. Non-owner occupied homes have 1½ times the default experience of owner occupied homes.

The volume and quality of sub-prime mortgage originations are inversely correlated. The opposite is true of the prime mortgage market, where high volumes prompt originators to closely scrutinize their

[12] "FICO score" refers to generic consumer "credit scores" generated from data compiled by the major credit bureaus and by using algorithms supplied by Fair Isaac & Company (www.fairisaac.com).

offerings and production. On the other hand, origination standards in the sub-prime mortgage sector have been getting tougher; newer loans have higher FICO scores.

Extension Risk: Increasing equity in borrowers' homes has been a strong driver of prepayments through cash-out refinancings. If home price appreciation moderates, prepayments on sub-prime mortgage loans could slow by 2% CPR to 5% CPR (however, prepayment speeds on sub-prime mortgage ABS remain less sensitive to changing interest rates than prepayment speeds on securities backed by prime-quality mortgage loans). If conforming mortgage rates go to 7½%, virtually the entire conforming mortgage market will become non-refinanceable. If interest rates rise by two percentage points, prepayments on sub-prime mortgage pools could drop to the 15% CPR ballpark. This could cause many outstanding securities to extend and could hurt option-adjusted spreads. In contrast to the prime/conforming loan sector, most of the option cost associated with sub-prime mortgage loans comes from extension risk rather than prepayment (shortening) risk.

Real estate appreciation has had a huge influence on sub-prime borrowers. The typical sub-prime borrower responds to home appreciation by taking cash out of his home. Sub-prime adjustable-rate mortgage loans (ARMs) generally display even higher propensity to prepay than fixed-rate sub-prime mortgage loans. Credit curing is also an important driver of sub-prime mortgage loan prepayments.

MANUFACTURED HOUSING

Shipments of manufactured housing (MH) units grew in the early 1990s and then shrank. The growth in MH shipments brought new lenders into the area. The decline in shipments ultimately produced a contraction and a shake-out among the lenders. MH lending was less profitable in the late 1990s than it is now because net interest margins are 2-3 percentage points wider now.

If Conseco goes away what will happen? The easy availability of credit some years ago is part of the reason for today's problems. Another cause arguably is overly aggressive "loss mitigation" strategies used several years ago which may have masked deteriorating performance. A new servicer (or a reorganized Conseco) is likely to take a more streamlined approach to servicing Conseco's huge portfolio of MH loans. In particular, the new servicer is likely to hold the inventory of repossessed units to a much lower level. When a new servicer steps in, it is likely to be very aggressive and might succeed in reducing delinquencies.

But, it does not seem that there is any logical servicer to take over the whole Conseco MH servicing portfolio. On the other hand, if the servicing fee is sufficiently large, one of the gigantic mortgage servicers might step in to take over the whole portfolio.

The MH lending sector cannot disappear. Physical MH units remain in demand and shipments have *always* remained above 10,000 units per month since the 1960s. Financing for those units is necessary. The real question is: What level of activity can be sustained? Some level is sustainable. Today's MH market is laboring under the burden of a huge inventory of repossessed units.

RELATIVE VALUE

The panelists offer the following relative value recommendations:

- Premium-priced, 5-year home equity ABS are attractive. Par-priced ABS have relatively low carry. Investors should avoid the short end of the curve because of extension risk.

- Senior tranches of deals backed by seasoned collateral are attractive. The triple-A-rated tranches of real estate ABS offer wider spreads than the triple-B-rated tranches of ABS backed by other asset classes.

- Mezzanine tranches from Conseco home equity and home improvement ABS are attractive. The securities carry double-A and single-A ratings. They have de-levered significantly, but there is no chance for an upgrade because of the Conseco name.

- Single-A-rated and double-A-rated floating-rate tranches of home equity deals are attractive.

- NIM (net interest margin) ABS are a good opportunity for short-WAL (weighted average life) paper. HELOC (home equity line of credit) ABS will outperform ABS backed by sub-prime mortgages.

- HELOC ABS should not trade at the same spreads as ABS backed by sub-prime mortgage loans. Investors should adopt a defensive posture by preferring securities with short WALs. There are more risks in securities with longer WALs. Demand from overseas (for floaters) will increase.

2:45 PM – ABS - Safe Haven or Not: A Research Analysts' Roundtable (Non-Real Estate ABS)

The whole ABS sector is divided along a number of lines. One major dividing line is the mortgage vs. non-mortgage dimension. However, the non-mortgage side of ABS is still tremendously diverse. Even within seemingly benign areas such as "credit cards" there is substantial diversity.

NextCard: NextCard's failure and subsequent receivership is a hot topic. The FDIC should have handled things differently. Investors need to ask themselves what they should consider when they invest in credit card ABS. The most controversial aspect of the FDIC handling of the receivership was the FDIC's decision to forestall the early amortization of the trust that arguably had been triggered by the appointment of the FDIC as receiver. The FDIC was trying to protect its insurance fund and not focusing on protecting ABS investors. It wanted to prevent the early amortization in order to try to sell the portfolio.

The FDIC wanted to handle the flow of information to ABS investors through the ABS trustee. The market learned that this does not work. Another lesson of the NextCard experience is that the regulators in Washington do not talk to each other. The FDIC argues that it did a fine job of holding the portfolio together after it took over the bank, but it could have taken a proactive approach to working with the portfolio rather than the re-active approach that it actually took.

The class B and class C bondholders of the NextCard deals likely will experience a loss. The market may turn to reserve funds as a way to protect class B and C bondholders in future credit card deals. Metris and Providian should not suffer the same fate as NextCard. The market will continue to express its differentiation of prime quality credit card accounts from sub-prime accounts.

Away from NextCard, investors in triple-B-rated credit card ABS are fairly well protected from losses. Triple-A credit card ABS are well protected in all deals, including the NextCard deals.

Early amortization is much more of a possibility than had been previously appreciated by the market. Formerly, market participants may have demanded just a single basis point for negative convexity of credit card ABS; now they will demand incrementally more.

The old story for ABS was: "Here's the collateral and here's the structure; don't really worry about the issuer." That story is now dead. The market appreciates the impact of the issuer on a deal. Moreover, the impact is magnified in the subordinate bonds. Investors in subordinate ABS have to scrutinize the issuer closely. In fact, investors in subordinate ABS arguably should price subordinate ABS just as they would price a secured loan to the issuer. The opportunity for investors to find value in subordinate ABS is when they disagree with the rating agencies and prevailing market sentiment. In particular, the rating agencies (and the market) systematically ascribe too little value to excess spread and to the effect of de-leveraging. Likewise, the rating agencies and the market are not fully efficient in differentiating the effects of various trigger mechanisms.

Bank issuers have less flexibility to rescue troubled deals than non-bank issuers. Mitsubishi added $7 million to an ABS reserve fund earlier this year but it probably could not have done so if it was a bank.

In real estate ABS, triggers usually operate by redirecting cash flow that would have gone back to the issuer. In non-real estate ABS, triggers operate by forcing amortization or by re-allocating cash flows among the classes.

Franchise ABS: One of the most successful franchise lenders (FFCA) took the view that a franchise loan should be adequately secured by real estate collateral. Other franchise lenders took the opposite view: that real estate should not be significant in the lending decision. Based on subsequent experience, the first of the two approaches has proven to be a better business model.

There are a number of failed "emerging asset classes" that have resulted in ugly litigation. Investors feel burned by the "other" category of the ABS universe (*i.e.*, not credit cards receivables, auto loans, home equity loans, or manufactured housing loans). That explains the shrinkage of the "other" component during 2002. Investors will continue to be wary of ABS backed by off-the-run asset classes.

The franchise loan ABS sector is not dead, but it is in critical condition. On top of all the other troubles that the sector has experienced, FFCA deals recently have come under pressure. Franchise loans continue to be originated and banks are trading them among themselves. Franchise loans should eventually come back as a minor ABS asset class.

Spreads: ABS spreads were very tight earlier in the year. Then they got wider, and subsequently tightened a little bit. Spreads are too tight on two-year WAL ABS backed by prime-quality auto loans. There is prepayment risk in auto ABS, and they should not trade at the same spread levels as credit card ABS.

ABS are still expensive compared to the unsecured corporate debt, but ABS still offer much greater rating stability. On an option-adjusted spread (OAS) basis, credit card ABS are more attractive than home equity ABS because home equity ABS have *negative* OAS.

The ABS market is bifurcated. There are investors who need to remain liquid and there are investors who can hold positions based on fundamental value. For the latter group, Capital One credit card ABS may offer good value. For the investors that require liquidity, focusing on rate reduction bonds and benchmark credit card ABS is a good strategy. For investors seeking more yield, a good strategy is to consider the single-A and lower-rated tranches of benchmark credit card deals.

Who's Next: Panelists' views on which ABS issuers will be the next ones to get into trouble:

- regional banks
- Metris
- smaller consumer lenders, mostly non-prime
- small specialty finance companies
- Conseco (already gone)
- smaller credit card issuers who have relied on FDIC insurance to raise deposits
- First Consumers, Metris, monoline credit card issuers generally, emerging asset issuers; although manufactured housing and credit cards have wide spreads by historical standards, the spreads are where they ought to be because circumstances have changed
- anyone lending to sub-prime borrowers will come under greater pressure because of regulatory initiatives in areas such as predatory lending

There is clear disagreement over whether the FDIC will become more investor friendly following the feedback it received after the NextCard incident.

4:15 PM – State of the Industries: A Real Estate ABS Researchers' Roundtable

Plan for the discussion: Each of the eight panelists will each give a four minute presentation on the home equity ABS sector and then a three minute presentation on the manufactured housing sector.

HOME EQUITY

1. Home price appreciation, whether there is a bubble: It is too difficult to determine whether home prices are fair in an absolute sense. However, it is reasonable to conclude that the likelihood of severe home price declines in the near term is extremely low. Home prices are affected by unemployment on a 4-quarter-lagged basis. Thus, the recent rise in unemployment in California should reveal itself in downward pressure on home prices several quarters hence. However falling interest rates in the meantime will have a countervailing influence. On balance, the prediction is for home prices to remain flat in California. This will produce rising loss severities because the market will lose the "tail wind" of a rising value environment.

2. "Serial refinancing" is the basic idea of the home equity market. The core paradigm is a debt consolidation loan. A slowdown in home price appreciation will curtail activity in debt consolidation loan originations. Origination has shifted from fixed rate loans to hybrid ARMs. At the same time, sub-prime mortgage interest rates have not moved down as much as LIBOR. Lenders are getting more gross margin, which strengthens their deals.

3. Home equity collateral has improved substantially since 2000. FICO scores are higher and loan-to-value ratios are lower. Home price appreciation gives a "serial refinancer" strong incentives to keep on refinancing his loans. Improved loan characteristics are partly attributable to the 2001 recession, which prompted lenders to tighten their standards. However, as the yield curve flattens and home price appreciation slows or stops, new loan originations will slow and lenders will loosen their standards to compete for volume.

Why do investors buy bonds that have negative option-adjusted spreads (OAS)? At least one investment bank has recently recalibrated its OAS model, reflecting an acknowledgement of the model's shortcomings and limitations. Also, implied volatility of interest rates is very high right now. If an investor expects volatility of interest rates to become more moderate, OAS calculated on that basis would be much better (*i.e.*, positive).

4. Sub-prime borrowers continue to choose ARMs rather than fixed-rate loans. One reason is that they have become accustomed to the low rate environment. Another reason is that mortgage brokers may be advising borrowers to take ARMs because they will credit cure in two years.

There is no housing bubble. Demographics, household income, and employment levels fully justify the growth in home prices that has occurred over the past several years. The potential for rising interest rates is the only factor that could challenge the resiliency of home prices. However, although there is no national housing bubble, there are regional bubbles. San Francisco is ***not*** an area now experiencing a bubble. Household income growth supports home values in San Francisco.

5. EquiCredit's exit from the home equity loan market accounts for a material portion of the home equity ABS issuance over the past year and for some of the origination growth at other lenders.

6. Home prices probably will continue to appreciate at a single digit rate of growth. Income growth over the past three years supports the appreciation of home prices.

Borrowers' ability to pay will also be a driving factor. Consumers' debt service load is very high. The proportion of borrowers with a debt service burden over 40% has grown significantly. Although consumer bankruptcies are very high, the rate of increase has slowed. Other data suggest that conditions probably have bottomed-out.

7. Apart from the issue of a possible housing bubble is the issue of whether whole loan prices have gotten too high. Although the home equity ABS sector ran into trouble in 1998 because whole loan prices got too high (because of gain on sale accounting), today's prices do not result from originators booking illusory gains. Origination costs are about 2½ points today compared to 4½ points around 1998.

Lender-paid mortgage insurance (MI) can have the effect of reducing credit enhancement levels by half. There is concern in the market about whether the insurers will make good on claims. A key issue is whether the insurer performs sufficient due diligence. The rating agencies have been "rational" in their treatment of lender-paid MI. Rating agency analysis seems to recognize that lender-paid MI reduces loss severities by half. Investors in triple-A-rated ABS need to be comfortable with the claims paying ability of the MI providers (most of which are rated double-A).

Premium-priced paper is attractive. Seasoned paper is attractive. There is selective opportunity in the NIM sector. Issuer tiering arguably does not make as much sense as it did in 1998. The lower tier has disappeared and the former top tier now composes most of the market. Thus, the top tier actually represents the average.

8. The risk for home equities right now is on the legislative and regulatory front. Initiatives in New York City and Georgia[13] are threatening. Lenders that have their own retail origination channels will be less vulnerable than those that rely entirely on brokers. Predatory lending regulation is not helpful to the sub-prime consumers because it is curtailing credit. The market is likely to see more tiering in the sub-prime mortgage sector and thus wider spreads. Most investors should not increase their exposure to Conseco home equity and home improvement deals. It is hard to explain the low delinquencies and low prepayments that characterize the Conseco-serviced deals; there may be hidden problems in the deals.

<u>MANUFACTURED HOUSING</u> (very little time remaining is the session)

1. Manufactured housing is a viable sector. It will survive even if Conseco does not. MH will remain part of the ABS market. One issue that plagues the Conseco MH portfolio is the high level of repossessions. When other MH lenders exited the business and their portfolios were take over, serious delinquencies first spiked and then repossessions and delinquencies declined as defaults and realized losses rose.

2. The manufactured housing sector is a mess.

3. A key question is whether the proposed Conseco debt-for-equity swap will go through.

4. The Conseco situation is very dangerous and will drag on for a long time.

5. The market for Conseco paper is headed wider. The 1997 vintage is stronger.

6. The problem is not just from weak underwriting in years past. New originations are very weak because they include large quantities of loans backed by repossessed units.

5:15 PM – Securitization Workouts, Successor Servicing & Enforcing Investors' Rights

By the time a distribution date occurs, the collection account for a deal should have 45 days' worth of collections. Oversight parties need to reconcile the distribution amount against the amount properly available for distribution, which can be less than the full amount in an account.

[13] The Georgia Fair Lending Act (Title 7, Chapter 6A of the Official Code of Georgia Annotated) was enacted in April 2002 but became effective on 1 October 2002. *See* http://www.ganet.org/services/newleg/legsearch.cgi?year=2002&bill=HB1361

Oversight parties should focus on cash. Although fraud is not common, it does occur. In the case of a recent high profile fraud incident in the equipment leasing sector, investors wished they had done more testing and due diligence of the obligors. Doing so would have made sure that the debt actually existed.

A more frequent problem than fraud is trying to reconcile the underlying data that drives the production of the servicing report. Trying to reconstruct a servicing report from the underlying account-level data is very difficult. Fraud is almost never apparent from the face of a servicing report. Detecting fraud requires working with the underlying data. Trustees have sometimes received data that ties perfectly to the servicing reports, while the servicer itself is using entirely different trial balances.

Another view is that problems come from trying to force companies to push their working data into the format of servicing reports. The intermediate layer between the working systems and the securitization servicing report is where problems develop. The key is getting into the underlying information.

When a deal gets into trouble, the best thing for the issuer to do is to inform interested parties such as the trustee, the rating agencies, and the bond insurer (if there is one). This helps to avoid surprises, which can undermine trust.

Insured transactions have obvious benefits to investors. Additional, and less obvious benefits, relate to a bond insurer's expertise and its ability correct problem situations. Corrective measures can be servicing transfers of other steps that might avoid having to transfer servicing. Some bond insurers use a rolling termination to avoid problems with the automatic stay if the servicer goes into bankruptcy.

Most deals do not have a hot backup servicer. In most deals, the trustees are the nominal backup servicers, but they never intend to actually service the deals. A hot backup servicer should receive a daily data file, should have a complete transition plan, and should be able to reconcile the servicing report from the data file. In addition, the hot backup should receive a portion of the servicing fee that otherwise would have gone to the originator/primary servicer. That is, the hot backup servicer should actually do a small portion of the primary servicing. The last point has the added benefit of creating a champion vs. challenger environment in which the primary servicer can gauge its performance.

Paying for a successor servicer is an issue. There is no standardized approach for handling the task of finding a successor servicer for a troubled deal. Problems and solutions vary from one troubled deal to the next. Ideally, a deal is structured from the outset to have enough servicing fees to cover getting a successor servicer. A trustee can be in a very awkward position if the interests of the different classes of bondholders are not aligned.

Rating agencies are pushing on the issue of servicing fees. Simple fee structures may be inadequate to address a servicing transfer on a distressed portfolio. In transfer situations, the fee must be adequate to get a successor servicer and to provide incentives for performance. A danger with scaled fee systems is that it may create incentives for a servicer to allow an account to age into a higher severity bucket just to get a higher fee on the account.

Thursday, 3 October 2002

8:00 AM – The Cutting Edge of Asset-Backed Securitization - Trends, Opportunities & Pitfalls

New Assets: Credit is becoming tighter in the traditional bank finance market and the high-yield corporate debt market. Ship deals and aircraft engines are new asset classes. There is strong innovation in the real estate ABS sector. Whole company securitizations, intellectual property deals, and trade receivable deals also are happening. The motivation in all cases is to achieve the highest possible advance rate and the lowest possible cost of funds.

In the real estate ABS arena, the resurgence of NIM deals has changed the business dynamics in important ways. Issuers can now achieve positive cash flow by executing a net interest margin (NIM) securitization simultaneously with the main underlying securitization. However, despite the apparently strong structural protections, some panelists express skepticism about the possible presence of hidden dangers in the deals.

The growth of alternative liquidity sources for ABCP programs is another area of recent innovation.

<u>Subordinated ABS</u>: A major issuer of student loan ABS is going to issue subordinate ABS for the first time. The deal will issue securities down to the triple-B rating level.

"Buying anything that has less than two years of seasoning is selling too many options." By waiting a few years after a deal's initial offering, the potential buyer gets a "free look" at the product and its performance. The supply of subordinate product expands and shrinks; therefore a trader of subordinate tranches needs to have patience. Also, a trader of subordinate ABS can exploit nervousness in the market – essentially a market timing strategy. Many investors could achieve better performance than they now achieve if they substituted purchases of seasoned subordinate ABS for purchases of new issue subordinate ABS.

One investor favors the down-in-liquidity trade over the down-in-credit trade. Down-in-liquidity is often his favorite move.

<u>Innovations in Traditional ABS</u>: In the credit card area, more issuers are using de-linked subordinate and mezzanine tranches. That is, the subordinate and mezzanine tranches may be issued before the senior tranches are brought to market and the subordinate and mezzanine tranches can have different maturities from the maturities of the senior tranches.

<u>Synthetic Securities</u>: Synthetic securities allow separation of credit risk and funding risk. A bank can use synthetic securities to manage credit risk while funding itself through deposits or in other markets. Related objectives are to manage risk internally, to manage regulatory capital requirements, and to boost the bank's rating.

From an asset manager's perspective, synthetic structures are a means of boosting assets under management.

For an investor, synthetic structures are a powerful tool. However, workouts of synthetic structures are difficult because investors have fewer rights than in regular (*i.e.*, asset sale) deals.

<u>Legal Issues</u>: The securitization market is in the crosshairs of Congress. Congress seems to view too many diverse practices – including both proper and improper ones – as essentially the same. The Sarbanes-Oxley Act has some troubling provisions. The Durbin-Delahunt bill was even more threatening, but its worst provisions have been dropped.

On top of Congressional action, the FASB consolidation project and the evolution of the Basel standards[14] combine to produce shifting sands that challenge securitization professionals.

In the end, the securitization market will survive and will surpass the current round of legal challenges with greater strength. In the meantime, though, things will be difficult.

[14] The Basel Committee on Banking Supervision is developing international risk-based capital guidelines for banks. *See* http://www.bis.org/bcbs/index.htm

Predatory lending initiatives are creating difficulties for securities dealers that want to pursue an active sub-prime mortgage business.

ABCP: The latest trend in the ABCP market is that it is going the wrong way. The market has shrunk from $750 billion at the start of the year to roughly $700 billion now. A key driver of the contraction is the accounting uncertainty stemming from the FASB consolidation project. Innovations in alternative liquidity have become increasingly important in the present environment.

9:15 AM – Exploiting Investment Opportunities within the Primary & Secondary Markets: The Traders' Roundtable

Credit Cards: The credit card ABS market has taken many punches this year. Until this year, there had been only one early amortization of a small bank-sponsored credit card ABS issue. This year, the low rate environment nearly caused the early amortization of certain Chase credit card deals from 1996. Those deals pay a fixed rate and nearly broke their spread triggers because of yield squeeze. The market is in flux because there is not a universally accepted way to price early amortization risk. Traders now focus on master trust types (*i.e.*, socialized vs. non-socialized.)[15]

The re-pricing that has occurred in the credit card sector ABS is not enough to properly compensate investors. Investors have over-paid for structure. There are wide bid-offer spreads on certain triple-A card issues. Deals that get into any kind of trouble display severe widening of their bid-offer spread.

Valuing the implicit IO (interest-only security) in premium-priced credit card ABS is difficult. One way is to consider the pricing for the credit default swap on the issuer. This reveals a market expression of the likelihood that the issuer will fail, which likely would trigger early amortization and the loss of premium interest cash flow. Nonetheless, the calculation is not rigorous; most decisions are made on the basis of a "back of the envelope" analysis.

Another view is that the implicit IO in premium-priced credit card ABS represents a "binary risk" (*i.e.*, all or nothing risk). There are better IO bets that investors can take. At least it is possible to achieve a reasonable understanding of home equity IOs.

CMBS vs. ABS: The best place to get long duration in ABS is in securities backed by utility stranded costs. That is the best area for doing the "CMBS to ABS" trade. Post-Conseco and post-Enron, ABS have become more corporate-like. There is tremendous liquidity in long duration CMBS. The real question is not CMBS vs. ABS but rather structured vs. corporate.

Floating-rate vs. Fixed-rate ABS: There has been a high volume of recent issuance in short-WAL floaters. Other investors are joining the traditional buyers of such product. The demand is outpacing supply. The underlying cause is interest rate volatility.

Swaps Curve: Now the convention is to use the E-curve[16] for anything with a shorter WAL than 1.8 years. Wide window bonds (*i.e.*, bonds that receive principal repayment over an extended period) create a greater pricing challenge. Many investors do not use a Z-spread analysis and they really ought to. One view is that the E-curve should be used for all bond pricing because it provides the truest measure of the spread over LIBOR. Eventually the E-curve will supplant the N-curve.[17]

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[15] *See* Standard & Poor's, CREDIT CARD CRITERIA at 48 (1999) (general explanation of different credit card master trust structures) *available at* http://www2.standardandpoors.com/spf/pdf/fixedincome/creditcard99.pdf

[16] When calculating bond spreads on Bloomberg™ (*e.g.*, using the "YT" function), the "E-curve" refers to the Eurodollar spot curve. Spread calculations based on the E-curve are analogous to Z-spreads based on Eurodollar spot rates. *See* MTG SPREAD <GO> on Bloomberg™.

[17] When calculating bond spreads on Bloomberg™ (*e.g.*, using the "YT" function), the "N-curve" refers to the conventional swap curve. *See* MTG SPREAD <GO> on Bloomberg™.

<u>Stressed and Distressed Credits</u>: Traders have seen price migrations that they never previously had imagined. There has been a massive re-pricing as investors have backed away from troubled sectors. Prices of some bonds have dropped nearly to zero. Market participants too often take a binary (yes/no) approach when a bond gets into trouble. This causes them to miss potential opportunities to get cheap bonds. However, investors who purchase distressed credits face the risk of (1) heightened scrutiny from their managements and (2) possibly losing their jobs.

Because absolute yields now are so low, investors should be motivated to seek opportunities for earning higher returns in certain well-protected triple-B-rated ABS.

In the distressed sectors – aircraft, franchise, MH, CDOs – investors should focus primarily on senior tranches. The senior securities are trading as if they were mezzanine tranches (at the time of initial issuance).

<u>CDOs</u>: The CDO market is here to stay. The market is broadening. Trust preferreds will become an important sub-sector. The collateral that has been going into recent CBOs has been of higher credit quality (*e.g.*, triple-B home equity ABS). The CDO bid has been supporting the prices of subordinate ABS. However, the influence of CDOs has shrunk slightly. CDOs are not the dominant force in setting the bid for distressed ABS.

<u>Extension Risk</u>: Extension risk is a huge concern in the mortgage market. Many investors are nervous about their long positions. Mortgage-backed securities go up like a one-year T-bill and down like a five-year Treasury note (*i.e.*, mortgage-backed securities display negative convexity). Home equity loan ABS are the most negatively convex securities on the ABS landscape. Traders need to stay nimble and to respond quickly to changing conditions.

Premium securities give some protection against extension risk. That is one of the most attractive features of premiums.

<u>Best Opportunity Right Now</u>: Panelists express their picks for relative value

- Subordinate student loan ABS from 1999 offer opportunity. Older student loan deals that were initially below parity have reached parity. Sub-prime specialty credit card deals (*e.g.*, CompuCredit) have very high triple-A credit enhancement levels and offer strong credit protection. Investors should avoid ABS trading at LIBOR flat because there is no upside in those securities.

- Among short-duration ABS, student loan deals and credit card deals offer opportunity. There will be a strong tiering effect among ABS issuers. Floating-rate home equity ABS are cheap. The next three months will be a very defensive investment environment in which pricing differences between ABS from top-tier issuers and lower-tier issuers will increase. Only a small number of issuers deserve to be considered top-tier.

- ABS backed by mid-prime auto loans offer opportunity. So do manufactured housing ABS from the 1993 to 1995 vintages. Those deals have de-levered and have high levels of credit enhancement supporting their senior tranches. Some of those deals arguably are "diamonds in the rough" because they can withstand high CDRs (constant default rates). Investors should avoid the 2001 vintage of manufactured housing ABS because the senior tranches of those deals do not pay on a *pro rata* basis if losses reach certain trigger levels. In effect, the longer-weighted average life (WAL) senior tranches of those deals are subordinate to the shorter-WAL senior tranches. Sub-prime mortgage borrowers are over-leveraged and investors should exercise caution in the sub-prime mortgage ABS sector.

- Premium-priced home equity ABS and premium-priced credit card ABS offer opportunity. Investors should avoid all ABS backed by sub-prime consumer loans, including sub-prime credit card receivables, sub-prime auto loans and sub-prime mortgage loans.

- Investors can find value in (1) student loan ABS, (2) credit card ABS from top-tier issuers, (3) wrapped floating-rate home equity ABS, (4) wrapped sub-prime auto ABS, and (5) net interest margin ABS (NIMs). The A3 and A4 tranches of Conseco manufactured housing deals are now more double-A-ish than triple-A-ish. Nonetheless, they still represent good value at current spreads. Every sector has value at the right price.

- Investors should consider senior tranches of manufactured housing ABS and NIMs because those securities offer wide spreads for consumer credit risk. Among floating-rate ABS, short-maturity credit card ABS are attractive. Floating-rate home equity ABS also are attractive at spreads of LIBOR+40 or better.

- Sallie Mae securities pegged to T-bills are cheap. Short-WAL auto loan ABS offer good opportunity. Seasoned auto loan ABS often trade at a substantial spread concession to new issues. Investors will be rewarded for doing the work to carefully scrutinize available ABS investment opportunities.

- Total rate of return accounts should focus on floating-rate ABS. Seasoned, premium-priced home equity ABS are cheap because the embedded IO (interest only) yields are very high. Wrapped, non-prime auto loan ABS are attractive. Fixed-rate credit card ABS are risky because of regulatory/prepayment risk.

10:15 AM – Developments in the Manufactured Housing Sector

The problems in the manufactured housing (MH) lending sector can be described as "too much supply for the demand." In the mid- to late-1990s, there were many borrowers who should not have received credit. Now, fewer new MH units are being shipped. However, there is a huge overhang of repossessed units. Varying estimates of the overhang range from 40,000 units to 100,000 units.

Financing MH units is like financing autos. When pricing is at appropriate levels, the sector will attract capital – both for debt and equity. The ABS market spurred the growth of the MH lending sector by providing a flood of cheap capital. The pricing did not accurately reflect the real risk of the sector. Levels of excess spread in MH ABS were too tight. In retrospect, the pricing arguably should have been compared to pricing on high-LTV (125%) mortgage loans. High-LTV (125%) mortgage loans are under-secured positions backed by appreciating property whereas MH loans are secured by depreciating property.

It is debatable whether or not MH lending is a viable stand-alone business. One view is that it can only exist for the long-run as an adjunct to manufacturing MH units. The other view is that financing MH is viable so long as the net interest margin remains sufficiently large to support diligent operations.

Most mortgage lenders/servicers do not fully appreciate how labor-intensive an MH servicing operation is. A number of home equity servicers have made that mistake.

If Conseco starts to sell repossessed units in the wholesale market, wholesale prices will suffer. On the other hand, the situation could be worse. Conseco's repossession inventory is reasonably distributed across the country. For relatively newer units, Conseco's repossession inventory would likely fetch 25% to 29% even if sold wholesale. The used inventory overhang will eventually pass; in 12 to 18 months the situation should have stabilized.

A contrary view is that the situation will take much longer than two years to stabilize. Bombardier and Access are suffering severities of 85% to 90% when they liquidate repossessed units in the wholesale market. Conseco's loss severity, which used to be in the 55% range is creeping up to the 65% to 75% range.

Conseco is "looking under every rock" for some way to avoid having to sell units in wholesale market.

Conseco owns virtually all the B-2 classes of its outstanding deals.

[These notes cover only half of the MH session.]

12:30 PM – Healthcare Securitization - Checking the Vital Signs

Each of the top four healthcare finance companies claims to be the largest. As an asset class, medical receivables are growing by about 20% per year.

One of the rating agencies wants to get as much data as possible from potential new issuers of ABS backed by medical receivables. Static pool data is the most important form of information because it reflects how receivables might perform in an early amortization scenario. In addition, the rating agency wants to analyze pool stratifications by service provider type (*e.g.*, hospital, clinic, nursing home) and payor type (*e.g.*, Medicare, Medicaid, private insurance). Receivables aging and turnover are also significant in particular cases.

Medicare and Medicaid anti-assignment rules to do not prevent sales of Medicare and Medicaid receivables but rather simply mandate that payments must be made only to the related service provider. Lockbox arrangements can help to protect an ABS transaction from the risk of provider bankruptcy.

Companies involved in the healthcare finance industry must comply with government regulations in many different areas. An example is the rules pertaining to the protection of confidential patient information.

Healthcare receivables are just like any other receivables for purposes of perfecting a security interest. The same is true of insurance company receivables. This is a new development because of last year's revision to Article 9 of the Uniform Commercial Code.[18]

National Century Financial Enterprises (NCFE) has been the leading issuer of ABS backed by healthcare receivables. It has been involved, in some fashion, in the majority of transactions done to date. NCFE focuses on small- and middle-market borrowers. However, as small borrowers become mid-sized borrowers and as mid-sized borrowers become large, the average size of NCFE's credit lines has grown. In the past, only un-creditworthy borrowers sought asset-based financing. As the technology has matured and spread, even the most creditworthy healthcare providers use asset-based financing.

Healthcare finance companies that wish to use securitization must compile the information that rating agencies and investors will need to analyze their deals. This applies both to medical service receivables and medical equipment leases.

In analyzing the risk of dilution, one of the rating agencies focuses on the providers and their historical dilution experience. The rating agency then stresses the historical experience and performs simulations. A second analytic dimension is the risk of defaults by the underlying insurance company payors. A third dimension is the risk of offsets by Medicare or Medicaid. In each case the rating agency ascribes a (probability) distribution to the phenomenon based on historical experience.

Downgrades of certain medical equipment lease deals earlier this year were driven by poor performance. The deals were essentially more like straight commercial loans than asset-based financings.

One of the tough aspects of executing a healthcare receivable financing is establishing high standards for originating receivables (to satisfy the rating agencies) without unreasonably restricting the lender's ability to do business and to create new relationships.

[18] *See* U.C.C. §§ 9-102(a)(2), 9-102(a)(46) (1998 revision to Article 9).

Declining interest rates have produced a windfall of as much as two percentage points for the medical receivable finance sector; net interest margins are wider. Lenders' cost of funds has dropped substantially while the rates paid by healthcare service providers have not dropped nearly as much.

NCFE is focusing on acute care hospitals and nursing homes. In terms of receivable performance, hospitals perform well, nursing homes poorly, home healthcare poorly, and physical therapy well.

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