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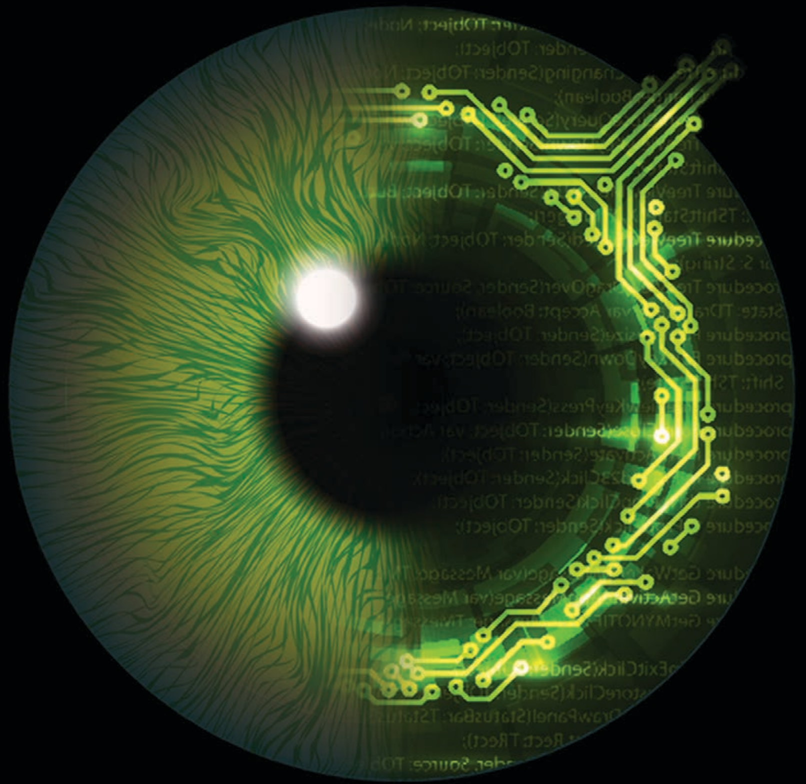

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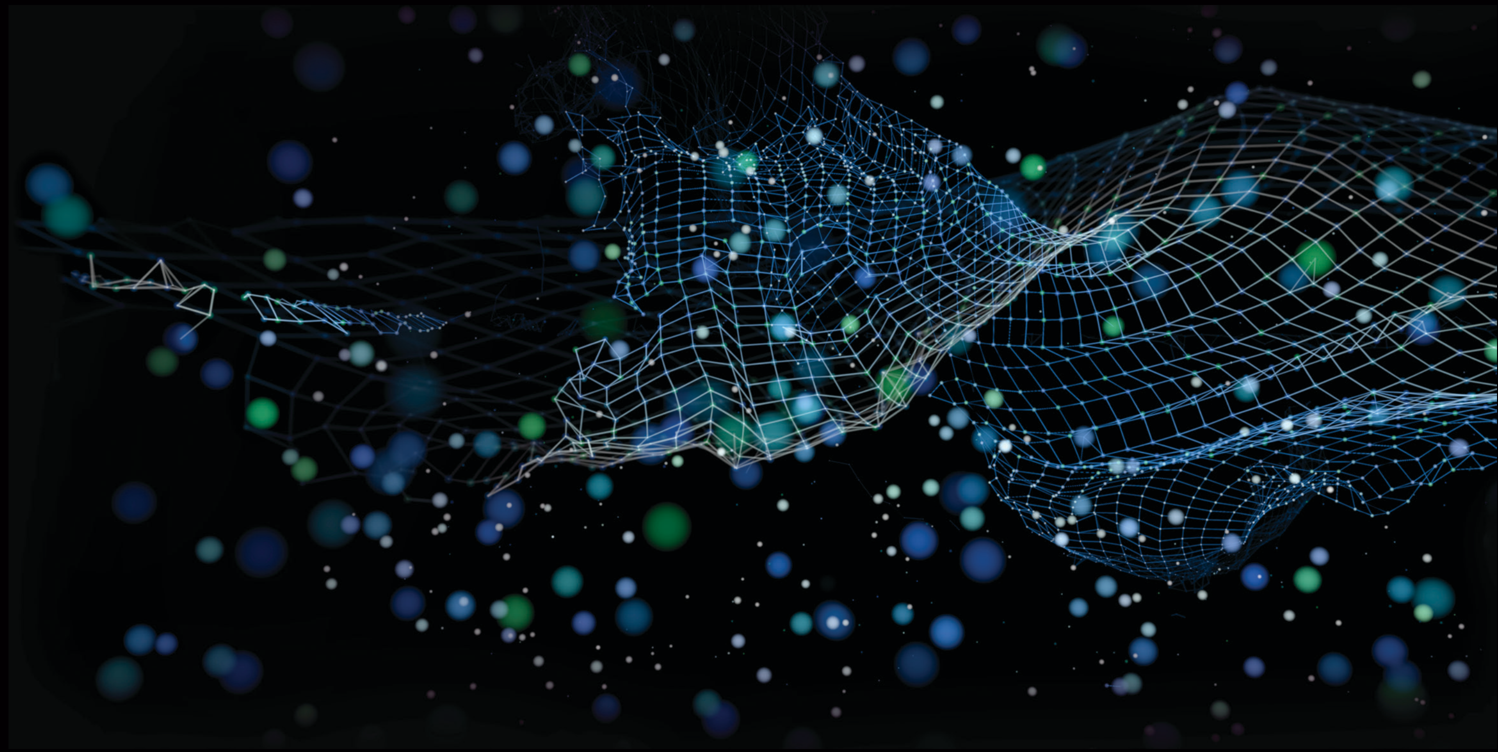

Asset Securitization Report

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THE RISE OF AN ASSET CLASS

The largest mortgage insurer
is using GSE-style risk transfer
in the private market

JAMES BENNISON
SVP, Alternative Markets
ARCH CAPITAL

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EDITOR'S LETTER

Capital Idea

If imitation is the best form of flattery, then an innovative form of private mortgage reinsurance being pioneered at Arch Capital says a lot about the perceived success of credit risk programs being employed by Fannie Mae and Freddie Mac. The two government-sponsored enterprises both issue bonds that are very similar to catastrophe bonds – if credit losses on mortgages that are being reinsured reach a certain level, investors may forfeit their principal. Fannie and Freddie can then use the funds to repay investors in their mortgage-backed securities.

Connecticut Avenue Securities (Fannie) and Structured Agency Credit Risk (Freddie) are complicated programs, and there's an ongoing debate as to how much risk they actually transfer. Arch's new program, called Bellemeade, works the same way, but with one important exception. Proceeds from the bonds are held in a trust until they are either needed to repay losses on mortgages Arch insures or to repay Bellemeade bondholders at maturity. In this way, the program is more similar to insurance-lined securities now commonly used to offload the risk of catastrophic property damages from natural disasters.

By comparison, CAS and STACR are general obligation bonds; proceeds go on the GSEs' balance sheet, and investors need to take into account the mortgage giants' own financial health, as well as the credit quality of the mortgages in the reference pools. But Arch's program does not have the same counterparty risk.

Another similarity between Bellemeade and the GSEs' various risk-transfer programs is that all provide a kind of capital buffer, since the funds raised can insulate shareholders (and ultimately, in the case of Fannie and Freddie, taxpayers) from losses. Again, there is an ongoing debate as to whether CAS and STACR are the right kind of regulatory capital. So it's interesting that funds raised by Bellemeade are counted toward capital requirements by state insurance regulators as well as corporate credit rating agencies. Fannie and Freddie also count the funds toward Arch's private mortgage insurer eligibility requirements – but that should come as no surprise.

—Allison Bisbey, Editor in Chief

OBSERVATION

Outlook Stable, Despite Risks

The securitization market is weathering risk retention and risking interest rates, though Fitch Ratings is keeping its eye on some consumer asset classes as the credit cycle lengthens

By Rui Pereira

The U.S. structured finance market has experienced numerous changes a decade after the financial crisis from changes to the broader economy, the emergence of new asset types and a regulatory environment that has shaped loan originations, collateral disclosure, and stringer alignment of interests in the sector. And it is by and large adapting to those changes.

As a result, Fitch's outlook for U.S. structured finance ratings is predominately stable for 2018. That said, given where we are in the credit cycle, Fitch is keeping a close watch on select asset types that could run into some issues over the next 12 months.

Entering 2018, Fitch has either Positive or Stable Outlook on over 90% of its rated securitized bonds. Helping matters is a supportive macro environment, low interest rates and solid structural enhancements. Outside pressures likely in the coming year remain either idiosyncratic or secular.

Risk Retention

Risk retention is now firmly ingrained into the fabric of the securitization markets (commercial mortgage bonds and collateralized loan obligations in particular) with a mix of three distinct structures being used in new deals – horizontal, vertical and L-shaped. CLOs had a bit of a head start by introducing risk retention structures into its new structures earlier in 2016, though CMBS appears to have also adapted to risk retention with surprising alacrity.

Perhaps the most notable change that has manifested from risk retention is the shrinking universe of originators bringing new securitizations to market. This is particularly notable in the universe of CMBS originators, which has shrunk from a high of roughly 40 to now less than 20 due to a combination of risk retention and Reg A/B.

Interest Rates

Like most other market sectors, a lingering question around securitization is what happens when interest rates start to rise more appreciably. Fitch's longstanding opinion has been that structured finance can weather interest rate hikes so long as they do not happen too quickly or rise too dramatically.

ABS

Consumer asset-backeds ratings remain stable. The same holds true for asset performance, though it clearly has peaked with some weakening likely in 2018 (though still well within Fitch's expectations). Prime auto and credit card losses will rise marginally off at or near record lows. Asset types likely to see more cracks in the armor are subprime auto and unsecured consumer loan (marketplace) ABS.

ABS deal performance remains largely in line with Fitch expectations and should continue to benefit from the solid macro environment and solid structural enhancements in place. Fitch

has either a Positive or Stable Outlook on over 97% of its rated ABS bonds.

Competitive pressures, long in place for subprime autos, are escalating in a marketplace ABS environment that is struggling to find its footing by testing recent underwriting models, asset quality and, in some cases, business models. Delinquencies and chargeoffs of existing assets continue to increase as marginal borrowers increase their leverage. Not likely to help is the drive for growth among large marketplace lenders coupled with rising market pressure from competing banks like Goldman Sachs (Marcus), Discover, and Suntrust. And unless originators tighten their credit policies with discipline, the strain will intensify.

CMBS

While ratings performance is stable, the outlook for asset performance is a bit murky. Pockets of concern heading into 2018 rest largely with CMBS 1.0 tail risk and technology-driven secular shifts, most glaringly in retail.

As the winding down of U.S. CMBS 1.0 continues, many of the remaining loans are adversely selected with approximately 40% of remaining loans delinquent. By contrast, CMBS 2.0 makes up well over 90% of U.S. CMBS and should be mostly stable with idiosyncratic risk being the biggest performance influence. Barbelling is also worth a close watch, as the trend of placing high percentages of credit opinion loans into deals continues.

Meanwhile, traditional brick and mortar retailers are struggling to keep up with the growth in online shopping, which will continue to place pressure on CMBS containing large amounts of Class B and C mall loans. Lower rated classes in deals with poorer performing regional malls may be subject to negative rating actions, many of which currently have Negative Rating Outlooks. Other secular shifts worth a closer look in 2018 will be with hotels with the advent of AirBnB and other alternative travel and offices as WeWork and other co-working alternatives gain ground.

RMBS

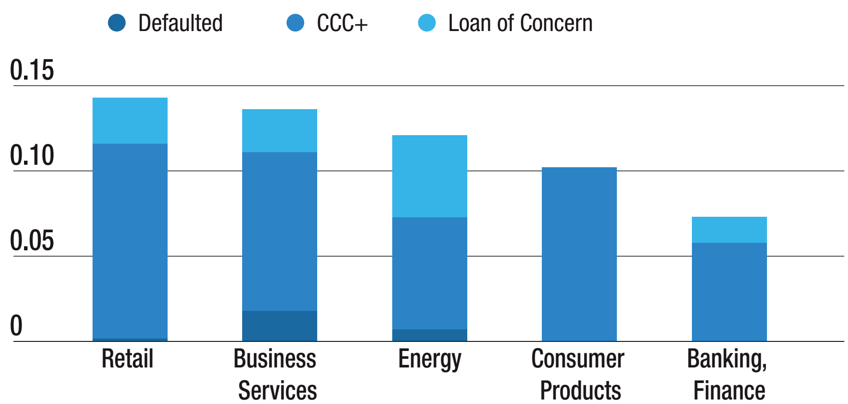
Both rating and asset performance of residential mortgage bonds are positive for next year. The sector will continue to benefit from excellent performance on RMBS that has come to market since 2010 and solid home price gains that are now sustainable throughout much of the country.

While the number of distressed mortgages is now back to pre-crisis levels, performance for post-crisis RMBS has been exemplary with losses near zero for prime jumbo RMBS.

Fitch expects home price growth to remain steady for most regions. The rate of price growth is still uneven nationally with prices in California, Arizona, Nevada and Washington up over 50% since 2012 and New York, New Jersey and Massachusetts home prices up less than half that figure over the same period. The country still has some overheated pockets such as Dallas, Phoenix, Riverside and Portland.

Limited exposure

The five industries where CLOs have the biggest exposure to defaulted or watchlist loans, as a percentage of their total assest



Source: Fitch Ratings

CLOs

The outlook for both CLO rating and asset performance remains stable in 2018. Chief catalysts include a relatively modest high yield default environment and the success of managers in navigating retail and commodity sector shocks.

Strong credit protection in place for 'AAA' notes has not changed much at all over the last few years. That said, lingering concerns exist with leverage multiples on underlying loans on the rise documentation standards showing signs of weakening. Other key credit metrics like weighted average spread could also come into some pressure in the coming months.

CLO managers have been effectively weathering troubles in both the retail and commodity markets by curbing exposure to both sectors. In fact, troubled exposure in Fitch-rated U.S. CLOs has declined to its lowest point in over a year. Fitch's most recent Leveraged Finance "Loans of Concern" list shows just under $10 billion in concerning among its rated CLO universe of over $167 billion, a manageable 6.2%.

In conclusion, 2018 is looks to be another strong year. There's positive momentum for RMBS and CLOs, though CMBS could see some marginal weakening in spots. Normalization is now in play for consumer ABS while asset performance risks should be largely contained to assets like marketplace and subprime auto ABS.

Rui Pereira is head of North American structured finance for Fitch Ratings

THE RISE OF AN

ASSET CLASS

The largest mortgage insurer is using GSE-style risk transfer in the private market

By Allison Bisbey

WHEN ARCH CAPITAL GROUP acquired United Guaranty Corp. last year from American International Group, one of the attractions was an innovative form of reinsurance modeled on risk-sharing programs developed by Fannie Mae and Freddie Mac.

Over the past four years, the two government-sponsored agencies have transferred the credit risk on hundreds of billions of dollars of mortgages they insure by selling bonds whose performance is linked to that of a pool of residential mortgages. If losses in these pools reach certain levels, the GSEs can hold on to the principal of the bonds. The risk-sharing programs serve as a kind of capital, because they reduce the likelihood of another taxpayer bailout.

Arch's new insurance-linked securities serve a similar purpose, according to James Bennison, senior vice president and head of capital markets.

Fannie and Freddie's flagship programs, Connecticut Avenue Securities and Structured Agency Credit Risk, look a lot like bonds that AIG and others use to transfer the risk of catastrophic insurance losses from natural disasters such as hurricanes and earthquakes. So when CAS and STACR were launched in 2013 and subsequently developed a strong investor following, AIG saw an opportunity to do something similar with private mortgage insurance. Under the insurance giant, United Guaranty completed two private transactions transferring risk on its own portfolio.

The first deal, for $298.9 million in 2015, was used to reinsure a portfolio of mortgage insurance policies issued from 2009 through the first quarter of 2013.

The second deal, for $298.6 million in 2016, was used to reinsure a portfolio of mortgage insurance policies issued in 2008 and prior years.

Arch is picking up where AIG left off. In October it completed a third transaction under the same program, dubbed Bellemeade Re. But this one has the benefit of a credit rating, from Morningstar Credit Ratings, which broadened the investor base. It transferred the risk from three of Arch's private mortgage subsidiaries, and not just United Guaranty. And the policies benefiting from this reinsurance were all underwritten in the first half of 2017.

Going forward, Arch plans to be a programmatic issuer, coming to market twice a year. It expects to complete another transaction in the first quarter of 2018 that will reinsure its production for the second half of 2017.

Bellemeade is more than just a way for Arch to diversify its sources of reinsurance, however. Bennison explains that the securities help it to meet capital required to do business with Fannie and Freddie — private mortgage insurance protects lenders from losses on mortgages with low down payments.

There's an important way that Bellemeade differs from CAS and STACR, however. Proceeds from the bonds issued are placed into a trust where they are held either until maturity or until they are needed to meet insurance claims. By comparison, CAS and STACR are both general obligation bonds. That means CAS and STACR investors are exposed to both credit risk and counterparty risk, as least as the programs are currently designed. Bellemeade investors are not taking on the same counterparty risk.

Just as important, according to Bennison, capital markets investors have a broad perspective on mortgage risk that is valuable in pricing insurance policies. "The feedback loop that's created will help [us to] appropriately manage a long-tailed risk," he said in a November interview with Asset Securitization Report.

No small thing, considering the losses sustained by the mortgage insurance industry following the credit crisis.

The program has already spawned at least one imitator. In April, NMI Holdings announced it had sold $211.3 million of 10-year mortgage insurance-linked notes in a private, unrated transaction called Oaktown Re. NMIH's subsidiary, National Mortgage Insurance Co., obtained reinsurance on an existing portfolio of mortgage insurance policies written from 2013 through 2016.

What follows is an edited transcript of Bennison's interview with ASR

ASR: The first two Bellemeade transactions were unrated; was the credit rating for the third transaction designed to broaden the investor base?

Bennison: The rating helped broaden the investor base. For example, it's the first Bellemeade transaction with any insurance company participation, which is a key investor class. Insurance companies run the gamut, but in this case, only one credit rating was sufficient. It just depends on the (insurance) company's internal guidelines.

How does the transaction help Arch with capital requirements?

One of the key considerations goes to the credit we get for the assets raised. They are placed into a trust, and the trust's assets are used to repay bonds or pay claims, in the event our first loss position is exhausted. We get credit in a couple of different ways: from state regulators, from the GSEs under the PMIERS [private mortgage insurer eligibility requirement] assets test and from the rating agencies that provide Arch's corporate ratings. When factoring all of these together, from a purely capital perspective, there's a strong incentive for us to continue to do this as it's an effective way for us to raise capital.

What else does the transaction accomplish?

We view the ability to go into the capital markets and price a portion of our risk

Conforming loans

The vast majority of mortgages being reinsured conform to Fannie and Freddie underwriting guidelines

Average balance - $244,023

Weighted average FICO - 744

Weighted average current LTV - 91.79%

Fixed rate - 94.8%

Owner occupied at origination - 97.2%

Source: Morningstar Credit Ratings

to be a key element in proactively managing the business. It provides feedback about how investors view the risk in our portfolio, which is a key observation we can use in determining how we price and adjust guidelines in taking mortgage risk on a go forward basis. This information feedback loop helps us to appropriately manage the long-tailed risk of mortgage insurance.

Given strong investor interest in the Bellemeade ILS, we believe that there is enough demand for us to issue these securities a couple times a year.

Can't investors become complacent about risk?

History suggests that mortgage insurers can be complacent, too. For this reason, it's best to have as many eyes as possible looking at what you do. Fixed-income investors are looking at a much broader swathe of the mortgage market than mortgage insurers. While we are in the conventional above-80-LTV space, investors like money managers, hedge funds and insurance companies invest in a broader range of mortgage credit and develop a perspective that we might miss.

Would it benefit Arch if other insurers develop similar programs; would a broader market benefit everyone?

Certainly. Fannie and Freddie's CAS and STACR programs influenced our thinking about what we could accomplish. Additionally, our transactions are truly insurance-linked securities not general obligation bonds, like CAS and STACR. We were also influenced by what had been done in the cat bond market. By being a regular issuer, we're in the best position to manage risk, and we hope to reduce volatility in the business.

What percentage of Arch's total mortgage reinsurance will the program provide?

That's not how we think about it. The goal isn't to achieve a particular mix of capital sources. Rather, we evaluate the total capital need for the business and consider the options available. Though this is one tool, it's one with a particular benefit because of the pricing and risk information we are getting from the institutional market. We can certainly go to the traditional reinsurance market; most of our peers are more active there. However, we find our approach to be more efficient and it provides us with specific information that we view as critical to managing the business effectively.

"We have a fairly robust banking group … that's intended to help support the secondary market."

Can't Arch's peers get the same information?

It takes a bit of an investment. It was expensive to get the Bellemeade program off the ground. We've already been through that and now we're benefiting. I suspect that other mortgage insurers haven't pursued this strategy because of the relative ease with which they're able to attract reinsurance versus the cost of starting an issuance program in the capital markets.

Is it meaningful to compare pricing of Bellemeade to CAS and STACR?

The liquidity premium we pay is real. Liquidity absolutely matters because we want to see good support in the second market. We have a fairly robust banking group on the deal; that's intended to help support the secondary market. More frequent issuance should help, but it's unlikely to ever trade on top of CAS or STACR.

But is it the same risk?

It's a different risk. We have the first-loss position on above-80-LTV loans, which puts Fannie and Freddie in secondary position if they do high-LTV loans. The GSEs' investors benefit from our mortgage insurance. In our deal, investors accept a little higher risk and [sit] lower in the credit structure for an individual loan. But the structure we're using offsets some of the additional risk they take. For example, credit enhancement on our transaction is 225 basis points for the B1 tranche, versus about 50 basis points for CAS or STACR. This reflects the fact that investors are taking deeper risk on the underlying loans, but have more protection via the structure.

Are Bellemeade investors getting exposure to the same loans as they are in CAS and STACR?

Arch MI is the largest mortgage insurer in the country. When investors take part in future CAS or STACR exposed to this vintage in January through June 2017, they will almost certainly have exposure to some of the same loans. They'll just be accepting a slightly different risk.

Appeals Court Limits Cramdown

The U.S. Second Circuit ruled that the silicon and quartz manufacturer should use a "market rates" formula to determine the appropriate payout for a series of replacement notes

By Glen Fest

Banks and other lenders scored an important victory in October when a federal appeals court issued an opinion restricting a debtor's ability to "cram down" a bankruptcy plan on senior secured creditors.

The decision by the U.S. Second Circuit Court of Appeals reversed a 2014 decision by the U.S. Bankruptcy Court for the Southern District of New York.

The appeals court ruled that Momentive Performance Materials should use what's known as a "market rates" formula to determine the appropriate payout for a series of replacement notes to be issued to bondholders. Momentive's Chapter 11 plan called for senior creditors to receive replacement notes bearing interest at substantially below market rates – an outcome that some argued could have made it more difficult for junk-rated companies to obtain financing at attractive rates.

"The alternative could have resulted in a road map for debtors to devise bankruptcy reorganization plans that cram down over-secured lenders with below market rate replacement notes rather than paying them in full, in cash," the Loan Syndications and Trading Association said in a statement posted on its website.

In 2012, Momentive, a silicone and quartz manufacturer controlled by Apollo Global Management, issued $1.1 billion of first priority senior notes due 2020 that paid 8.875% interest and $250 million of senior secured notes due 2020 that paid 10% interest. The company filed for chapter 11 in April 2104.

Its reorganization plan offered senior creditors a choice: They could accept new notes that paid lower interest and waive their right to a "make whole" provision entitling them to a premium on interest that would have accrued to maturity in the event of a prepayment. Alternatively, they would have to litigate their entitlement to the make whole provision and accept new notes paying even less – the applicable Treasury rate, plus a modest premium.

Holders of both classes of notes rejected the plan, but it was passed over their objections. Judge Drain accepted the debtor's argument that their proposed plan satisfied the cram as applied by the U.S. Supreme Court in a 2004 decision, Till v. SCS Credit Corp.

A U.S. district court subsequently upheld the bankruptcy court's decision.

But the appeals court disagreed. "We do not read the Till plurality as stating that efficient market rates are irrelevant in determining value in the Chapter 11 cramdown text," the court's opinion stated. "And, disregarding available efficient market rates would be a major departure from long-standing precedent dictating that 'the best way to determine value is exposure to a market.'"

The LSTA filed an amicus brief alongside the Managed Funds Association and the Securities Industry and Financial Markets Association backing the use of market rates to more accurately determine the value of what was owed.

"The issue to us was it was fundamentally wrong," said Elliot Ganz, senior counsel for the LSTA, in an interview. "Under [bankruptcy code] section 1129 you're required to do something that's fair and equitable and it seem to us that fair and equitable is not replacing par notes with a claim that is immediately significantly below par."

> **"Fair and equitable is not replacing par notes with a claim that is ... significantly below par."**

Although Momentive lost the decision over the rate formula, it won a bigger victory involving whether creditors could enforce "make whole" premiums on a bankruptcy filing. In that instance, the panel sided with Momentive and two lower court rulings that disallowed creditors from claiming they were due the make-whole premium that lenders normally receive from corporate borrowers who pay off loans early.

Leveraged Lending in Limbo

A GAO determination has effectively nullified banking guidance published in 2013; but that leaves the future uncertain about what, if anything, regulators will devise to replace it

By John Heltman

When a government watchdog's decision effectively scrapped federal regulators' guidance on leveraged lending, it was the culmination of a yearslong effort to roll back an action that the industry had long reviled.

But the move also left the future uncertain about what, if anything, regulators will devise to replace it and bankers on their own in determining how to treat such lending.

"It leaves things kind of in limbo," said Kevin Petrasic, a partner at White & Case and former Treasury and Office of Thrift Supervision official. "It doesn't negate the fact that the agencies have safety and soundness authority. [Banks] just don't have the comfort, if you will, in terms of clearly delineated guidance that was set out in the rule."

Bloomberg News

Sen. Patrick Toomey, R-Pa.

On Oct. 19, the Government Accountability Office said in a letter to Sen. Patrick Toomey, R-Pa., that 2013 guidance issued by the banking regulators was a rule, and as such was subject to the requirements of the Congressional Review Act. The decision meant that the regulators should have formally notified Congress of the guidance four years ago.

Because they didn't, regulators must resend the guidance to Congress, which then has a window to review and reject it. "This is an important reminder that agencies have a responsibility to live up to their obligations under the Congressional Review Act," Toomey said. "When they don't, Congress should hold them accountable. I will explore steps to do so."

The decision means regulators must now decide whether to reissue the guidance, revise it or let it drop entirely. In November, acting comptroller of the currency Keith Noreika ratcheted up the criticism by telling the Wall Street Journal that the standards "shouldn't be binding on anyone," and that a new joint agency statement revising the standards could be forthcoming.

The 2013 guidance was developed jointly by the banking regulators to address risks posed by leveraged loans — a $939 billion market of loans made to heavily-indebted corporate borrowers that are syndicated to multiple institutions and investors. The loans include financing for mergers and acquisitions as well as equity share buybacks and private-equity dividends.

The regulators issued the interagency guidance after noticing a sharp increase in leveraged loans since the previous guidance on the subject in 2001, and after identifying lax post-crisis underwriting for leveraged loans. (The guidance effectively established a 6x debt-to-EBITDA ratio cap on ns-bank-issued speculative-grade loans).

Since it was designed as a guidance, is was only intended to give banks uniform expectations about what the regulators' attitudes would be for leveraged loans. But Mike Alix, financial services advisory risk leader at PricewaterhouseCoopers, said that banks bristled at the guidance, fearing that nonbanks would just swoop in and steal the business and with no risk management benefit.

"This was a direct intervention in a particular business where the balance sheet risks to the institutions weren't really present," Alix said. "So it was a lucrative business for the banks, and the competitive forces in the market were such that there was worry about entities that weren't subject to the guidance being able to fill the void."

Because the guidance is now considered a rule for Ccongressional Review Act purposes and was never sent to Congress for review, the guidance cannot now be technically enforced.

Regulators are formally undecided on what to do with the GAO's report, but they have a few options. They could send the existing guidance to Congress for review, thereby either codifying it if Congress lets a 60-day legislative window pass without acting. But if regulators resend it, Congress could reject it.

Petrasic said that striking down the guidance via review might complicate whatever future moves the agencies pursue since under the law, regulators could not issue a guidance — or a rule similarly designed — to replace it.

"At that point, what is spelled out in the statute is that it ... effectively strikes down any similar iterations that could be sent back up," Petrasic said. "That means the regulators would have to take a somewhat different approach, and it couldn't be substantively too close to the [old rule]."

Alix said that may not be ideal, since banks aren't opposed to everything in the guidance and have spent a long time adapting to it. Having to change to an entirely new regime — and one that by definition can't resemble the old — might be more disruptive than helpful, he said. "I don't know what the great benefit is of unwinding all those things," Alix said. "They have some more freedom perhaps, but they've done the hard work to adapt to the guidance. The guidance has been out there for years."

Another option would be to develop a new guidance — or even a formal rule — that would embody the aspects of the old rule that banks accept and whittle down the sharp edges that bothered them.

"The [banking] industry will probably still be wary of going too far down the risk curve."

The Treasury Department previously indicated that leveraged lending was a top priority in its June report on banking regulatory reform, saying the 2013 guidance should be reissued for public comment and "refined with the objective of reducing ambiguity in the definition of leveraged lending and achieving consistency in supervision."

Wayne Abernathy, vice president of for financial institutions policy and regulatory affairs at the American Bankers Association, said the likely immediate effect of the GAO report is to move that recommendation up the list of concerns by regulators.

"There are a hundred-some recommendations in the [June] report, and another hundred or so recommendations in the October report, and the question is where they go in the priority list," Abernathy said. "This decision maybe moves it up."

In the meantime, the agencies could also do nothing, since the guidance is already unenforceable and there are greater risks associated with moving too quickly. But that leaves banks without any bright lines on what might be an acceptable leveraged loan.

Alix said that one of the biggest problems with the guidance was the effect that it had on banks' ability to know their own risk, since the definition of a leveraged loan under the guidance was often more expansive. That makes models less precise, and often overestimates the firm's risk exposure. But the guidance's de facto rescission isn't likely to result in a bonanza of new leveraged loans.

"The best outcome for the industry is probably the freedom to make their risk underwriting decisions according to their own risk tolerance, rather than having to adhere to prescribed distinctions by the regulators," Alix said. "But the industry will still probably be wary of going too far down the risk curve."

Abernathy agreed, saying that while the guidance may be gone, banks are unlikely to use this opportunity to move forward with loans they wouldn't have pursued otherwise — at least not without asking your regulator first.

"Banks are by nature cautious enterprises," Abernathy said. "I would doubt that they would want to go forward with some kind of leveraged lending that is clearly in violation of the existing guidance. But it maybe creates an opportunity to have a conversation with your regulator."

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Asset Securitization Report

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Kennedy Glasscock, Business Development Manager

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Our technology is robust and battle tested by billions of dollars of assets administered daily. We have fully integrated other best-in-class software- like SunGard's VPM for portfolio accounting and Misys FusionBanking Loan IQ for core loan agency functions. With the addition of Alphakinetic in 2017, we have significantly enhanced our trade order management, portfolio analytics, and credit research technology for the front office.

If you'd like to know more, please contact us:

Kennedy Glasscock, Business Development Manager
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Fannin St. 17th Floor Houston, Texas 77002
call: (713) 993-1039 **email:** Kennedy.Glasscock@virtusllc.com **visit:** www.virtusllc.com

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A look behind the scenes: The essential role of CLO Trustees

U.S. Bank Global Corporate Trust Services is a leading provider of corporate trust services in the United States and Europe. With a network of more than 50 domestic offices and two international locations, we have the resources, expertise and financial strength that few in the industry can match. Our tenured teams provide expert guidance through our full array of services, including CLO trustee services, custodial services, bank loan administration and loan closing, loan agency, and middle office services.

David Keys, Senior Vice President, Head of CDO Relationship Management
U.S. Bank Global Corporate Trust Services

Global CLO issuance is on track for well over $110B. What are you seeing as major trends in the market?

Investor appetite is strong and CLO issuance is approaching record territory as managers have implemented their risk retention strategies. Even as loan supply remains tight and collateral spreads continue to shrink, managers are coming to market with new transactions and service providers are working to improve operational efficiency. As a CLO trustee, bank loan custodian and middle office service provider, we are seeing innovation during the deal warehouse period to better comply with risk retention. Additionally, we are noticing increased focus around trading and settlement following the recent market adoption of the new delayed compensation rules.

Could you expand on the role of a CLO trustee and the value they can bring to a transaction?

A CLO trustee serves as the conduit between the CLO manager and investors, administering the bank loan collateral, modeling the transaction and distributing investor payments and reports. The core responsibilities of a CLO trustee have remained largely unchanged; however, the execution has changed drastically with the implementation of new technology and processes that have improved overall market efficiency. CLO managers need to partner with a stable, proven trustee that provides operational experience, a proactive approach to the business and a modern technology platform. Complications from the bank loan asset class can accumulate quickly, and a committed trustee can be a valuable partner through the life of a CLO.

What operational elements should CLO managers and investors consider during different stages of the CLO lifecycle?

Each deal milestone presents unique challenges that must be addressed with a carefully considered approach. As CLO managers are working to build par during the warehouse and ramp-up periods, operational expertise can help ease the burden during that stressful time. The account structure and flow of funds for risk retention vehicles is far from an operational afterthought, given the importance of compliance considerations. Relationships between custodians, arrangers, investors and CLO managers are especially important as customized warehouse reporting and the ability to manage tri-party reconciliation improves efficiency of the closing process. Following a successful ramp-up period, the CLO Effective Date approaches and requires the diligent build and reconciliation of compliance tests. Later in a deal's life, as the opportunity to refinance or reset the CLO notes arises, document negotiation experience and efficient investor notice posting can save time and money. Regardless of the point in a CLO's lifecycle, clear communication between all involved parties and preparation in order to act promptly gives investors, managers and their service providers a clear advantage.

What operational changes and trends are developing in the market?

The bank loan asset class is evolving and trends around streamlined, accelerated loan settlement and increased transparency into asset characteristics are underway. These contribute to improved economics with shorter settlement times and individual data points fueling more powerful analytics. Self-service reporting, online portal interaction between transaction parties and data delivery through customized feeds are also driving efficiencies and streamlining daily operations. Service providers are exploring transformational changes through the application of distributed ledger technology, which could revolutionize the industry and its operations. We're excited to be at the forefront of this evolution.

CLOs Take Their Rightful Place In The Spotlight

BY DAVID ADLER

Collateralized loan obligations (CLOs) were once easily overlooked by investors who might have confused them with similar sounding alphabet soup investments that stumbled badly during the crisis. But CLOs are getting a well-deserved second look: their solid performance during the crisis, high yields, and floating rate features have propelled them into the spotlight. New issuance is approaching record highs, at $92 billion dollars through October 2017, according to Thomson Reuters figures, which is already higher than all of last year combined.

Investors new to CLOs might justifiable view them as complex investments, but an understand of the basics should make their positive attributes clear. A CLO is a structure that invests in a diverse pool of U.S. senior secured loans. These loans are usually backed by collateral. They also tend to be floating rate, meaning when interest rates go up, so does the interest paid by the loans. The CLO manager issues debt and equity to finance its investment in the pool of loans. Payments are made in cash flow "waterfall" with debt tranches holding the highest priority. CLOs are actively managed, allowing the manager to take advantage of arbitrage opportunities.

The importance of CLOs for investors is the structure allows investors with different risk appetites to select tranches for their risk tolerance.

-Kevin Kendra
Fitch U.S.
Structured Credit

"Investors find CLOs attractive today because they have stood the test of time – and of the financial crisis," says R. Bram Smith, Executive Director of The Loan Syndications & Trading Association (LSTA). His colleague, Meredith Coffey EVP – Research & Regulation at the LSTA adds, "Specifically, CLO default and loss rates were miniscule – far below equivalently rated structured products and plain vanilla corporate bonds. Moreover, CLOs today provide a yield pick-up relative to these other products. Thus, a remarkable combination of lower risk and higher returns."

CLO debt tranches have had very low historical default rates. The highest rated tranches, AAA or AA, never suffered a default during the financial crisis. Though the crisis is now firmly in the rear view mirror, a danger ahead is the possibility of rising interest rates. Federal Reserve Chairwoman Janet Yellen has hinted throughout the year that the Fed will raise interest rates, but no one knows when exactly. Rising rates pose problems for existing fixed income investments. In contrast, CLOs, because they are floating rate, are a natural hedge for interest rate risk.

Kevin Kendra, head of Fitch's U.S. Structured Credit group, says, "because CLOs are a floating rate asset class, even with spreads tightening the appeal is stronger than ever relative to other asset classes." He observes that the CLO investor base has broadened. Domestic U.S. demand from banks and insurance companies has always been a constant, but it has been supplemented by new demand from institutional investors in Japan, Korea, China and Australia, as well as sophisticated high net worth individual investors.

Beyond the floating rate aspects, the design of the CLO structure itself hold appeal for investors. Kendra say, "The importance of CLOs for investors is the structure allows investors with different risk appetites to select tranches for their risk tolerance." Investors who are extremely concerned about losses can select the highest rated debt tranches, whereas those seeking the possibility of outsized returns can choose equity investments.

Additionally the CLO structure is self-correcting, with various performance tests to make sure the CLO can meet its cash flow objections. More recently, CLOs have been subject to "risk retention rules," requiring that managers retain some of the risk of a CLO. This rule further aligns the interests of CLO managers and investors.

Can the market handle the inflows?

Investors might have reasonable worries about whether the market can handle all the newfound investor interest in CLOs. "Strong demand for the loan asset has overwhelmed the supply of assets but we saw pick-up in the deal pipeline after Labor Day and arrangers are hopeful for more transactions which would boost the pipeline in the new year.," says Ioana Barza, Director of Analysis, Thomson Reuters. Given strong demand, the ability of companies to reprice the underlying loans has made the arbitrage performed by the CLO manager more challenging, but as Barza points out, "spreads on liabilities have tightened as well, helping to ease that pressure."

The credit cycle might be another concern for investors. But Fitch's Kendra says, "While we expect another credit cycle at some point, we haven't seen any erosion in fundamental credit quality yet and we still expect growth in the US economy. We are very comfortable with the ratings we have assigned."
This is not to say CLOs are not without many other risks only some of which can be anticipated. For instance, the boom in private equity, which is driving so much of the loan market, could end. And if history is any guide, the underlying loans experience periods of occasionally illiquidity and CLO investors need a long enough time horizon to be able to ride out this risk.

Finally, any "hot" investments such as CLOs bring with them other risks, beyond just the obvious one of an overheating marketing. A key one is operational concerns. The structure requires the involvement of many different parties to get deals off the ground. Are there bottlenecks?

Hugo Pereira, Senior Market Analyst at Thomson Reuters says, "while a shift in investor preference and a sudden market dislocation all have the potential to disrupt CLO issuance, these are not constraints with regard to the mechanics of structuring a deal." This good news about operational capabilities should help ease investors' concerns about limits to growth to the asset class.

What's next for CLOs?

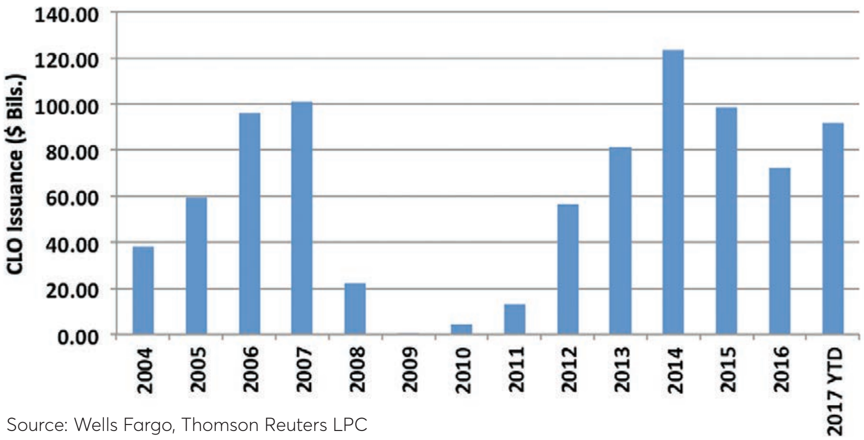
Investors in CLOs have already been aware of their positive characteristics including comparatively high yields and the low default record of debt tranches. In another words, CLOs haven't really changed. What is new is that they are finally getting more attention, and so attracting a broader investment base. "Post crisis there was an educational process about loans themselves as well the CLO vehicle and so new investors have been getting comfortable with CLOs," says Barza. Though CLOs are still not yet a truly mainstream investment, they are undoubtedly becoming a better-known one.

And the CLO industry has been able to overcome some past hurdles to growth. When the risk retention rules were initially rolled out, there were worries it would impair the size of the CLO market. However, Barza says, "CLO managers have been able to find solutions for the risk retention rules, and although this is an ongoing challenge, the slowdown in new CLO issuance didn't happen as expected." In fact, quite the opposite took place and both demand and supply of CLOs are robust today.

Specifically, CLO default and loss rates were miniscule – far below equivalently rated structured products and plain vanilla corporate bonds.

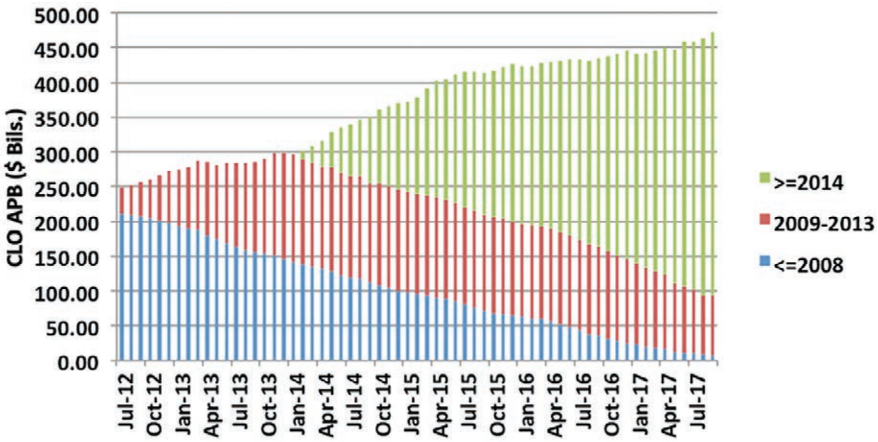
-Meredith Coffey
The Loan Syndications & Trading Association

U.S. CLO New Issuance ($B)

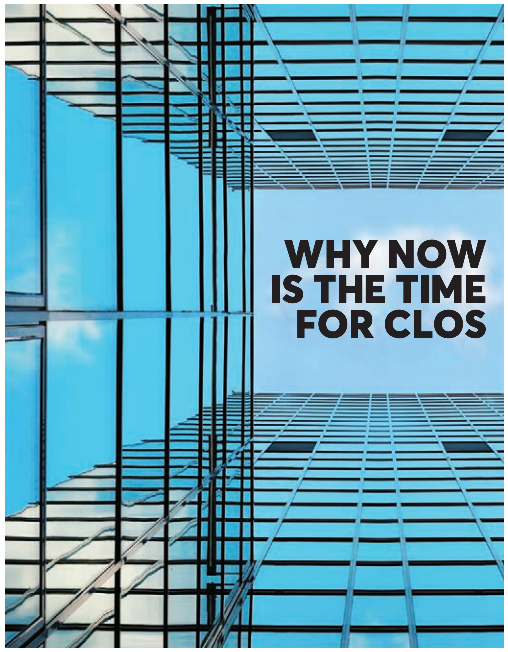


Source: Wells Fargo, Thomson Reuters LPC

CLOs Assets Under Management ($B)



Source: Thomson Reuters LPC Collateral



A SUPPLEMENT TO

Asset Securitization Report

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Refis for Medical Residents

SoFi, Darien Rowayton, as well as several upstart student loan lenders see them as strong credits with high earnings potential, despite their low incomes

By Allison Bisbey

Heavy load

Median indebtedness of students graduating from medical school in 2017; figures exclude graduates with no debt

Total debt: $192,000

Premedical education: $25,000

Medical education: $180,000

Credit cards: $5,000

Residency/relocation loans: $12,000

Source: American Association of Medical Colleges, Social Finance

When the online lender Social Finance recently unveiled its latest refinancing product, it put a spotlight on a perhaps overlooked corner of the student loan market: medical residents.

SoFi launched an offering in October designed specifically for medical school graduates who practice in a residency program at a hospital or clinic. The company is following in the footsteps of established players like Darien Rowayton Bank and several upstarts.

Yet the move is notable not only because of the disruption it could create in a once low-profile niche, but it also shows how lenders are trying to use data to mine untapped business opportunities right under their noses and pitch those credits to investors.

Medical school students graduate with an average debt load of $190,000 but are typically paid no more than $60,000 a year during residency, a fraction of their eventual earnings potential. So the savings offered by refinance loans are extremely attractive. Yet their low incomes may disqualify them for standard refinance loans.

SoFi's new product allows residents to consolidate their existing loans and make a single, $100 monthly payment during residency or fellowship. Full repayment starts once borrowers have completed their training; or up to 54 months. Repayment terms range from five to 20 years; both fixed and variable rates are available.

Meron Colbeci, SoFi's senior vice president of product management, said it was developed in response to customer feedback and data which showed that medical residents would not qualify for the company's loans. "Residents did not have enough cash flow," he said.

Because medical residents earn far less than a licensed and practicing doctor, SoFi projects future income to determine if a borrower has the ability to repay student loans upon completion of a residency program.

SoFi will have to square off against several competitors, however. There are already at least two refinance lenders that cater exclusively to medical professionals, including those still in residency: LinkCapital and Splash Financial. Darien Rowayton Bank also offers a medical residency refi loan in addition to its standard refinance loans for graduates with a broader range of degrees and good paying jobs.

There's no question that medical residents are good credits, nearly as good as fully practicing doctors.

"Failure to complete [residency] is less than 1% after adjusting for program transfers, and once they do, the placement rate is almost 100%," said Rich Rein, the chief financial officer and head of capital markets at LinkCapital.

Borrowers who fail to complete their residency, perhaps because they decide that they don't care for their chosen specialty, are still highly employable in areas such as biotech research or medical technology. "The big risk comes down to timing — will they complete a program on schedule," Rein said.

Yet funding residency loans can be tricky because these loans are negatively amortizing. The unpaid interest that accrues during residency is eventually recapitalized, adding to their debt load.

For many potential loan buyers, even banks, "there's a mindset, they want a current-pay asset," Rein said. The fact that residency loans offer higher returns than standard refinance loans, because they pay slightly higher interest rates, fails to sway some investors.

Prepayment profiles of residency loans are also tricky. Prepayments on typical refinance loans are pretty high, as high as 15% to 20% a year in pools of securitized loans rated by the credit rating agency DBRS, because the borrowers tend to have a lot of disposable income that allows them to repay their loans ahead of schedule. The opposite is true of residency loans; yet once they are fully practicing, borrowers may have an incentive to refinance again, if they can get a slightly better rate based on their current income.

For this reason, LinkCapital's residency loan features a fixed rate of interest that steps down to a predetermined level once borrowers complete their training. This results in a lower annual percentage rate over the life of the loan than on the loans the company offers fully practicing doctors, but it also takes away some of the incentive for a borrower to refinance.

LinkCapital has been lending since mid-2015, and to date all of its funding has come through whole-loan sales, though some of the buyers have subsequently securitized these loans.

Splash Financial is an even newer entrant. It launched a residency refinance loan this summer that is funded through forward-flow agreements with banks. The monthly payment while borrowers are in residency is just $1 a month, as opposed to the $100 for borrowers who refinance with SoFi, LinkCapital or Darien Rowayton. But the unpaid interest is capitalized monthly rather than at the end of the residency.

Steve Muszynski, the company's CEO, said the low monthly payment is a selling point, at least for borrowers. "One dollar a month really helps when you are cash poor," he said. "We explain to banks and utilize historical data on losses in our analysis; that $300 doesn't even cover the interest, so what's the difference between that and $1?"

"This is a group of individuals that is incredibly intelligent, but has not had much financial training."

While many medical school graduates go into some kind of loan forgiveness or repayment program while in residency — 47% of the class of 2017, according to the Association of American Medical Colleges — they may still have monthly payments of several hundred dollars.

Refinancing is "the difference between living in a nice apartment versus one that is not so desirable, between going out to dinner, traveling a bit," Muszynski said. He said Splash has worked with medical residents who have been taking out high interest credit cards to pay for such expenses. "They're swapping one type of debt for another. This is a group of individuals that is incredibly intelligent, but has not had much financial training."

SoFi's entrance into the residency refi market has forced Splash to rethink some of the features of its product. Some of the shorter terms that SoFi offers allow it to advertise very low interest rates, even if a five- or seven-year loan might not make sense for many medical residents since it usually takes them far longer than that to fully repay.

So Splash is mulling whether to expand the range of terms it offers, just to make its products more easily comparable to those offered by SoFi and others. Splash may also eliminate features that can be perceived as negative. An origination fee is being removed Nov. 17.

The company may also change its capitalization policy. "Capitalization is a function of interest rates," Muszynski said. "We do it monthly, and they do it at the end of the [deferral] period. [Our] all-in cost should still be lower, but it's confusing to borrowers. We're trying to eliminate any confusion and clearly present the strongest product in the market."

Negative amortization may be a tough sell for some banks and other investors in whole loans, but Darien Rowayton has had no problem funding residency refinance loans in the securitization market. They represent 11.4% of the outstanding balance of the bank's most recent transaction, the $300 million Laurel Road 207-C, which priced in early November. In fact, DBRS thinks that the inclusion of medical residency loans may actually increase the appeal of such bonds for investors. That's because the loans may help moderate prepayment speeds, which have been a concern for investors in these deals.

Auto Lenders Brace for Losses

They are starting to tally the financial damage from late-summer hurricanes that destroyed an estimated 500,000 to one million vehicles

By Kevin Wack

U.S. auto lenders are starting to tally the financial damage from late-summer hurricanes that destroyed an estimated 500,000 to one million vehicles.

So far, the impact on lenders has been relatively small, since many are offering forbearance to car owners who are struggling to rebuild their lives. Moreover, the biggest U.S. auto lenders have less than 10% market share, so hurricane-related losses will be spread widely, hitting banks, credit unions and the financing arms of automakers.

Still, the industry's eventual losses seem likely to run into the hundreds of millions of dollars across Texas, Florida and Puerto Rico. Major auto lenders such as Ally Financial, Wells Fargo and Capital One have significantly boosted their loan-loss reserves in anticipation of higher default rates.

Loans with longer terms, as well as loans to borrowers who have little equity in their vehicles, are more vulnerable when borrowers default, since insurance proceeds are less likely to cover lenders' losses in those situations, according to Fitch Ratings.

The costs to specific banks hinge largely on their geographic footprint. Wells Fargo has significant exposure in Puerto Rico, where damage estimates are emerging more slowly than they did in Texas and Florida. A Wells Fargo subsidiary, Reliable Auto, is the largest vehicle financing company on the storm-ravaged island.

Bloomberg News

Wells said during its third-quarter earnings call that it built its reserves by $450 million to plan for hurricane-related losses.

The $1.9 trillion-asset bank did not say how much of that total is related to auto loans, however.

Capital One set aside $23 million during the third quarter for higher future expected losses on auto loans as a result of the hurricanes.

Ally Financial, one the nation's largest auto lenders, set aside $48 million during the third quarter because of the hurricanes. "We would expect higher chargeoffs over the coming few quarters due to the localized impact of the hurricanes, which we've largely provisioned for," CEO Jeffrey Brown told analysts on a conference call.

Ally also insures the vehicle inventories held by auto dealers. The company said that it absorbed an additional $19 million in losses in that business, but that some dealers did not file claims because they were able to move vehicles from potential flood areas to higher ground.

Because auto lending is so fragmented, the impact of credit losses on any single institution "should be relatively manageable," Fitch analyst Michael Taiano said in a recent research note.

S&P Global Ratings expect the hurricanes to have a bigger impact on subprime auto lenders than on firms that focus on more creditworthy borrowers, who tend to have more equity in their cars.

Santander Diving into Subprime

Even as others flee, the Dallas consumer lender says it plans to boost subprime originations again after retooling its portfolio and taking stock of the economy

By Kristin Broughton

After several months of playing it cool in the red-hot subprime auto market, Santander Consumer USA Holdings is getting ready to once again boost production.

During a conference call Oct. 27 to discuss quarterly earnings, Santander Consumer executives said they plan once again to rev up lending to auto borrowers with blemished credit, emphasizing that they feel encouraged by positive signs in the macroeconomy, such as low unemployment and strong overall growth.

Its total auto originations fell 3% in the third quarter from a year earlier, and 9% from the previous quarter, to just under $5 billion.

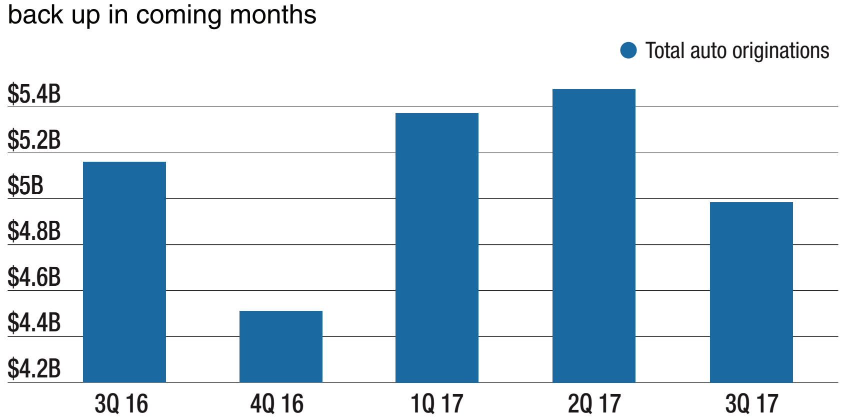
Santander attributed the decline to its disciplined underwriting. The subprime auto market, of course, has been marred by risk-taking, delinquencies and worries among investors about underlying credit quality.

"As we think about the market going forward, I think our outlook is less negative than it was earlier this year," CEO Scott Powell said in an interview prior to the call.

The company did not provide details about how much volume it expects to add. Originations for prime borrowers, with credit cores above 640, are also expected to increase, as the company looks to expand its dealer partnership with Chrysler. As of Sept. 30, the average FICO score in the company's loan book was 605.

Ready to reset?

Santander Consumer has pulled back on auto originations twice in the past four quarters on subprime concerns. However, it could build volume back up in coming months



Source: The company

The strong lending projections, Powell said, underscore what's turning into "a positive, pivotal year" for the Dallas auto lender, which has struggled in recent quarters with everything from regulatory headaches to accounting woes. The company — a division of the Spanish banking giant Banco Santander — declared its first dividend in three years; the Federal Reserve in August lifted restrictions on its ability to distribute capital. Santander is still working through two separate Fed orders.

It also recently overhauled its executive suite. Powell was named CEO in August, replacing Jason Kulas. Earlier the same month Juan Carlos Alvarez de Soto, previously corporate treasurer for the U.S. parent company, was named Santander Consumer's chief financial officer, succeeding Izzy Dawood.

Still, quarterly earnings continue to drag. The company reported profits of $199 million, or 6% less than a year earlier. Earnings per share were 55 cents, or 9 cents higher than an estimate of analysts polled by Bloomberg.

The pullback in originations weighed on net finance and interest income, which slid 10%, to $1.1 million. Credit quality improved, however, as the provision for credit losses — a closely watched metric at the company — fell 12% to $563.4 million.

Santander operates a call center in Puerto Rico, which suffered extensive damage from Hurricane Maria but is now back up and running.

CRE Regulation Passes House

A bill that would ease Basel III capital requirements on commercial real estate loans could spur more construction lending if it passes in the Senate

By Brad Finkelstein

A bill that would ease Basel III capital requirements on commercial real estate loans could level the playing field between depository and nonbank lenders and spur more construction lending.

The Clarifying Commercial Real Estate Loans Act, H.R. 2148, codifies and clarifies exemptions to the requirement that high-volatility commercial real estate loans carry a 150% risk weight for capital retention purposes. The bill passed the House on Nov. 7 and now heads to the Senate.

HVCRE lending is a subset of acquisition, development and construction loans that applies to commercial properties being built. The current Basel III requirements forces banks to keep more capital on their books for these loans, resulting in higher borrowing costs compared to other lenders not subject to Basel III.

"Many of these changes are just very practical adjustments to conform the rule better to the way real estate development is conducted," said Gregg Loubier, a partner in Alston & Bird's Finance Group. Some banks were cautious and classified all construction loans as HVCRE to avoid regulatory problems. Others, typically smaller banks, only made loans that qualify for the exemption to avoid the capital hit.

It also benefits the bridge lending space by removing from HVCRE status loans for improving income-producing properties under certain conditions, such as when cash flow is sufficient to support the debt service and the expenses, Loubier added. The current exemptions include a loan-to-value test and a separate prerequisite that the borrower has contributed 15% in cash equal to the property's as-completed valuation. If the borrower has those in place, the risk weighting drops to 100%.

The bipartisan bill redefines the valuation standard to stabilized value. It also creates an exit ramp that should move loans out of the HVCRE category when they reach certain milestones, allowing them to be reclassified as permanent financing. Permanent commercial loans have a 100% risk weighting.

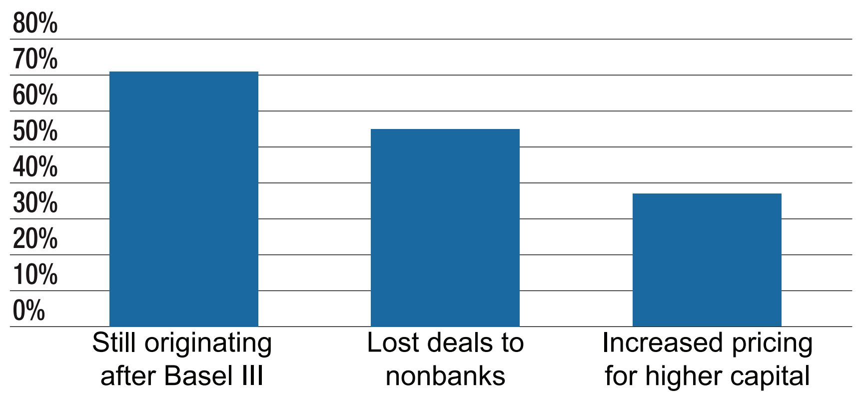
If passed, banks should be used more often as a capital source for construction loans, said Bruce Oliver, the Mortgage Bankers Association's associate vice president for policy in the commercial and multifamily group.

"What it does is it helps level the playing field, making banks a more competitive source because some of the requirements under the HVCRE rule are not well aligned with risk.," he said.

That higher capital charge reflected in loan pricing makes banks less attractive for an AD&C loan when other commercial real estate lenders could offer a lower interest rate, including life insurance companies, commercial mortgage-backed securities issuers and debt funds, none of which are subject to Basel III capital requirements, added Ashley Gunn, associate director of the MBA's Commercial/Multifamily Group.

Capital crunch

Banks with high volatility commercial real estate loans on their books report challenges after Basel III took effect



Source: American Bankers Association

Impac Preps for Securitization

The mortgage lender's nonqualified mortgage origination volume increased 248% year-over-year in the third quarter across all origination channels

By Brad Finkelstein

Impac Mortgage Holdings' nonqualified mortgage origination volume increased 248% year-over-year in the third quarter as the company accumulates loans for a planned securitization next year.

Because they are higher-margin products, Impac has emphasized growing non-QM production and government loan originations. Combined, these products made up 35% of its total originations of $2.1 billion for the third quarter. Last year, Impac originated $4.2 billion in the third quarter.

The retail channel produced $1.4 billion, with correspondent adding $376 million and wholesale contributing $282 million. In April, Impac sold $56 million of common stock to capitalize the growth and eventual securitization of non-QM originations.

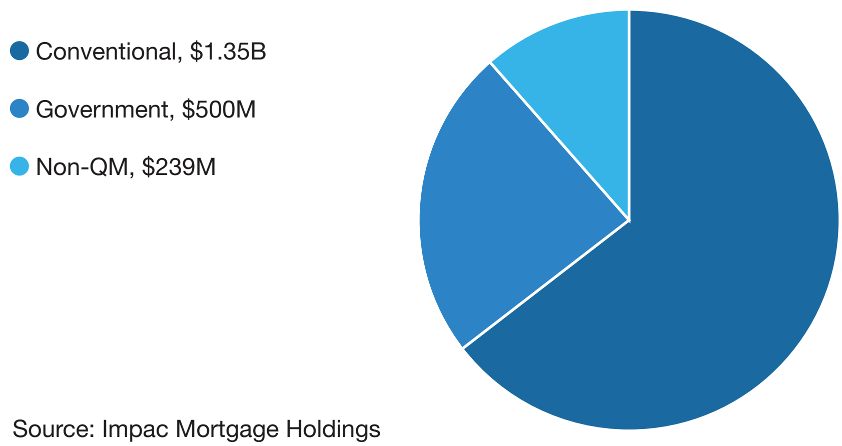
The Irvine, Calif.-based mortgage banker originated $239.4 million of non-QM loans during the third quarter, compared with $68.9 million one year earlier. The wholesale and correspondent channels combined for 74% of non-QM originations, with the remainder coming through the retail channel.

In the first three quarters of 2017, Impac originated $656.2 million of non-QM loans, with a weighted average credit score of 726 and a weighted average loan-to-value ratio of 64%. For all of 2016, it did $289.6 million in non-QM volume.

Originations of government-insured products increased year-over-year to $499.7 million from $439.2 million.

Looking for revenue

Impac increased its share of government and non-QM production to 35% from 12% last year to boost its margins



Source: Impac Mortgage Holdings

"Since the end of the third quarter, we have seen our non-QM and government production grow across all origination channels," Impac Chairman and CEO Joseph Tomkinson said in a press release. "We still anticipate securitizing our non-QM production in the first quarter of 2018, which will be a significant milestone for the company."

Impac had net earnings of $2.3 million in the third quarter, down from $16.5 million one year earlier. The drop in origination volume, combined with significantly lower gain-on-sale revenue ($42.5 million versus $113.2 million for the third quarter of 2016) and margins (204 basis points versus 268 basis points), were the primary causes.

Impac's servicing portfolio increased 66% compared with the end of the third quarter in 2016, $15.7 billion from $9.5 billion as the company elected to retain more mortgage servicing rights.

As a result servicing fees increased to $8.5 million from $3.8 million. But because of prepayments driven by lower interest rates in the third quarter that affected the fair market value of the portfolio, it had a $10.5 million net loss on its MSRs.

"Prepayments in the servicing portfolio remain high, causing a write-down on the mortgage servicing assets. However, as our servicing portfolio continues to grow, it is generating significant and stable quarterly revenue, in excess of $8.5 million a quarter," Tomkinson said.