SFIG Vegas 2017 Conference Notes

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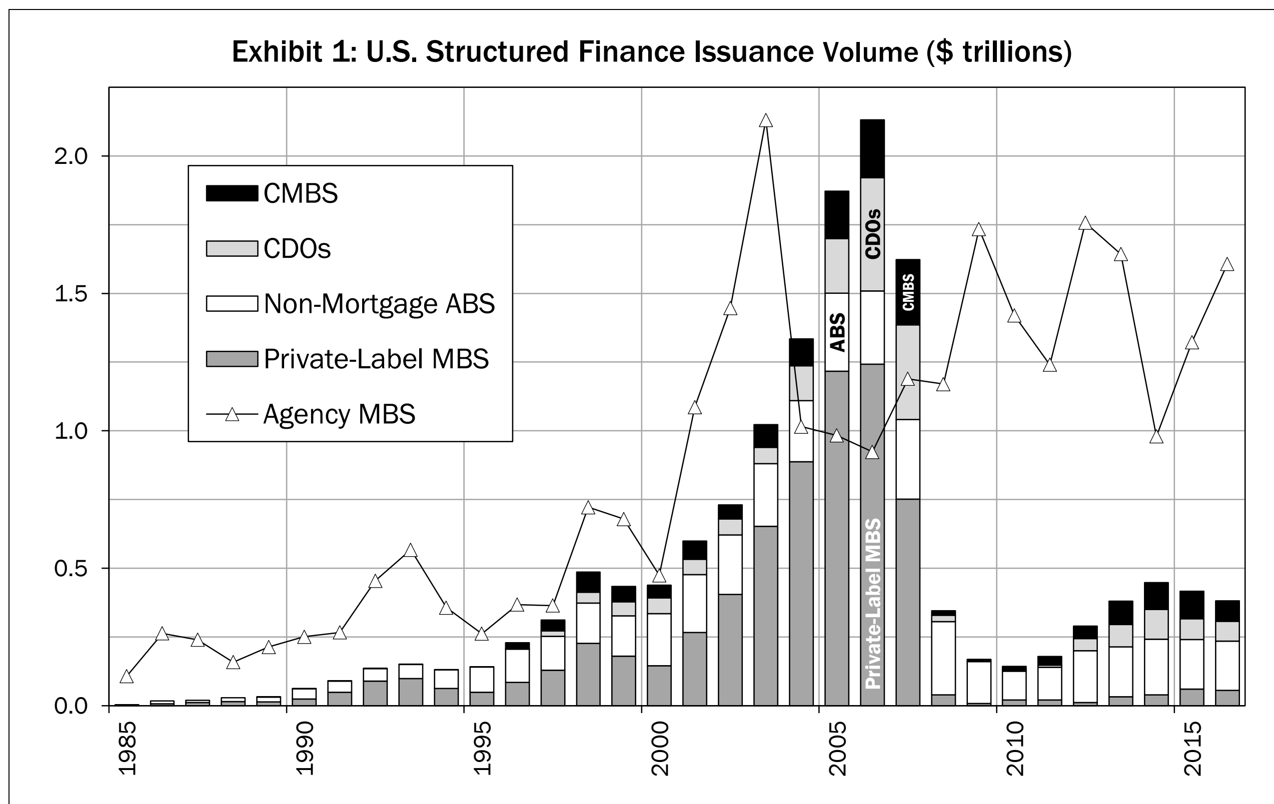
The SFIG Vegas 2017 conference at the Aria in Las Vegas attracted roughly 6400 attendees, including more than 1,400 investor delegates and nearly 1,200 issuer delegates. The conference started on Sunday, February 26 and ran through Wednesday, March 1. The sessions drew moderate levels of attendance and the overall mood was positive.

In contrast to past events, there was somewhat less focus on regulations. The great majority of the post-crisis regulations have been on the books for some time, though a few have just recently become effective (*e.g.*, loan-level disclosure for non-mortgage asset classes under SEC Regulation AB II). The new area of focus is the potential for the rollback of regulations by the Trump administration. Congressman Hensarling's Financial Choice bill (H.R. 5983) showed a possible direction that a rollback might take, but the bill could face insurmountable challenges in the Senate.

Also, in contrast to past events, there was less focus on the issue of reviving the private-label MBS sector. Nearly 10 years after the financial crisis, the sector remains moribund. The prospect of rising interest rates and the possibility of GSE reform provide a glimmer of hope that this year (or next) might bring conditions where private-label MBS become the optimal funding source for a reasonable slice of the mortgage finance pie.

The event's strong level of attendance and positive mood were somewhat at odds with the level of private-sector financing activity in the U.S. securitization market (Exhibit 1). Activity levels in non-mortgage ABS and in CLOs are slightly below pre-crisis levels, while CMBS activity is sharply lower. As indicated above, private-label

MBS activity is very slow. Meanwhile, mortgage financing through Ginnie Mae, Fannie Mae, and Freddie Mac is humming along briskly.



Sources: SIFMA; 2007 Mortgage Market Statistical Annual (for private-label before 1996); Thomson-Reuters (for 2016 CDO Issuance). Note: Agency includes MBS issued or guaranteed by Ginnie Mae, Fannie Mae or Freddie Mac, and excludes CMOs. Private-label MBS includes transactions backed by prime, alt-A, sub-prime, and manufactured housing loans, and excludes resecuritizations, credit risk transfer deals and single-family rental securitizations.

The following summaries reflect the remarks of the panelists who participated in selected sessions at the conference. For the most part, the summaries are drawn from notes taken during the sessions. 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 SFIG and Information Management Network in organizing and hosting the conference.

Sessions Covered **Page**

Monday Sessions
The Post-Election Round Up: What the New Leadership Means for the Markets and Regulation 3
Joe Scarborough Keynote Address 6
SFIG's 2017 Advocacy Agenda 8
PLS RMBS 3.0 Update 10
CRT, PLS, and Private Capital in the RMBS Market 11
The Marketplace Lenders' Roundtable 14
The Outlook for Securitization and Marketplace Lending 15
Single Family Rental Securitization 17
The CRA Roundtable: Key Updates from the Major Rating Agency Leaders 18
Tuesday Sessions
The Annual Investor vs. Issuer Family Feud Game and Fireside Chat 20
Michael Chertoff Keynote Address 22
Blockchain! What Is It, and Should You Care? Understanding the Implications and Applications for Structured Finance 24
Consumer ABS Financing Outlook: Researcher Roundtable 26
The Commercial and Residential PACE Market Overview 28
Key Considerations for Investing in NPLs 29
CMBS Market Outlook: Getting Closer to the Dirt 31
Equipment ABS 33
CMBS Originators' Panel: Dealing with Risk Retention 34
Railcar, Shipping & Container ABS: Transportation Finance 35
The CMBS Investor Panel 36

Monday, February 27, 2017

9:15am – The Post-Election Round Up: What the New Leadership Means for the Markets and Regulation

One panelist observes that the market is in a period of transition from the style of the Obama administration to the style of the Trump administration. There is optimism about potentially positive developments on both the legislative and regulatory fronts. However, despite Republican control of both houses of Congress, legislative changes may be difficult to achieve. The prospects for beneficial change on the regulatory front are brighter.

Another panelist notes that there are important staffing changes coming at federal regulatory agencies. However, there is not universal support for all proposed regulatory changes. For example, small banks and large banks may have differing views about the Financial Choice bill.[1] It is still unclear what the regulatory roadmap looks like and where things will be in three months or in 18 months.

In a poll of the audience, only about one fifth of the audience would grade President Trump's performance so far as either "A" or "B" (on the traditional scale for academic grades). By contrast, 58% of the audience would give the President grades of "A" or "B" in the area of financial regulation reform.

A third panelist remarks that it takes time to replace heads of regulatory agencies, and many of the Dodd-Frank rulemaking mandates call for joint rulemaking by the three bank regulatory agencies (Federal Reserve, OCC, and FDIC). Others require joint rulemaking by the bank regulatory agencies as well as the SEC and the CFTC. And, even after the agencies propose regulations, it can take a year or longer before the proposed regulations get finalized and take effect.

Treasury Secretary Mnuchin has identified GSE reform as an important issue. However, GSE reform must compete for attention with other issues, such as healthcare reform and immigration. The appointment of sub-cabinet level positions maybe very important.

What are you doing to prepare for changes? An investor panelist explains that his company is preparing for potential legislative and regulatory changes by expanding its capabilities in the area of trading whole mortgage loans (*i.e.*, unsecuritized loans) so that it will be able to invest in non-QM loans (*i.e.*, loans that do not meet the regulatory criteria for being "qualified mortgages"). The company is looking at its CMBS exposure and is focusing particularly on the exposure to the retail sector in its CMBS holdings. The company has a positive outlook on consumers and the residential housing market. The company takes the view that there is room for credit to loosen. Tax cuts should be positive for securitization activity.

A second panelist explains that his company thinks in terms of three areas: legislation, regulation, and enforcement. The company is focusing on how the supervision and enforcement areas are going to change. A third panelist observes that the tone of enforcement activities is likely to change. A fourth panelist notes that

[1] Financial Choice Act, H.R. 5983, 114th Cong. (2016).

investors in financial institutions may have mixed feelings about short-term regulatory changes that might make institutions riskier over the medium- to long-term.

What parts of Dodd-Frank Act are in the cross-hairs? One panelist observes that the Treasury Department is supposed to come back with a proposal for revising the Dodd-Frank Act in roughly 120 days.[2] The Financial Choice Act would provide relief for community banks and would eliminate risk retention for CLOs and CMBS.[3] Republicans are focused more on leverage ratios than on risk-based capital ratios. Also, the Republicans are more skeptical of international standards like the Basel risk-based capital guidelines.

Another panelist remarks that the views of Congressman Hensarling(R., TX), who is the lead sponsor of the Financial Choice bill, have resonance in the new administration. Hensarling's Financial Choice bill has solid support in the House of Representatives but it may face challenges in the Senate, where it will need bi-partisan support in order to succeed. GSE reform will face similar challenges, if and when it starts to happen. Other areas for financial reform focus are the Volker Rule, CFPB reform, and the structure of the Federal Reserve System.

A third panelist notes that residential mortgage finance is a key area. The proportion of new mortgage loans going into agency programs (*i.e.*, securities issued or guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac) has recently declined to about 50% because banks are choosing to hold more loans in their loan portfolios.

What about the CFPB? One panelist highlights that eliminating the CFPB is high on Republicans' wish list. Another panelist notes that Republicans may be able to force the issue through the "reconciliation" process in the Senate (which prevents the use of a filibuster).

Regulatory effects on the market: One panelist states that securitization accounts for about 30% of the total funding through the U.S. capital markets. That level is down from nearly 60% in the years preceding the financial crisis. The Trump administration has not focused on securitization as an important component of the financial system. CLO managers have found ways to comply with the risk retention regulations, but a side effect has been a reduction in the number of managers. Smaller collateral managers

[2] Presidential Executive Order on Core Principles for Regulating the United States Financial System, § 2 (3 Feb 2017).

[3] Financial Choice Act, H.R. 5983, §§ 442 and Title XI, 114th Cong. (2016).

have dropped out of the market. There were about 10 fewer CLO collateral managers in 2016 than in 2015.

New requirements under Regulation AB II have pushed issuance from the public market to the 144A market. Risk retention has hurt the CMBS market. The proportion of all commercial mortgage loans that are funded through securitization has declined. The amount of outstanding CMBS has declined by about $100 billion over the past few years.

Another panelist disagrees about the interpretation of the CMBS market. An alternative interpretation is that the requirement for CEO certifications under Reg AB II[4] is the primary cause of the decline in securitization funding for commercial mortgage loans. Also, the decline in the number of CLO managers may be a good thing. The panelist asserts that risk retention in its current form is absolutely good for the market.

ABCP: The level of outstanding asset-backed commercial paper (ABCP) has contracted markedly from the period before the crisis but it has stabilized in the area of $250 billion outstanding, and it continues to be a viable portion of the securitization landscape.

Secondary liquidity: Secondary trading activity in ABS is roughly stable, slightly down in CMBS, up in CDOs, and down in CMOs.

10:15am – Joe Scarborough Keynote Address

[Note: Joe Scarborough is a co-host of "Morning Joe" on MSNBC. Scarborough is a Republican and was a member of the House of Representatives from 1995 to 2001, representing Florida's 1st congressional district.]

It is impossible to explain what is happening in Washington, D.C. because nobody knows. The President's television persona is not at all like his true personality. On TV he exaggerates wildly. Away from the media spotlight, he is not narcissistic and is effusive with praise for others. So, it seems contradictory when he launches mean-spirited attacks against Hollywood stars and issues mean spirited-policies on travel and immigration. But it is his nature to exaggerate and to play the bad cop: "the U.S. will withdraw from NATO" as prelude to the Secretary of Defense supporting NATO. The rhetoric was just a way to get NATO allies to agree to contribute more for defense.

[4] 17 C.F.R. §§ 229.601(b)(36), 239.45(b)(1)(i) (2016).

Power has shifted back and forth between Democrats and Republicans much more quickly over the past twelve years than over the prior 40 years. It used to be that power shifted much more slowly. The culmination was Donald Trump's takeover of the Republican Party in 2016 after having been a Democrat for most of his life. He essentially crushed the Democratic Party after having crushed the Republican Party.

The Democratic Party has lost 62 seats in the House of Representatives and 14 seats in the Senate. In addition, the Democrats have lost roughly 1,000 seats in state legislatures. But Republicans should not be happy. Demographics are working against the Republican Party and should help the Democratic Party to reassert control over time.

President Trump's proposed budget calls for huge deficits that would increase the national debt from roughly $20 trillion to the range of $30 trillion to $35 trillion. Trump plans to increase military spending and to sustain all entitlements. It is not possible to produce enough spending cuts in other areas to pay for the tax cuts that Trump wants to make.

American politics has degenerated in that the parties are not willing to work with each other to govern effectively. They don't simply disagree; they view each other as evil. This has to change. Republicans and Democrats need to get back to working together to figure out how deal with government spending and the growing national debt. Eight out of ten Americans surveyed want Republicans and Democrats to work together.

Winston Churchill said that Americans can always be counted on to do the right thing, after they tried everything else.

Donald Trump is a product of New York. He is not personally a racist. The Muslim travel ban and the racist comments that he has made do not represent his true personal beliefs. His insults of Hollywood stars via twitter and his antagonizing behavior toward important allies like Australia are disturbing but ultimately manageable. However, Trump's attacks on the independence of the judiciary and his attacks on the legitimacy of the press are unforgiveable.

Trump has achieved enough success so far in his candidacy and his presidency that he does not allow advisors to tell him he is wrong. Only after his approval numbers fall to 30% or lower will he start to listen to advisors who tell him when he is wrong.

11:00am – SFIG's 2017 Advocacy Agenda

One panelist observes that SFIG represents the entire securitization industry and the full range of securitization market participants. Some regulations have enhanced protection for both investors and issuers. Another panelist remarks that the mortgage industry has adapted to TRID[5] and ATR[6] rules and undoing them now would be detrimental. Two additional panelists agree that some post-crisis regulations have been beneficial for the market.

On the other hand, some regulations seem to be unnecessary and should be scrapped. One example is SEC Rule 17g-5(a)(3), which was supposed to have encouraged rating agencies to issue unsolicited ratings by requiring a securitization issuer to maintain a website containing all the information that it has provided to the rating agencies it hired to rate its deal. Another example is SEC Rule 17g-7, which requires a rating agency to publish reports on the representations and warranties in deals that it rates. Another panelist notes that credit card issuers would like to see the Durbin Amendment[7] rescinded. Many issuers would like to see the CFPB enforcement activities revised. Also GSE reform but must preserve the TBA market in order to sustain liquidity.

Another panelist explains that the requirements for posting margin on swaps included in securitizations does not benefit any parties, and it creates downgrade risk for deals that include swaps. It would be beneficial to exclude securitization transactions from the margin posting requirements.

A bad regulation is one that fails to achieve its intended goal or that is disproportionately expensive for the benefit it produces.

Capital and liquidity regulation: One panelist asserts that bank capital regulations[8] concerning securitizations have been around since the late 1980s and they have never been good. In the wake of the financial crisis, regulators believed that securitization had been a contributing factor to the crisis, and they used capital regulation to discourage securitization. This was a mistake because the goal of the

[5] TRID stands for TILA-RESPA Integrated Disclosure. TILA refers to the Truth in Lending Act. RESPA refers to the Real Estate Settlement Procedures Act. See 12 C.F.R. Parts 1024 and 1026 (2016).

[6] ATR stands for ability to repay. See 12 C.F.R. § 1023.43(c) (2016).

[7] 15 U.S.C. § 1693*o*-2 (2015).

[8] 12 C.F.R. Parts 3, 167, 217, 325, and 390 (2016).

capital regulation should be to allocate capital in proportion to the risk of an activity or asset. The regulatory approach of tying capital treatment to accounting treatment does not closely track risk. The models embedded in the capital regulations are biased. The capital regulations for securitizations are bad regulations because they are not tied to risk in a fair way.

The liquidity regulations[9] are also bad because they classify all non-GSE securitizations as illiquid, which means that they will almost certain be illiquid during times of crisis.

The European proposals for "simple transparent standardised" (STS) securitization are examples of bad proposals because they would entail a whole second layer of regulation. The treatment proposed to be given to STS securitizations would arguably be the "right approach" and, therefore, it should apply to all securitizations.

Risk retention: One panelist observes that many ABS issuers have been retaining risk in their securitizations all along. The risk retention regulations[10] create administrative burdens but do not change the essential economics of transactions. Another panelist notes that there is a lack of consensus about whether the risk retention regulations are good or bad. However, there is a role for SFIG in establishing uniform practices for complying with risk retention.

A third panelist remarks that the qualified residential mortgage (QRM) rule[11] has helped to create beneficial discipline in the residential area.

Regulation AB II: One panelist explains that there is continuing uncertainty about whether the SEC will institute loan-level disclosure requirements for equipment loans and leases, student loans, and floorplan loans.[12] Those asset classes were not initially included in the loan-level disclosure requirements under Reg AB II. The regulatory uncertainty imposes a burden those asset classes. It is not clear whether loan-level disclosure for those asset classes would be helpful to investors. Additionally, the

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[9] *See, e.g.*, 12 C.F.R. Part 50 (2016) (liquidity coverage ratio); Office of the Comptroller of the Currency (OCC)., Federal Reserve, and Federal Deposit Insurance Corporation (FDIC), *Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements*, 81 Fed. Reg. 35124 (1 Jun 2016).

[10] *See, e.g.*, 12 C.F.R. Part 43 (2016).

[11] 12 C.F.R. §§ 43.13, 1026.43(e)(2) (2016).

[12] SEC, *Asset-Backed Securities Disclosure and Registration*, Release Nos. 33-9638, 34-72982, 79 Fed. Reg. 57184, at 57190-91 (24 Sep 2014).

proposal to extend all the disclosure requirements under Reg AB II to deals executed under Rule 144A is a bad idea. It should not go forward.

1:45pm – PLS RMBS 3.0 Update

One panelist explains that the reason for SFIG to sustain the RMBS 3.0 working group and publish the RMBS 3.0 green papers is to identify and promote strong practices *before* the revival of the private-label MBS market. The RMBS 3.0 green papers do not establish standards but propose alternatives that can inform choices by market participants when the revival occurs. In addition to the RMBS 3.0 green papers, the SFIG RMBS working group also produced the TRID compliance green paper and the model "deal agent" agreement.

Another panelist explains that understanding the deal agent issue starts with understanding what did not work well in pre-crisis RMBS deals (RMBS 1.0). Those deals revealed conflicts of interest that were not properly addressed in the deals' structures and documentation. The takeaway from the RMBS 1.0 experience was that there should be some party (*e.g.*, the deal agent) that acts in the interest of the transaction. The deal agent role grew out of the fact that there was no other party that was willing to perform the necessary functions. The RMBS 3.0 working group wrestled with the notion that somebody has to take the role of acting in the interest of the deal.

One panelist asserts that some post-crisis private-label jumbo RMBS deals (RMBS 2.0) actually had even weaker investor protections than the pre-crisis deals (RMBS 1.0). Two other panelist agree with assertion that some RMBS 2.0 deals had weaker protections and that it is a problem. The RMBS 3.0 proposals for reform face headwinds from the trend of deteriorating protections evident in RMBS 2.0. One panelist argues that standardization is necessary so that there is not incremental hidden deterioration in successive deals.

The RMBS 3.0 working group developed the deal agent concept from the functions that need to be performed in a transaction. Many functions can be performed by a master servicer, a servicer, or a trustee. A deal agent has oversight and enforcement responsibility. Although there is some overlap of deal agent functions with the functions of other parties, the working group took pains to avoid unnecessary duplication. A problem with RMBS 1.0 deals is that the contracts are too watered-down and fail to specify which parties are responsible for different functions.

One panelist emphasizes that a deal agent is supposed to be empowered. It is supposed to have the power to get information and to act on that information.

The RMBS 3.0 green papers include suggested forms of representations and warranties and variations on the suggested forms. The green papers also include a "representation and warranty transparency matrix," which is designed to help investors understand how the representations and warranties in a given transaction differ from the suggested forms. However, no issuers have adopted the RMBS 3.0 green paper proposals. Another area that the RMBS 3.0 working group has considered is triggers for review of potentially defective loans. The working group is also considering the issue of giving an originator of a loan may be liquidated at a loss so that it can have a chance to mitigate the loss before it occurs. A future version of the RMBS 3.0 green paper will address materiality standards for breaches of representations and warranties.

One panelist explains that there are two broad conceptual frameworks for representations and warranties. One is prescriptive and the other is open-ended. The prescriptive approach uses representations that are readily testable. The open-ended approach is harder to test. Representations and warranties are inherently a back-end mechanism for quality assurance. Front-end due diligence is a separate quality assurance mechanism. Even if there is extensive front-end quality assurance, it is still necessary to have a back-end mechanism to deal with defects that slip through the front-end process.

Another panelist highlights the balance of costs and benefits associated with having a deal agent in a private-label RMBS deal. Will investors accept tighter spreads for having a deal agent in a deal? They will likely do so only if they believe that the losses averted will exceed the reduction in spread.

Panelists differ slightly in what they think investors should want the most. Most panelists identify transparency as the main issue. Others identify standardization.

RMBS 3.0 is designed to protect an RMBS trust regardless of whether or not the different parties behave properly or not. RMBS 3.0 is supposed to provide clear contractual obligations and effective enforcement of those obligations.

2:35pm – CRT, PLS, and Private Capital in the RMBS Market

One panelist explains that residential mortgage loans originated before 2008 still account for the great majority of loan delinquencies and defaults. The loan vintages from 2004 through 2007 account for only 18% of active mortgages but more than 50% of all troubled loans. There are roughly 313,000 troubled loans from the 2004 through 2007 vintages in private-label MBS.

Another panelist observes that home price appreciation has been roughly 5% for the past few years, which seems high given the rate of household income growth. However, the rate of home price growth may be due to other factors, such as supply. Additionally, Chinese investors have been active buyers of U.S. real estate. They have achieved very strong returns, driven largely by currency exchange rate movements. Low interest rates are another factor that has helped to support strong home price appreciation. However, the recent increase in interest rates (and the expectation of continuing interest rate increases) may create headwinds that somewhat counterbalance strong demand. Apart from the movement of interest-rate benchmarks, tightening spreads are another factor that has supported strong home price appreciation.

Relative value across residential spectrum: One panelist observes that, through most of last year, it was more efficient for a bank to hold a residential mortgage loan in its loan portfolio than it was to securitize the loan. However, things have recently changed. Now the cost of holding loans on balance sheet is roughly even with the cost of private-label securitization. Also, the credit curve has flattened significantly over the past six months; banks and investors accept lower yields for holding riskier exposures to residential credit risk.

Another panelist highlights that spreads on the GSE credit risk transfer (CRT) transactions have tightened over the past year. Strong credit performance arguably justifies the tightening. However, the 2015 vintage of underlying loans is weaker than the 2014 vintage, which is weaker than the 2013 vintage. The structures of the deals and the levels of credit support account for the differences.

CRT programs: One panelist explains that Freddie Mac has used CRT deals to transfer risk on $665 billion of mortgages. Nearly a third of Freddie Mac's loan portfolio is protected by CRT transactions. Freddie Mac has more than 220 investors in its CRT transactions. The company executes deals regularly. Freddie Mac's primary type of CRT transactions its Structured Agency Credit Risk (STACR®) deals. The company has a whole-loan CRT approach called WLS® and a mortgage insurance initiative called ACIS®. Freddie Mac also transfers risk through regular mortgage insurance and, to a small degree, through seller indemnification. Secondary trading volumes in STACR® securities are increasing, establishing liquidity for the product. Roughly eight to ten dealers trade in STACR® securities. The performance of all post-crisis loan vintages has been quite strong; in most post-crisis vintages, less than 0.4% of the loans have ever been delinquent by 90 days. Both tighter lending standards and better servicing contribute to the strong performance.

Another panelist explains that Fannie Mae also has extensive risk transfer activities. Its Connecticut Avenue Securities™ (CAS) securities cover more than $721

billion of loans. The company also has a program called Credit Insurance Risk Transfer™ (CIRT™) for transferring credit risk to insurance companies. CIRT™ transactions cover $131 billion in loans. Fannie Mae approaches credit risk management along several dimensions. The company manages credit risk on the loans "all the way through." Fannie Mae retains vertical and horizontal risk slices in all of its deals. Fannie Mae has issued $21.2 billion of CAS securities to date, or which $17.4 billion was outstanding as of January 2017. The CAS deals have displayed strong credit performance. The depth of the investor base has continued to expand, with increasing participation by overseas investors and insurance companies. Secondary trading volume in CAS securities is in the range of $2 billion to $3 billion per month. As an issuer of CRT transactions, Fannie Mae emphasizes transparency and information flow to investors. It has introduced several tools to help investors monitor performance.

One panelist explains that cumulative private-label RMBS issuance – including CRT transactions by Fannie Mae and Freddie Mae – has been around $205 billion since 2010, of which $98 billion remains outstanding.

Exhibit 2: Residential MBS Issuance 2010–2016

Sector	**Original Amount** ($ billions)	**Outstanding** ($ billions)	**Serious Delinquencies** (%)
GSE CRT	34	27	0.15
Prime Jumbo	50	30	0.10
NPL, RPL, Seasoned (Non-Rated)	93	23	47.63
NPL, RPL, Seasoned (Rated)	25	16	4.96
Non-Prime	1	1	0.60
Total	205	98	

Loans backing Prime-quality jumbo MBS have displayed the lowest rates of serious delinquencies. Loans referenced by the GSE CRT transactions have displayed performance that is nearly as strong. Unrated deals back by non-performing loans (NPLs) or reperforming loans (RPLs) have displayed very high rates of seriously delinquent loans, but the delinquency levels in rated NPL/RPL deals have been modest.

The 2012 loan vintage has performed significantly better than the 2009 vintage, after correcting for loan characteristics and economic factors. Fitch has a strongly positive outlook for outstanding PLS. A high proportion of outstanding GSE CRT deals show the potential for receiving upgrades.

Volume prediction: Another panelist states that combined 2017 issuance of both private-label MBS and GSE CRT securities will likely be in the area of $10 billion. A third panelist agrees that the volume will remain very low for the near term, and that majority of near-term volume will be from GSE CRT deals.

A survey of the audience reveals a range of views about which factor is the main impediment to revival of the private-label MBS sector:

Exhibit 3: What Is the Biggest Obstacle to the Return of the SEC-Registered PLS Market?	
Market conditions	24.4%
CFPB/disclosure concerns	22.0%
Integrated waterfall models & collateral	2.4%
GSE CRT programs filling the market need	29.2%
Lack of RMBS 3.0 adoption	17.1%
Other	4.9%

2:35pm – The Marketplace Lenders' Roundtable

In assessing further growth opportunities, the panel was generally optimistic. In addition to organic growth within the marketplace lending sector, one panelist saw a natural expansion into additional assets classes such autos. Because lenders already have access to a large set of customer data, adding auto loans to their systems would require only modest extensions to the existing technology to include factors such as LTV and vehicle age. Another panelist stated that there is opportunity in student loans as an analogous type of unsecured consumer loan.

In terms of challenges facing the industry, one panel member noted that the market already appeared overcrowded, while another panelist, in a related vein, expressed concern about potential bad actors. A third panelist noted a continued concern about potentially increased regulation, which may be on the horizon and which would accelerate if there were additional negative events within the industry.

In terms of the sector's strengths, the panel noted that transparency protects investors, who have a good view of the risks they undertake as a result of the highly detailed pool stratifications available.

Most panelists indicated that risk retention is important to investor confidence, but they observed that regulation was not needed as the market was already functioning well in this regard and that incentives would continue to provide appropriate levels of risk retention even without formal regulation. Another panelist remarked that a reduction of the regulatory risk retention requirement is unlikely, but it is not likely to be a major issue for the MPL business.

Not surprisingly, established issuers see their investor base and banking relationships as a strength going forward. The panelists emphasized certain differences in focus among different MPL lenders. For example, some lenders, like Funding Circle,

concentrate solely on business loans. Each of the other panelists emphasized a different factor. One focused on their company's size and relatively long track record as distinguishing factors. Another emphasized that their company will stand by its customers and maintain their credit lines even during cyclical downturns. A third emphasized their company's disciplined approach to credit, hoping to attract investors by highlighting credit quality regardless of the competitive environment. A fourth stated it would seek growth in student loans, which it considers an underserved market.

3:45pm – The Outlook for Securitization and Marketplace Lending

One panelist explains that the marketplace lending (MPL) area started with companies that used a peer-to-peer funding model. Then the sector evolved to include companies that used a variety of funding approaches. Recent experience confirms that companies benefit from having diversified funding sources, including sources that give it balance sheet capacity for funding loans (*i.e.*, a company is strong if it is not entirely dependent on loan sales or securitization to fund its production). Two other panelists agree, noting that the ability to retain risk helps to achieve credibility with investors. At some level, MPL lenders compete with banks along the dimensions of cost of funds and operational efficiency. The MPL market has to be able to withstand temporary market disruptions because they are inevitable and occur even in established product areas like credit cards.

Non-banks are going to lead way toward the securitization of digital assets (*i.e.*, financial assets that are created or maintained in paper form). Banks will follow eventually, but will not be the leaders. The securitization process for digital assets is not very different from the process for paper assets, but it can be done faster. We are moving from a "document centric" world to a "data centric" world.

Another panelist explains that the *Madden* case[13] stands for the principle that although preemption of state usury law applies to a national bank that makes a loan, the preemption does not extend to an assignee of the bank. The decision comes from the U.S. Court of Appeals for the Second Circuit. The Court of Appeals sent the case back down to the U.S. District Court to decide which state's usury law should apply. The U.S. District Court recently ruled[14] that New York law applies and that the plaintiff can pursue a class action. The Financial Choice bill proposed by Rep. Hensarling would

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[13] *Madden v. Midland Funding*, 786 F.3d 246 (2d Cir. 2015)

[14] Madden v. Midland Funding, No. 11-cv-8149 (S.D.N.Y., 27 Feb 2017) (opinion and order).

reverse the *Madden* holding and allow the assignee of a national bank to have the benefit of preemption of state usury laws. More generally, Rep. Hensarling's recent proposals, which are likely to become the next version of the Financial Choice bill, could potentially eliminate risk retention for all asset classes other than residential mortgage loans, eliminate the notion of "too big to fail" for financial institutions, and limit the CFPB's powers.

Kroll has rated 20 MPL securitizations. There was a slowdown in activity in the middle of 2016 because of corporate events at Lending Club.[15] In rating an MPL securitization, Kroll considers the issuer's experience, business model, performance data, and operational capabilities.[16] Kroll has adopted a conservative point of view in rating MPL securitizations because the sector is new. How does and Internet-based loan origination process affect performance over time? What are the coverage multiples relative to other types of consumer loans? Kroll recently issued as surveillance report on Avant and upgraded the company's deal.

Other rating agencies embrace a range of views about the riskiness of MPL loans.[17] The diversity of views highlights the need for the sector to establish a performance track record.

Investor confidence in the MPL sector relies on confidence in the data. There must be confidence that the electronically documented terms of a loan are unalterable. The sector uses extensive third-party verification of data. Without confidence in the data, it will not be possible to create scale efficiently.

One panelist remarks that the challenges the MPL sector faced in 2016 show that the sector is still evolving and has to prove its resiliency as new, unanticipated challenges emerge. Another panelist observes that there is a trade-off between triggers and advance rates in securitizations. Trigger breaches do not necessarily indicate a failure of a deal to perform in accordance with the issuer's expectations. However, regardless of an issuer's intent, investors may interpret trigger breaches negatively.

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[15] LendingClub Corporation, Quarterly Report on Form 10-Q for the Period Ending 30 Jun 2016, at 38-40 (9 Aug 2016).

[16] Kelley, R., E. Neglia, L. Giltman, and W. Carson, *Online Consumer Marketplace Lending Update*, Kroll (28 Oct 2015).

[17] See, e.g., Black, W., K. Muni, and J. Shenn, *2017 Outlook - Credit Quality Will Be Generally Steady as Lenders Look to Reestablish Confidence*, Moody's (5 Dec 2016); Koulouriotis, Y., B. Medwig, C. Weilamann, D. Laterza, K. Tilwitz, and C. Mezzanotte, *Volatile Markets for U.S. Marketplace Lenders Provides First Test of Their Models*, DBRS (15 Sep 2016).

Outlook for 2017: One panelist asserts that MPL securitization growth will continue in 2017. Last year was important for the sector because challenges emerged, which created a focus on controls and caused a pause in the rapid growth. There are many open questions on the regulatory front that will continue to evolve in 2017. Another panelist says that the key challenges for the MPL sector going forward could be regulation and the inevitable turning of the credit cycle. A third panelist asserts that MPL securitization will continue to grow and that there will be greater rating agency participation. He adds that tiering among issuers will likely emerge as well. A fourth panelist notes that the industry is very young but has matured quickly; continued growth will depend on the regulatory environment. A fifth panelist says that the MPL sector will continue to grow, but some of the growth will likely be inside banks (*i.e.*, banks will have in-house MPL operations). A sixth panelist says that 2017 will be a good year and that the industry will continue to weed out bad actors. The industry has not yet experienced a period of stress, which will test the sector when it happens.

4:35pm – Single Family Rental Securitization

Starting with the state of the market, the panelists expressed general agreement that issuance volume in 2017 would likely be unchanged from 2016 absent a large change from the government.

Two of the panelists indicated that while overall expectations for pool income and performance have largely been met in the aggregate, the components have varied. Capital and renovation expenses have generally been higher than originally anticipated, a negative for pool income. On the other hand, higher than expected growth in rents and lower than expected turnover have effectively offset the increased capital costs. One panelist noted the trend in rental growth but added that net cash flow from the pools was generally declining because of the unanticipated growth in capital costs.

While still too early to predict the ultimate impact, panelists noted the potential involvement of the GSEs should be watched. One panelist opined that leverage ratios would be lower in deals involving the GSEs while another thought GSE involvement might makes sense since this was one area of the residential mortgage market where the GSEs have not been involved previously.

The panel generally expressed the view that public deals would likely see a decrease in leverage ratios regardless of GSE involvement.

The panelists also generally agreed that complying with U.S. risk retention rules would add complexity, but one thought loans could be structured to accommodate any new requirements.

With respect to the investor base, the panelists indicated that investor participation in the SFR sector had been typical of that of a new securitization asset class. Some investors simply experiment by investing in one or two deals, while others invest in almost every transaction offered by their favored issuers. The net effect has been to create a stable demand for the product.

Most panelists expected a continued rise in rental rates, particularly in single borrower transactions. One panelist noted that lenders in multi-borrower deals may have prioritized occupancy over rental rates, so while rental rates will likely increase, the rate will be slower than in single borrower transactions.

One panelist noted that inventory is currently quite tight by historical standards.

4:35pm – The CRA Roundtable: Key Updates from the Major Rating Agency Leaders

What regulations are beneficial to securitization? One panelist states that examples of beneficial regulations are those that promote the integrity of ratings and the integrity of governance within the rating agencies. The Financial Choice bill would eliminate annual SEC exams of rating agencies and shift to a risk-based approach.[18] It would also eliminate board approval of rating methodologies and the need for CEO attestation.[19] However, regulatory relief in the U.S. might not have meaningful effects unless European and other overseas regulators provide similar relief. Even so, some requirements under U.S. regulations have no counterparts under non-U.S. regulatory schemes, and eliminating those requirements would reduce regulatory burdens. An example is the U.S. requirement of board approval of methodologies (15 U.S.C. § 78*o*-7(r)(1)(A)).

Globalization: One panelist remarks that one of the new rating agencies started with a focus on the U.S. regulatory framework and now has to deal with overseas regulation as it expands it activities geographically. Although being a new rating agency is advantageous in many areas, it is not an advantage in dealing with different regulatory regimes around the globe. Another panelist, from a large rating agency, observes that a rating agency with international activities has to view differing regulatory schemes in different countries through the lens of preserving consistency of a global product.

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[18] Financial Choice Act § 448, H.R. 5983, 114th Cong. (2016).

[19] Elimination of board approval of rating methodologies and elimination of CEO attestation are not readily apparent from the bill's language.

Rating agency selection: One panelist criticizes the recent proposal to require multiple ratings on all deals and to throw out the "high" rating to create a disincentive to have overly lax standards.[20] Another panelist argues that it is just as bad for a rating agency to be too strict as it is to be too lenient.

Loan-level data: Another panelist states that loan-level info is necessary in his rating agency's process for rating certain types of deals but not for others. Introducing loan-level data to the analysis of an asset class where it has not customarily been available would not necessarily change analytic outcomes. A third panelist asserts that the issue of loan-level data is complicated because investors may not need all the data that rating agencies would like to have.

Risk retention: One panelist observes that issuers are using various approaches to risk retention. Practices will evolve over time. Investors like risk retention because it produces alignment of interest between issuers and investors. A strongly positive effect of mandatory risk retention is that loan originators will not allow loan quality to deteriorate as quickly as they did in the period preceding the financial crisis. The effect of risk retention is visible in the superior asset quality of recently originated assets. The bottom line is that risk retention is good for the long term prospects of the market. Another panelist questions whether risk retention regulations may have unintended consequences. So far the results of risk retention seem very good, but it is not yet clear that risk retention is improving the quality of leveraged loans going into CLOs as much as it is improving the quality of commercial mortgage loans going into CMBS. A third panelist counters that market participants need to decide for themselves whether they think that the risk retention regulations have succeeded in aligning issuers' interests with investors' interests.

Rules 17g-5(a)(3) and 17g-7: One panelist asserts that 17g-5(a)(3) was intended to encourage rating agencies to issue unsolicited ratings on securitizations. It did not produce its intended result. However, it did produce central repositories of information, and it somewhat curtailed the role of bankers as intermediaries between issuers and rating agencies. Another benefit of 17g-5(a)(3) is that it assured that all the rating agencies received the same information at the same time. [The rule made it harder to lie to the rating agencies.]

[20] H. Esaki and L. White, *Reforming the Selection of Rating Agencies in Securitization Markets: A Modest Proposal*, working paper (17 Nov 2016) (forthcoming in the Milken Institute Review).

Another panelist remarks that Rule 17g-7 requirements for publishing reports on representations and warranties are onerous. Nearly half of the reports by the panelist's rating agency are never viewed by investors.

Margin posting requirements for swaps: One panelist explains that CFTC rules would require securitization structures to post margin with respect to embedded swaps. Many old deals have no ability to post margin. This raises the issue of whether the rating agencies would downgrade the deals.

Another panelist says that margin posting requirements will drive the use of swaps out of securitization deals. He asserts that legacy deals with outstanding swaps would likely have to be downgraded. The good news is that embedded swaps are less prevalent in U.S. deals than they are in European deals.

2017 Outlook & Opportunities: One panelist identifies the Tesla–SolarCity merger as a key development and cites infrastructure as an area of potential opportunity. He notes that state revolving funds already use pooling. A second panelist remarks that the credit cycle is long in the tooth and interest rates have been low for a very long time. Meanwhile there is the rise of nationalism in both the U.S. and Europe. All this creates the potential for very volatile markets over the coming year. A third panelist states that consumer assets sectors will have interesting developments in 2017, citing particularly the MPL sector and cellular handset securitization. A fourth panelist identifies esoteric assets classes as the fastest growing part of the ABS landscape, citing PACE and commercial PACE securitizations. A fifth panelist adds that PACE credit quality is very strong. The sixth panelist urges caution with respect to the MPL sector because of its "originate to distribute" business model. The panelist also expresses surprise that none of the others mentioned residential MBS because GSE CRT deals are a hot area.

Tuesday, February 28, 2017

9:00am – The Annual Investor vs. Issuer Family Feud Game and Fireside Chat

Of all post-crisis regulation, which rule would issuers most like to see repealed? Answers from an securitization industry survey, in descending order: (i) risk retention, (ii) Reg AB II, (iii) the Volker Rule, (iv) the three day rule, (v) liquidity coverage ratio, (vi) rating agency reform.

Of all post-crisis regulation, which rule would investors like most to see retained? Answers from a securitization industry survey, in descending order: (i) risk retention, (ii) Reg AB II, (iii) the Volker Rule, (iv) money market reform, (v) rating agency reform, (vi) living wills, and (vii) the fiduciary rule.

If risk retention were eliminated by the Financial Choice bill, which asset class would cause investors the most angst? Answers from a securitization industry survey, in descending order: (i) RMBS, (ii) CMBS, (iii) CLOs, and (iv) marketplace lending.

What factor has been the biggest driver of market liquidity in the past year? Answers from a securitization industry survey, in descending order: (i) interest rates, (ii) capital/liquidity regulations, (iii) risk retention, (iv) election (v) excess cash, (vi) TRACE reporting, and (vii) improved credit.

Besides the Great Wall of China name a famous wall? Answers from a securitization industry survey, in descending order: (i) the Berlin Wall, (ii) Wall Street, (iii) Pink Floyd's "The Wall," (iv) the Western Wall, (v) Hadrian's Wall, (vi) the Mexican border wall proposed by President Trump.

Positive developments: One panelist remarks that the structured finance industry today has different practices than it did in the past. The changes are based largely on the lessons learned from the financial crisis and from post-crisis regulations. Another panelist highlights the increased emphasis on due diligence and credit fundamentals. Also, the market benefits from ongoing efforts to improve communications between issuers and investors. The requirement of using a single prospectus is an improvement that was introduced with Regulation AB II.[21] Another beneficial development is including hyperlinks in electronic documents. A third panelist states that the growth of technology platforms and the ability to use the technology are important improvements. The panelist adds that transparency has improved but there is still room for further progress. Structured finance allows an investor to take risk across different sectors: residential mortgages, commercial mortgages, consumer loans, leveraged corporate loans, and others.

A fourth panelist observes that the focus on credit fundamentals is a positive development, particularly in the residential mortgage area. A fifth panelist remarks that risk retention regulations enhance the credibility of issuers in talking to investors. Also,

[21] Securities and Exchange Commission, *Asset-Backed Securities Disclosure and Registration; Final Rule*, 79 Fed. Reg. 57184, 57190, 57291-92 (24 Sep 2014).

the ATR[22] rules are beneficial in that they reduce litigation risk for mortgage lenders. A sixth panelist highlights that equipment ABS issuers have always had skin in the game. The seventh panelist asserts that the improved dialog between investors and issuers is a positive development that can be traced back to regulatory changes.

Concerns & headwinds: One panelist asserts that it is expensive for issuers to produce loan-level disclosure. Applying loan-level disclosure requirements to the equipment ABS sector could limit some companies' access to funding through securitization. Another panelist highlights wide bid-ask spreads and regulatory uncertainty as important challenges for the securitization market. In the past, when an investor wanted to sell a structured finance security, it could get more than a dozen bids, all in a tight range. Now, by contrast, and investor is likely to get five widely dispersed bids.

A fourth panelist highlights GSE reform as a source of uncertainty. A fifth panelist notes changing rating agency methodologies since the financial crisis as a challenge. A sixth panelist notes new compliance risks from accidental regulatory violations and execution risk from new delays and speedbumps that have been added to the issuance process. The seventh panelist argues that there needs to be more consistency across asset classes; rating agency reports should highlight differences across deals.

One panelist states that the 2016 level of U.S. securitization issuance, not including agency MBS, was roughly $500 billion. Another panelist predicts that issuance for 2017 will contract to $400 billion, while a third panelist predicts that it will grow to $600 billion.

10:00am – Michael Chertoff Keynote Address

[Note: Michael Chertoff was the Secretary of Homeland Security from February 2005 through January 2009. Subsequently he served as chairman of BAE Systems and was a cofounder of the Chertoff Group.]

The Internet was started by academics who knew and trusted each other. Preventing cyberattacks was not initially a priority. That has changed now that the Internet has become part of daily life for billions of people.

[22] 12 C.F.R. § 1026.43(e)(2) (2016).

The Internet is the most powerful marketing tool of all time. Companies that acquire the ability to use and analyze consumer data collected over the Internet will have great advantages over their competitors. Also, the Internet has enabled individuals to sell goods and services without using traditional intermediaries. An example is Airbnb.

The Internet also facilitates criminal activities. Criminals have used hacking to steal from banks' ATMs, and in some cases, to commit bank larceny using fraudulent wire transfer instructions. Apart from stealing money, other types of criminal activity using the internet include disrupting the commercial activities of legitimate businesses (*e.g.*, denial of service attacks). Sometime criminals steal confidential information to facilitate fraud by identity theft, and sometimes they steal confidential information to release embarrassing content (*e.g.*, Sony and the Democratic National Committee). An even scarier example of criminal activity on the Internet is taking control of systems for infrastructure like power plants and dams. Perhaps the worst type of Internet crime is attacks against the political system of a target country, like the Russian attacks on the U.S. electoral process.

Ten Cybersecurity Tips: Chertoff offers ten tips for businesses:

Impossible to eliminate risk: Do not expect to eliminate cyber risk. It is impossible to eliminate. The best that a company can do is to manage the risk. It is possible to reduce the overall risk by taking steps to mitigate the harm that ensues from having hackers penetrate a company's network.

Protecting digital assets is a top level issue: A company should take a strategic approach to protecting its digital assets. Different businesses have differing needs for allowing customer access to their systems. A company should not allow greater access than is necessary to meet clear business needs. Protecting assets must be an enterprise level activity and not merely delegated to the technology department.

Know your threats: Different companies face different types of threats. A company has to evaluate whether it might be a potential target of ideologues. A company that deals with nation states as customers or counterparties must exercise special caution. All companies need to have ways of dealing with the risk of insiders, such as terminated employees.

Have strong internal controls: A company should compartmentalize access to information. An employee should have access only to the information that relates to his function.

People are the biggest vulnerability: Employees can inadvertently compromise security by visiting dangerous websites or clicking on dangerous links to malware. A company should train its employees to avoid dangerous activities.

Network access by vendors can be dangerous: A company should exercise caution in allowing vendors to connect to its network. Vendors can introduce malware just like employees.

Beware the Internet of things: A company should monitor the connection of seemingly innocuous devices to its network. Such devices may not have strong security features and each one expands the "surface area" for potential attacks.

Use encryption: A company should use encryption for both data in transit and data at rest. This means that it is not enough to merely encrypt data when it is being transmitted via the internet. Data on a company's servers should also be encrypted.

Use blockchain technology where applicable: Blockchain technology may help promote data integrity with its system of ledger entries that are immutably linked in chronological order.

Embrace best practices for cybersecurity: A company should communicate and participate in information sharing about best practices for cybersecurity. It should try to learn from the experience of other firms.

A bonus cybersecurity tip is that a company should recognize that the whole world is digitally connected and this means that threats are ever present.

A key challenge of dealing with cybersecurity threats is that they are asymmetric. Adversaries do not need massive resources to become significant threats; they need know how and determination.

11:00am – Blockchain! What Is It, and Should You Care? Understanding the Implications and Applications for Structured Finance

Is blockchain over-hyped? One panelist asserts that blockchain technology has the potential to greatly change the securitization industry and, more broadly, the whole financial services industry. Another panelist agrees, adding that it will take time for blockchain technology to be broadly embraced. There is potential for blockchain technology to streamline business processes and reduce operational risk. It is important

for the buy side to appreciate that using blockchain technology will reduce investors' exposure to operational risk.

A useful analogy for understanding how blockchain technology can produce massive change is to consider how U.S. mail delivery of DVD movies from Netflix has been almost entirely displaced by streaming video over the Internet.

Blockchain technology is a way to maintain information in a secure distributed ledger. Records are maintained in chronological order with cryptographic security. Blockchain eliminates the need for a trusted intermediary to maintain a ledger. On the negative side, it limits the ability to cancel or change a transaction. The system allows nearly real-time access to transactions as they occur. Blockchain eliminates the risk of duplicate transactions in the same "assets" because all transactions are timestamped (*i.e.*, blockchain technology inherently prevents double pledging of an asset maintained in the blockchain ledger). A blockchain system uses consensus for verification. A hacker would need to take control over a majority of the nodes on the network in order to maliciously manipulate the blockchain data.

Blockchain allows smart contracts. An example would be coding the waterfall of an RMBS deal into the blockchain data.

Governments are interested in blockchain technology. The use of blockchain technology is being explored in many countries. There is a congressional blockchain caucus. Dubai has said that it wants to "be on" blockchain by 2020. Consider the analogy to the Internet. Twenty years ago it was not obvious that the Internet would become an important factor in commerce. Blockchain technology is in its early stages today, but it has the potential to have huge effects.

The State of Delaware has established an initiative to maintain corporate records in blockchain form. Blockchain would eliminate problems created by both the delay between trade and settlement on stock sales and the separation of legal from beneficial ownership in holding arrangements.

Blockchain technology is not just about streamlining back office operations. It has the potential to improve data quality and, therefore, analytics. Blockchain technology will not entirely eliminate problems with data but it will mitigate them.

One panelist asserts that trustees should not worry about having their role displaced by blockchain technology. There will still need to be a trusted intermediary to act when something goes wrong in a transaction. Blockchain technology may make the trustee's role more efficient, but it should not eliminate the role.

Likewise, smart contracts will not eliminate the need for lawyers. Blockchain will provide access to perfect data.

There is no single standard for implementing blockchain technology. There are many competing blockchain implementations right now. Data must be standardized to take advantage of blockchain technology. Perhaps in the future the market will coalesce around a single form of blockchain implementation as the common standard.

1:30pm – Consumer ABS Financing Outlook: Researcher Roundtable

In a poll of the audience, the majority view is that spreads on triple-A-rated consumer ABS will tighten slightly from their current levels. Most of the audience expects consumer ABS issuance will be slightly higher in 2017 compared to 2016.

Subprime consumer credit risk: One panelist explains that consumer credit fundamentals are good. Job growth, low interest rates, low energy prices, and home price appreciation are factors that are supporting good consumer credit quality. Additionally, debt levels have declined for mortgage loans, home equity lines of credit (HELOCs), and credit cards. On the other hand, debt levels have increased for auto loans and student loans.

There is a misconception that securitization is fueling easy credit on subprime auto loans which, in turn, is fueling auto sales. That is not right. The securitization market is funding only 11% of auto lending in the U.S. In 2016Q4, subprime loans accounted for only about a quarter of all auto lending. That is a lower proportion than over the past several quarters.

Many of today’s subprime auto lenders were established after the financial crisis, and they are funded by private equity. That has worked well for the companies so far, but it is not clear what the exit strategy will be for the private equity investors. Now, during the benign phase of the credit cycle, the companies should be building their collection departments to be ready for when the credit cycle turns.

Another panelist remarks that subprime auto deals have credit enhancement levels that appropriately reflect the risk of their underlying loans. When loans have risky features, such as long maturities, the credit enhancement levels in the deals reflect it.

A third panelist observes that, despite reasonably good economic conditions, the cumulative loss levels on subprime auto deals are relatively high. From an investor

perspective, this argues for moving up in quality within the subprime auto sector. In a similar vein, investors should take a conservative posture in the area of marketplace lending (MPL); they should favor MPL lenders that are well established and have a "brick and mortar" presence in addition to an online origination channel.

Another panelist remarks that competitive pressures from banks and others may squeeze the profitability of subprime lenders (in various asset classes), which may drive weaker players to the sidelines.

One panelist observes that no MPL companies have experience through an economic cycle. This is cause for taking a cautious posture. Many MPL borrowers have high incomes but also have too much debt.

Auto sales have strengthened in the recovery following the financial crisis. However, many new car "sales" were actually leases. Now the market is facing a "wall of lease maturities." Concerns about vehicle residual values at the end of lease terms are well founded. On the positive side, cars are built better today than they used to be, and the average age of cars on the road is rising. On the other hand, used car prices seem to be softening slightly. Another panelist argues that used vehicle prices will likely remain fairly stable as the dynamics of car ownership evolve with the advent of self-driving cars. A third panelist expresses a more pessimistic view that a glut of used cars from maturing leases will trigger a vicious cycle of falling prices for both new and used cars.

One panelist notes that ABS backed by auto leases have very high credit enhancement levels that sufficiently cover the residual value risk of the cars backing the deals.

In a poll of the audience, most audience members express the view that credit deterioration will be the biggest challenge facing consumer ABS in 2017.

Student loan ABS: One panelist states that the FFELP ABS market has mostly stabilized, and there should be few additional downgrades. The levels of forbearances, deferments, and income-based repayment plans have stabilized. However, a negative change in the economic outlook could put credit pressure on FFELP ABS if levels of forbearance, deferments, and income-based prepayment plans increase. Spreads on FFELP ABS have tightened as rating uncertainty has been resolved.

Another panelist remarks that the FFELP ABS sector has been the only sector that has recently appeared cheap. A third panelist argues that spreads on subordinate tranches are likely to tighten further.

One panelist highlights that the average size of student loan debt is only $25,000, which is less than the price of a car and is manageable for most households. A second panelist counters that although the average level of student loan debt is manageable, a much higher proportion of today's households have student loan debt than in the past, and there are many households that have unmanageably high levels of student loan debt.

In a poll of attendees, most express the view that off-the-run ABS represent the best investment opportunity among consumer ABS in 2017

Credit card ABS: One panelist explains that the credit card ABS sector is generally in good shape. The area for possible concern is private-label credit cards from retailers. The risk in that area is that if a retailer goes out of business its customers are likely to stop using the company's private-label credit card (which could produce a risky declining pool scenario). Other panelists express agreement and emphasize that it is important for a retailer to have brick-and-mortar stores at which consumers can return merchandise.

Effect of the Trump administration on consumer ABS: One panelist states that a wave of optimism following the inauguration has fueled a rally across many market sectors, including consumer ABS. However, if promised changes don't materialize, then the optimism could fade and the rally could be reversed. Another panelist remarks that infrastructure development, tax cuts, and repatriation of corporate earnings could all be positive developments for the consumer ABS sector. A potential countervailing factor could be actions by attorneys general to curtail excessive lending.

Recently enacted disclosure requirements on consumer ABS: One panelist observes that asset-level data is new for the auto ABS sector, though it has been the norm in the residential mortgage area for many years. Auto ABS investors have to gain experience using and analyzing the data in order to get value from having it.

1:30pm – The Commercial and Residential PACE Market Overview

The panel noted several distinctions between commercial and residential PACE lending. First was that there are a far larger number of states with commercial PACE activity than with residential PACE, which has been most successful in California. Unlike residential PACE lending, Commercial PACE lending typically involves obtaining the consent of existing lenders (and so is potentially less controversial in terms of the PACE loan's priming existing first-mortgage liens), but it also has a more involved process with each loan negotiation. The size of commercial loans is also larger,

often about $600,000 according to one panelist. Another panelist thought that there are about 1.5 million buildings potentially available to commercial PACE.

On the residential side, one panelist noted that their company files suit to establish certainty that no lender consent is required and that the resulting residential PACE lien is in fact senior to any existing mortgage liens, thereby reducing the chance of any future dispute.

In ratings, there is also a bifurcated approach between residential and commercial PACE. Residential PACE analytics borrow heavily from RMBS modeling and look at factors such as LTV and seasoning – but with very high recovery rates given the very senior nature of the PACE lien position and its relatively small amount. Any losses are assumed to be due to abandonment of the property or a natural disaster. DBRS has not published a specific methodology for rating commercial PACE transactions, but it is likely future approaches will borrow from its CMBS ratings methodology.

One panelist noted that interpreting the limited historical loss data on PACE loans is difficult. A challenge is that losses to date have been very low in percentage terms because there is no acceleration of a PACE loan. Another panelist noted that one challenge in rating transactions has been the limited history available over the last year or two for what is often a 20 year loan. This limited history of PACE loans has proved a challenge for the major agencies none of which has issued a rating on a PACE transaction to date. It has also been a challenge to the smaller agencies in assigning their highest ratings (though Morningstar has reportedly assigned a "AAA" rating to PACE ABS from Ygrene Energy Fund[23]). One panelist speculated that this year might finally see a major rating agency feel comfortable enough with historical performance to rate a transaction, and for similar reasons other smaller rating agencies might become willing to assign their highest ratings.

2:20pm – Key Considerations for Investing in NPLs

One panelist asserts that the inventory of non-performing loans (NPLs) on the balance sheets of banks and the GSEs is about $130 billion. He expects that roughly $10 billion of NPL deals will get done in 2017. Another panelist explains that the GSEs also have around $100 billion of reperforming loans (RPLs); they can use either securitization or whole loan sales.

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[23] Xu, P., B. Sandler, B. Grow, and B. Vanderhorst, *GoodGreen 2016-1 Trust*, Morningstar, presale report (26 Oct 2016).

One panelist explains that the mechanics of NPL sales vary transaction to transaction, and a potential buyer may encounter a range of due diligence alternatives. Another panelist observes that a GSE transaction takes one to two months from start to finish.

One panelist observes that the average life of an RPL deal is quite long. The investment has meaningful interest-rate sensitivity, and servicing is not very intensive because the loans are performing. By contrast, NPL deals have short lives, are very servicing intensive, and have little sensitivity to interest rates. Yields on RPL deals are in the area of 5%, while yields on NPL deals are in the range of 6% to 8%. Another panelist explains that delays in processing NPL foreclosures sometimes occur because small law firms doing the actual work become overburdened. The delays can increase losses for NPL investors. A third panelist remarks that reverse mortgage loans are starting to experience defaults and foreclosures. Reverse mortgage defaults are likely to increase in 2017. Dealing with a decedent's estate can be difficult and time consuming.

One panelist explains that two key due diligence items in an NPL deal are lien position verification and confirmation of property values.

Another panelist explains that servicers have different capabilities and an RPL deal benefits from having a servicer that excels at "borrower hand holding." Additionally, a servicer's capacity for advancing on delinquent loans is important.

The GSEs have been the largest source of supply for NPLs and RPLs. California has been the largest geographic source of NPLs and RPLs. Today, however, the long foreclosure timelines in judicial states mean that a higher proportion of NPLs now come from the judicial foreclosure states. The judicial foreclosure states are behind the times. Loans secured by properties in judicial foreclosure states should have lower prices than comparable loans in non-judicial foreclosure states.

Another panelist emphasizes that servicing transfers need to be handled properly on RPL deals in order to avoid breaking the continuity of cashflow from the borrowers.

One panelist explains that *changes* in regulation have been very expensive for NPLs. He emphasizes that changes are a bigger issue than the absolute level of regulation because regulatory changes can force operational changes in the middle of the foreclosure process. The panelist asserts that the collapse of home prices in the period from 2006 to 2008 was due to the contraction of funding for the marginal buyers, who were subprime borrowers. Today's marginal buyers get their funding from HUD (*i.e.*, the FHA), which is a source that is not as likely to dry up.

Another panelist emphasizes that foreclosure delays increase losses for investors. A frequent problem has been that originators were sloppy with documentation at time loan originations. Later, the need to retrieve necessary documentation during the foreclosure process can create delays that should have been avoidable if documentation had been handled properly in the first place.

One panelist emphasizes that a deal's servicing fee must be large enough to make sure that servicing is done well. Another panelist asserts that the NPL and RPL business help the American dream by providing an orderly and minimally painful way for defaulting borrowers to deal with a bad situation. A third panelist highlights that servicers have a very tough job dealing with NPLs and RPLs.

3:30pm – CMBS Market Outlook: Getting Closer to the Dirt

One panelist asserts that increased regulation of CMBS is unjustified because the crisis-period troubles were primarily associated with residential MBS. Ironically, most residential mortgage loans are exempt from risk retention regulations, while regulatory relief for commercial mortgage loans is very slight.

Another panelist asserts that, over the long term, the demand for different types of real estate may change significantly. The demand for retail space has already changed. The demand for office space and for multifamily housing may change in the future. In retail, the big change is not necessarily from e-commerce but rather from companies like Walmart, which operates in many respects more like a manufacturing company than a pure retailer. Walmart tells manufacturers what to make, rather than simply reselling what manufacturers decide to make on their own.

One panelist asserts that the anticipation of widespread acceptance and use of self-driving cars and shared vehicles is already changing the specifications for how many parking spaces must be provided in new construction projects.

Another panelist observes that the commercial and financial systems are becoming more fragile as certain structural changes occur. American society today depends more on cell phones and Uber cars than on traditional wallets and personally-owned cars.

One panelist observes that some categories of real estate will be winners and others will be losers as demographic and economic changes occur. Suburban office buildings are likely to be losers. Industrial properties, especially those near urban centers, will likely be winners.

Loan volume: One panelist asserts that commercial mortgage securitization volume has been depressed by increased lending volumes from insurance companies. About 60% of current CMBS production is backed by commercial mortgage loans refinanced from maturing CMBS. CMBS is not currently the most aggressive funding source for commercial mortgage loans. The CMBS sector is healthy with modest volume. Another panelist adds that CMBS activity levels are probably sustainable for the long term. CMBS has traditionally been a funding source for stabilized properties, not a funding source for loans in transition states. Additionally, CMBS serves as a means for bringing funding to the center of the country from the East and West coasts. Banks cannot replace CMBS because the regulators will not allow them to increase their exposure to commercial real estate. Another panelist adds that life insurance companies are not likely to increase their allocations to commercial real estate. This means that CMBS performs a vital role in the system for supplying credit for commercial real estate. One panelist asserts that although CMBS issuance activity may decline, it will remain an essential part of the commercial real estate funding landscape as long as the professionals in the sector continue to focus on credit fundamentals.

Another panelist explains that the CMBS sector has gone through phases of irresponsible behavior. Examples include "aspirational underwriting" and triple-A credit enhancement levels near (or even below) 10%. The sector must avoid such excesses in the future.

Wall of maturities: One panelist asserts that the "wall of maturities" has already passed in an orderly fashion. The 2006 vintage of loans had low interest rates, which made them more difficult to refinance than the 2007 vintage, which is coming due in 2017. The loans of the 2007 vintage have weaker credit quality, but they have higher interest rates, which should make them easier to refinance. Another panelist argues that there are clearly stresses on the 2007 vintage, but it is still quite possible for loans with problems to find refinancing. A third panelist explains that the CMBX6 index, which is based on CMBS from 2012, is clearly distressed because of exposure to retailers.

Another panelist expresses concern that "class B" and "class C" shopping malls are at risk of losing retail anchor tenants. Experience shows that the loss of an anchor tenant at a B/C mall can lead to a "death spiral" for the property. Multifamily properties funded through CMBS tend to have blemishes because the strongest multifamily properties get loans that are eligible for the GSE programs.

One panelist explains that the CMBS sector has found ways to deal with risk retention. Basel III capital requirements may create tough challenges. There are ongoing challenges with deal governance because of potential conflicts between servicers and B-piece holders.

Which is better: L-shaped, vertical, or horizontal risk retention: One panelist asserts that the horizontal approach is slightly better from an investor's perspective. A second panelist expresses indifference and adds that the market already appreciates the benefit of improved underwriting caused by the risk retention requirements.

3:30pm – Equipment ABS

The panel expressed a consensus view that it is still too early to predict the effects of potential regulatory changes from the Trump administration. One panelist stated that little was likely to change in the agricultural sector, where the government is cautious about making big changes. Another panelist indicated that there might be marginally more competitors introduced into small ticket leasing if banking regulations were relaxed. A third panelist added that any lightening of regulations would generally be a positive for the leasing sector overall.

In agricultural equipment leasing, the industry structure is stable with two large competitors dominating the market. In small ticket leasing, the technology barriers to entry have apparently resulted in little competitive entry according to one panelist, providing competitive stability in this sector as well.

Another panelist, from a rating agency, noted that the credit environment remains benign. He added, however, that the cycle must turn at some point. Other panelists noted a slight increase of loss levels from the very low levels of the immediate post-crisis period. Corn prices in the agricultural sector are also normalizing after insurance payoffs for a drought that occurred in 2012.

Panelists remarked that investors were not concerned about credit losses at this point, but often complained about the low yields currently available.

Technology remains a focus in both the small and large equipment ends of the sector. There are now tractors that can guide themselves with GPS while harvesting and even refuel themselves without driver intervention. One panelist quipped that the small ticket leasing sector was the original technology-based lending market because of the intensive data analysis necessary for success.

One panelist noted that one unwelcome and unanticipated cost potentially arising under risk retention was the request by some banks for a legal opinion that all risk retention requirements have been complied with. Understandably, the panelist would like this demand for a risk retention opinion not to become industry practice as the cost would be quite substantial, its provision was not part of the regulatory design,

and a legal opinion is ill suited to deal with determining whether actual requirements of the risk retention rules have been met.

4:20pm – CMBS Originators' Panel: Dealing with Risk Retention

The risk retention regulations became effective for CMBS on December 24, 2016. The rules require a sponsor of a securitization to retain at least 5% of the credit risk of a securitization. However, for CMBS, the risk retention requirement can be satisfied if one or more originators or originator-sellers, or up to two third-party purchasers, serve as the retaining parties. One of the requirements for a third-party purchaser is that it cannot hedge the position or finance it on a non-recourse basis. It can resell the retained position after five years.

One panelist explains that CMBS issuers have had concerns about using third-party purchasers for risk retention because the issuers would be responsible for violations of the risk retention rules by the third-party purchasers.

Another panelist remarks that most CMBS deals done since the effective date of the risk retention rules for CMBS have used vertical risk retention. Where issuers have used third-party purchasers, they have sought indemnification for potential violations of the rules.

One panelist observes that loans in new CMBS deals have lower LTVs. He asserts that risk aversion by sponsors is increasing costs for commercial real estate borrowers because they have to find alternative funding to replace the portion lost from CMBS. He adds that it is operationally difficult to use horizontal risk retention because doing so requires valuation of the retained portion. Another panelist adds that having multiple parties retaining risk means that each of them wants to have consultation rights associated with servicing troubled loans in the underlying pool.

One panelist argues that the CMBS deals backed by loans on a single property or loans to a single borrower should be exempt from the risk retention requirements. The CMBS industry sought such an exemption, but it was denied by the regulators. Some investors support having risk retention on all deals – even single asset/single borrower deals – because it helps to keep leverage lower. Another panelist counters that lower leverage may be illusory; rating agency analysis shows that the true leverage is roughly flat. The panelist is concerned that the risk retention regulations are keeping the CMBS sector from getting its fair share of commercial real estate loan originations. A different panelist counters that funding commercial real estate loans though other sources, such as banks and life insurance companies, may be more competitive at any given time. Another panelist notes that CMBS accounts for a smaller share of funding for

commercial real estate today than in 2006. However, the share in in 2006 was too high, reflecting poor practices. For CMBS to be competitive it will have to get back to its roots of well diversified pools and slightly higher leverage than other funding channels.

Financial Choice bill and risk retention: Risk retention is not likely to go away. This is because of the legislative calendar, among other things. Issues that will come first are the budget, Russia, and healthcare. Moreover, even if the Financial Choice bill[24] gets through the House, there is zero chance that it will get through the Senate. The bottom line is that risk retention is here to stay. There might be some tweaks by regulators, but nothing more. Additionally, investors like risk retention.

4:20pm – Railcar, Shipping & Container ABS: Transportation Finance

The panel generally agreed that there was a significant distinction in factors currently driving the demand for rail cars versus shipping containers. Rail is being negatively impacted by the dip in oil prices and coal production. Rail cars also have much longer useful lives than shipping containers, so correcting a supply imbalance takes longer. The panel generally agreed that the supply imbalance in shipping containers seemed to be moderating, with one panelist noting a 5% decline in per diem lease rates expected this year, compared to roughly 10% last year. In general, the panel expressed the view that while the supply situation in containers deserves watching, it shows no undue present danger. Most of the panel agreed that the situation is less favorable for rail.

The panel also noted that global GDP, rather than domestic stimulus, was more directly relevant to shipping container demand. Accordingly, even if U.S. tariffs are imposed on imports, the strong intra-Asia routes would suffer few adverse effects. Conversely an increase in domestic infrastructure spending could be beneficial to rail.

One panelist noted that securitization may have caused an excessive demand for shipping containers, so the current trend of consolidation of companies in the shipping container market makes sense and is contributing to balancing the supply.

More than one member of the panel noted the importance of the servicer in these long lived assets that will likely have more than one lease turnover during their life within a securitization trust. In addition, a container securitization is particularly

[24] Financial Choice Act, H.R. 5983, 114th Cong. (2016).

sensitive to the servicer's ability to manage complex logistics in placing containers in the right markets at the right times across the globe.

One panelist noted that investors in container ABS tend to buy and hold the securities. The secondary trading volume has been low, even when spreads widened significantly, say from 130 bps to 400 bps. Most investors realize there will be cycles. Even though the shipping industry may be going through stress, deal performance remains strong, something that should be reassuring to investors. Two other panelists also noted that initial investors receive access to detailed data on the types of containers that are involved in each pool, allowing them to run detailed stress scenarios. According to one panelist, this level of detail is not typically available to buyers in the secondary market; the information asymmetry is one source of the current liquidity premium.

One panelist noted that although investor demand remains strong for container transactions, given that almost no containers have been built since 2015, he does not see much new issuance coming this year.

5:10pm – The CMBS Investor Panel

One panelist explains that the pendulum of underwriting stringency has swung back and forth since the financial crisis. The introduction of risk retention in the CMBS sector has improved credit quality by forcing issuers to have skin in the game and aligning issuers' interests with investors' interest.

Another panelist observes that the current credit cycle is already unusually long. It is already 87 months old. Credit quality was probably highest around 2012. Standards have loosened somewhat since then. Interest rates were very low and capitalization rates became very aggressive. Another panelist argues that the weakest standards for commercial real estate lending were in 2015. Risk retention is a positive development because it is reducing the aggressiveness of lending. A third panelist highlights that property values have nearly doubled over recent years. The retail sector is a known problem. The hotel sector is a victim of its own success. Long Island City is an example of an unhealthy situation that is producing unsustainably high property valuations.

One panelist asserts that risk retention is improving loan quality and reduces "race to the bottom" competition. On the other hand, it may create refinancing challenges for some loans, and it may reduce secondary liquidity. If there was more investor demand for CMBS, there would likely be greater dealer participation in providing liquidity. This suggests that the product needs to become more desirable (to investors) in order to generate more demand.

Another panelist remarks that there has been negative net CMBS supply for the past several years (*i.e.*, contraction in the total amount of outstanding CMBS). The trend is likely to continue in 2017. The is reflected in the increased activity in the GSE programs, particularly Freddie Mac's. The negative net supply should cause CMBS spreads to tighten as investors bid up prices in trying to maintain their CMBS portfolio allocations. The "maturity wall" of 2007 vintage loans is not likely to be a problem because interest rates are low, which will allow for easy refinancing. A different panelist counters that some of the loans from 2007 vintage were too aggressive, and today's tighter credit standards may create challenges for those loans to get refinancing.

One panelist favors vertical risk retention because it keeps an issuer's interest aligned with investors' interest over time, even if a horizontal interest would have been extinguished by losses. Another panelist prefers horizontal risk retention because it shortens the duration of the investors' interest. However, the higher cost of horizontal risk retention may mean that the sponsor of a transaction leans toward riskier assets than it would if it used vertical risk retention. One panelist asserts that the CMBS sector is likely to gravitate eventually to the vertical or "L-shaped" risk retention structures because they are the most efficient.

The pricing of recent deals shows that CMBS investors are willing to pay incrementally more for deals that include risk retention. Risk retention has improved the quality of the underlying assets, but that is the whole point: risk retention is supposed to encourage better asset quality by making the sponsor of a deal "eat its own cooking."

Other regulations: One panelist observes that the Volker Rule and capital rules are having negative effects on both CMBS and other areas of structured finance. Banks are less willing to provide liquidity because they face restrictions on proprietary trading and high capital charges for holding certain bonds. Another panelist counters that the issue is really one of bid-ask spreads: bid-ask spreads must be wider to motivate dealers to participate. A different panelist adds that liquidity today is less than in the past because the market is smaller and the size of new deals is smaller. In the years preceding the crisis, deals of $2.5 billion or $3 billion were the norm, while today deals are often $500 million or smaller. Another panelist counters that the CMBS market was overheated in the pre-crisis period, and super-duper senior tranches that were originally offered at incredibly tight spreads ended up trading at 50¢ on the dollar.

One panelist explains that the market now seems to be correctly pricing risk across different product types and geographic areas. Another panelist would like to see more multifamily loans in conduit transactions. He would like to see fewer *pari passu* loans.

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