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THE RETENTION RISK-OFF TRADE

CLO managers have begun rewording amendments on new refinancings. The goal: position deals to benefit from the potential repeal of risk-retention rules

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EDITOR'S LETTER

CLO Relief

For some time, the asset-backed markets have been rallying amid expectations for both fiscal stimulus and regulatory relief. The biggest plum for collateralized loan obligations would surely be the repeal of rules requiring managers to keep 5% of the economic risk in their deals. They've long argued that they should be exempt, since they are asset managers that acquire, but do not originate, leveraged loans.

Now some CLO managers appear to be so convinced of the possibility risk retention will be repealed that they are amending deals so as to be able to take advantage. This is mainly an issue for deals that were initially grandfathered from the rule, and then took advantage of a workaround allowing them to refinance, but only once, without triggering the need to comply. The problem: If Dodd-Frank is repealed, they would not be in a position to benefit. Language used in their refinance documents precludes them from refinancing a second time.

So managers are starting to use different language in both new-issue and CLO refinancings allowing them to refinance a second time, in the event risk retention is repealed.

That's not to say the CLO industry has spent the last several years grappling with risk retention rules for nothing. In a Q&A, Sean Solis, a partner at Dechert, sees a possible upside to the complicated structures that managers have used to put themselves into compliance. He says they have attracted some new capital to the market.

Another potential form of relief for CLOs could come from distributed ledger technology. Synaps Loan, Credit Suisse and financial services consortium R3 say they have successfully demonstrated that blockchain can be used to syndicate, trade and make payment on leveraged loans. That would be a real boon for a market where it can still take weeks to complete trades.

—Allison Bisbey, Editorial Director

Words Matter for Student Loans

Borrowers have had an uphill battle maintain a class action against student loan servicers; this could change as a result of the Trump administration's efforts to dismantle the CFPB.

By Joseph Cioffi

Maintaining a federal class action concerning consumer rights has been historically difficult when there is a pending, competing government action. The difficulty arises from the so-called "superiority" requirement, which requires federal class action litigants to demonstrate the superiority of a class action relative to other available means of adjudication.

This obstacle, however, may soon be easier to overcome if courts begin taking notice of the president's desire to dismantle the Consumer Financial Protection Bureau and scale back regulations designed to protect consumers. The president's campaign rhetoric and post-election plans regarding student loans may support a decision that a class action lawsuit is a more reliable and superior way to enforce borrower rights relative to a competing action by a weakened CFPB or an inherently weak successor agency.

Even before any of the Trump administration's proposals become law, Navient, the nation's largest student law servicer, is seeking to have the CFPB's pending case against it dismissed on the basis that the CFPB "is not permitted to bring an enforcement action for unfair, deceptive or abusive acts or practices . . . without first promulgating regulations defining what is unlawful." If the court accepts Navient's position, the result could be a boon to plaintiffs seeking to maintain class actions against Navient. It appears Navient is poised to accept that consequence. However, beyond the issue of the CFPB's current authority, if the regulatory landscape changes in ways proposed by the new administration, ironically, Navient and other defendants will likely find they need to defend against similar and possibly stronger arguments by plaintiffs seeking to maintain class actions in the wake of weakened or compromised enforcement power of the CFPB or its potential successor.

President Trump certainly appears poised to follow through on his campaign promises of less regulation and reducing the CFPB's enforcement power. In fact, the continued existence of the CFPB is not at all certain: The House Financial Services Committee recently approved the President's bid to begin replacing Dodd-Frank. In its current form, the Financial CHOICE Act would rename the CFPB the "Consumer Law Enforcement Agency" and prohibit the agency from commencing any enforcement actions against financial institutions without congressional approval.

Although passage by both houses of congress may require some scaling back of these proposed "reforms," any final version could nevertheless preserve the original intent of stripping power from the agency and reducing its independence, thus creating more uncertainty as to whether government action is the preferred means of protecting student loan borrowers and consumers.

The president and his administration, in turn, at best have been sending mixed signals to the student loan industry. Candidate Trump stated that the government should not be making money on student loans and the president has trumpeted plans to assist student loan borrowers. For example, the president has proposed reducing the amount of time borrowers would have to pay under income-based repayment plans before their loans could be forgiven.

DeVos and the Department of Education, however, have suggested or taken action that could exacerbate the student debt crisis. For example, DeVos recently reversed a rule preventing student loan guarantee agencies from collecting default interest from borrowers who enter into a repayment agreement within 60 days after receiving an agency's default notice. Additionally, the DOE recently suggested that the government could renege on approval letters qualifying certain borrowers for debt forgiveness under the Public Service Loan Forgiveness program.

On balance then, the direction seems to be one of less, not more, regulatory protection for student loan borrowers. This could lead to courts applying more favorably the judicial standards that would allow class actions to proceed, permitting an alternative means of regulation through litigation.

Joseph Cioffi is chair of the insolvency, creditors' rights and financial products practice at Davis & Gilbert.

Big GSE Risk: Doing Nothing

Congressional action to reform housing finance is ultimately needed, but we must confront the risk of continued drift and inaction if Congress is unable to act.

By Scott Olsen

We are approaching the 10th year of the conservatorship of Fannie Mae and Freddie Mac, yet Congress continues to struggle to produce a comprehensive reform bill for the government-sponsored enterprises. GSE reform has stalled as Fannie and Freddie — which must sweep their profits to the Treasury — are projected to have zero net worth at the end of this year.

But there is good news. The GSEs have repaid their original $185 billion advance to Treasury, plus another $70 billion in funds to taxpayers. Significant reforms have been made to the old "private gain, public loss" GSE model, including an end to no-documentation loans resulting from new mortgage regulations, significant credit risk-sharing, a wind-down of the GSEs' portfolios and the development of the Federal Housing Finance Agency into a strong regulator.

Congress should try to reach consensus on GSE reform, but we should not wait indefinitely for Congress to act. Last month, the Community Home Lenders Association proposed a comprehensive reform plan that would not require congressional approval. This proposal builds on the reforms already in place, removes the taxpayer risk of Treasury continuing to advance cash to the mortgage giants, and relies on the expertise of the FHFA and Treasury to implement the plan.

The housing finance system should be rebuilt around the principle of full and competitive access to the secondary market, not dominance by Wall Street banks, as well as consumer access to mortgage credit.

Our plan starts with a no-brainer. The FHFA, with the support of Treasury, should use its authority under the 2008 Housing and Economic Recovery Act of 2008 to suspend GSE dividend payments to Treasury, allowing Fannie and Freddie to build a modest capital buffer. FHFA Director Mel Watt has referred to the GSEs' lack of capital as "the most serious risk" facing the companies. Enabling the GSEs to build a buffer would avoid a further Treasury advance. But note that a buffer should not be conflated with the notion of a complete GSE recapitalization.

Secondly, the FHFA — as the GSEs' conservator — should develop a capital restoration plan to show how the GSEs could emerge from conservatorship. We believe the best approach for such a plan is a utility model — with taxpayers protected through capital to absorb losses, risk sharing to reduce direct GSE risk, strong underwriting of loans and counterparty risk, and fees to compensate for the federal government backstop. Treasury must then amend the Preferred Stock Agreement, setting up the process of recapitalization.

Unlike some other reform proposals, we are focused on protecting small and midsize lender access through specific provisions to address the risks of control of GSE loans by the large Wall Street banks. Fannie and Freddie should be preserved, not replaced or supplanted by the large vertically integrated banks that can use their securitization powers to dominate the mortgage origination market. Such an outcome would be anti-competitive — bad for consumers and bad for small lenders.

Before the crisis, large lenders like Countrywide enjoyed preferred pricing in the mortgage market, but the lessons from the mortgage meltdown showed the need for formal protections against such favored treatment to ensure a fairer and more transparent housing finance system. The CHLA plan would prohibit GSE discounts to lenders based on loan volume. This includes discounts on guarantee fees as well as risk-sharing pricing. The plan also promotes the use of back-end risk-sharing, instead of upfront risk sharing. The latter could create a choke point that works against small lender access.

Congressional action to reform the GSEs ultimately is needed for steps such as providing an explicit government guarantee and ensuring that guarantee serves the full market. But we must confront the risk of continued drift and inaction if Congress is unable to act. This plan is workable, minimizes transitional risks, protects taxpayers, and puts consumers and the housing market first.

Scott Olson is executive director of the Community Home Lenders Association.

THE RETENTION RISK-OFF TRADE

CLO managers have begun rewording amendments on new refinancings. The goal: position deals to benefit from the potential repeal of risk-retention rules

By Glen Fest

THERE'S A GREAT DEAL OF Skepticism about the Trump Administration's ability to effect regulatory relief. Yet some of the players most affected by rules enacted under Dodd-Frank are preparing for its potential repeal.

Since December, sponsors of new-issue securitizations have been required to keep 5% of the economic risk in deals. This has proven to be particularly onerous for sponsors of collateralized loan obligations, most of whom are asset managers will little balance sheet of their own. CLO managers have gone to great lengths to avoid triggering the requirement on deals that predate the rule.

Now they are realizing that a workaround sanctioned by the Securities and Exchange Commission comes with a big drawback: If Dodd-Frank is repealed, they would not be in a position to benefit.

The workaround allows CLOs issued after April 2013 and prior to December 2014 to be refinanced without triggering the risk retention requirement – but only under certain conditions, and only one time. It was spelled out in a no action letter that Crescent Capital Group obtained from the SEC in 2015.

The problem: many of the $52.97 billion in refinance deals since December that relied on this exemption to lower the interest rate on outstanding notes put language in the deal amendments precluding them from refinancing more than once. So even if the risk retention requirement goes away, eliminating any penalty for a second refinancing, they would not be in a position to do so.

The contract language is so clearcut, a second refinancing isn't possible even if the manager were willing to put the deal in compliance with risk-retention.

"There's just one refi permitted under the Crescent letter," said a securities lawyer who works with CLO managers. "And the contracts being signed say 'no more refinancings.' Period. Full stop."

Another securities lawyer, Paul R. St. Lawrence of Cleary Gottlieb, said he started getting inquiries from clients shortly after the Presidential election in November about the potential repeal of risk retetion, and what that meant for deals refinanced using the Crescent exception.

"Some equity investors and some managers were asking whether it might be possible if further refinancings could be done if either they became compliant with risk retention, or if the [Dodd-Frank] law no longer applied," said St. Lawrence, a partner at the firm.

New Contract Language

As a result, a number of CLO managers, reportedly including CVC Credit Partners and Seix Asset Management, have recently begun to use different language in both new-issue CLOs and refinancing that would allow the deals to be refinanced a second time – if risk retention is repealed.

There does not appear to be any movement to revise contracts in deals that have already taken advantage of the Crescent no action letter to refinance, according to several securities lawyers interviewed for this story.

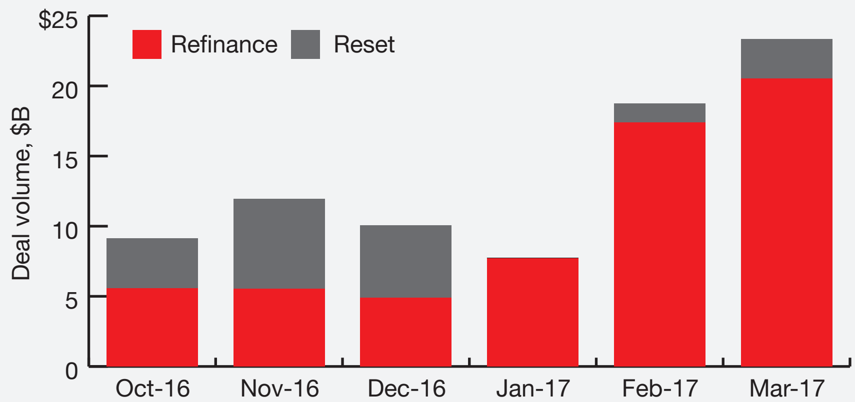
CVC and Seix officials declined to comment.

Refinancings account for the bulk of activity in the CLO market so far this year. Deals issued in 2013 and 2014 are now exiting their non callable periods (typically two years), but can still be actively managed. (Reinvestment periods are typically four years long.) Managers are taking advantage of tighter spreads available for replacement securities.

Some $49.5 billion of deals were either refinanced or had their interest rates reset in the first quarter, according to Thomson Reuters LPC. In April, another $20.2 billion was refinanced after March's $20.4 billion refi level.

One Shot

CLOs issued before December 2014 can rely on a special exemption to refinance without triggering risk retention, but only once.



Source: Thomson Reuters LPC

Potential Refis Aplenty

In a report published in early May, Wells Fargo structured finance analyst David Preston estimated about $50-$60 billion in remaining deals among the $165 billion in CLOs that could take advantage of the Crescent exemption to refinance without triggering risk retention. As of the first quarter 2017, about $91 billion (or 55% of those CLOs) had already been refinanced, with another 150 deals totaling $74 billion eligible to refinance or reset under the Crescent guidance. But only 123 of those deals are 10 basis points or more wider of the median AAA-paper refi price level (115 basis points above Libor during March and April) to justify a refinancing.

The Crescent no action letter applies to transactions in which only the interest rate on one or more existing classes of notes is changed within the first four years of a deal's life.

No other terms, including capital structure, maturities, voting/consent rights and other conditions may be changed, according to legal analyses of the letter.

A 'Safety Valve'

The SEC was responding to a legal quandary raised by Crescent's law firm, Cleary Gottlieb, as well as other managers and CLO industry groups like the Loan Syndications & Trading Association: if a CLO issued prior to December 2014 was exempt from the risk-retention rule, would the exemption be maintained if a CLO was refinanced through the issuance of new securities?

The question had been hounding the market since final rules for asset-backed securities were adopted by federal regulators in December 2014. The answer appeared to be no, at least not without investor consent, so the one-time refinance option became a contractual obligation - and would even apply to a deal if the manager chose to take on a retention-risk slice anyway.

So as part of a contractual "safety valve," the attorney speaking on background says, most new deals this year are being written up with language that would throw off the yoke of restricted multiple refinancing if the risk-retention rules were tossed aside, or if new interpretation by the SEC relaxed the guidelines for additional changes in refinancings.

How that repeal might happen remains unclear. Besides congressional repeal of Dodd-Frank, other potential avenues for removing CLOs (refinanced or new issue) from risk retention oversight include a dormant bill in the U.S. House of Representatives that could create a wide exemption for "qualified CLOs" that meet certain requirements.

LSTA's Appeal on Track

Another path is through the LSTA's ongoing federal lawsuit against the SEC and other regulatory bodies seeking to overturn the application of the rules to CLOs in the first place.

A U.S. district court in Washington, D.C. dismissed the LSTA's lawsuit in December; the LSTA has appealed that ruling to the federal appeals court level.

The LSTA in April filed its opening brief on that appeal, reiterating many of its prior arguments against the rules.

Among those points: the agencies lacked the statutory authority to impose the standards on CLO managers "at all"; applying the 5% standard to the market value of a deal rather than the credit risk standard; and for "abitrarily" assignign the rules without considering a "qualified CLO" exemption to deals that meet certain transparency and investor protection standards.

The SEC and other agencies have until June 7 to respond, and the LSTA afterward will have until mid-July to file its reply brief.

LSTA ENLISTS TRUMP IN REPEAL BID

For the past two years, the Loan Syndications & Trading Association has lobbied, largely unsuccessfully, to limit the impact of rules requiring CLO manager to keep "skin in the game" of their deals.

The trade group has appealed to Congress as well as federal regulators, arguing that risk retention requirements, which were designed to discourage irresponsible underwriting, should not be applied to collateralized loan obligations. It has even taken the Securities and Exchange Commission, as well as the Federal Reserve, to court.

Now it is appealing directly to U.S. Treasury Secretary Steven Mnuchin.

An executive order signed by President Donald Trump in February directs federal agencies to create task forces to evaluate federal rules and recommend whether to keep, repeal, or change them. In an April 7 letter, LSTA officials suggested several measures that would create exceptions to risk retention for CLOs.

The preferred method would be for the Securities and Exchange Commission to use its rule-making authority to exempt "persons, securities or transactions" from the Dodd-Frank Section 941 regulation requiring risk retention on asset-backed securities.

The LSTA said relief could come through either an outright exemption from the rules, or a modified requirement that managers be required to hold a much smaller stake in the credit risk (or equity portion) of a managed portfolio.

"The LSTA submitted this letter because we remain concerned about the long-term impact of risk retention on the CLO sector and loan market itself," Meredith Coffey, an executive vice president for research and regulation with the LSTA, said in a statement. "The leveraged loan market – and the thousands of companies that utilize it – benefit from the stability and reliability of CLOs."

Although the letter was directed to Mnuchin, the LSTA now has some potential allies at the SEC, in both acting chairman Michael Piwowar or his likely successor, Wall Street attorney Jay Clayton.

Piwowar, the only Republican appointee on the commission, has been a vocal critic of what he called "one –size-fits-all" credit risk retention.

Clayton's work, meanwhile, has been in merger & acquisitions as well as capital markets for clients such as Goldman Sachs, Barclays and UBS. He told a Senate banking committee in March the Dodd-Frank Act should be "looked at" in terms of what goals it has achieved.

The LSTA's letter reiterates arguments the organization has made since the risk-retention rule's application to CLOs was finalized in December 2014. The primary argument is the fact CLO managers are not originators of loans but "thinly capitalized" asset managers who purchase collateral for deal s from issuers and third-party investors, a business model "predicated on asset management rather than direct investment," the letter stated.

"Because CLO managers do not originate loans," the LSTA stated in the letter, "the originate-to-distribute concern does not apply." - GF

Risk Retention as a Capital Play

Rules requiring managers of collateralized loan obligations to keep "skin in the game" of deals are creating new opportunities for investors to participate in this market.

By Glen Fest

Risk retention rules created some big hurdles to creating new collateralized loan obligations. Yet they also opened up new avenues for investing in the market, as many managers serving as fee-for-service agents were compelled to raise the capital necessary to keep "skin in the game."

Five months in, investors are getting more comfortable with the complicated structures used to put managers into compliance. This helps explain why issuance is picking up steam after a slow start to the year, though there has also been a pickup in issuance of leveraged loans used as collateral.

An unexpectedly strong April for new deals, when $10 billion of CLOs were printed, prompted S&P Global Ratings to boost its forecast for full-year issuance to $75 billion from $60 billion previously.

"The refreshing thing has been the amount of capital that's come into risk retention structures from entities who traditionally have not been CLO investors," said Sean Solis, a partner at law firm Dechert. "We're hopeful that's going to be positive for the CLO market overall."

Solis spoke with Asset Securitization Report in April about the evolving structures that managers are using to raise capital, including creating a stand-alone business buoyed by third party investors, known as the capitalized manager vehicle (or CMV); using a lower-cost, single-purpose and self-capitalized investment unit, known as a majority-owned affiliates (MOA); or a hybrid option that brings some investment capital into an MOA, known as a capitalized MOA (CMOA).

He also discussed the pros and cons of for managers choosing to hold their retention stakes through either a "horizontal" position in the equity strip in a transaction or a more finance-friendly "vertical" stake consisting of a portion of each class of notes issued in a transaction.

ASR: How did the choices between CMV and MOA models evolve?

Solis: Each manager had to identify how they were going to structure their risk retention solution and some managers came to the realization they wanted to create a stand-alone business and create something that could be monetized and taken public in an IPO. They were therefore attracted to the CMV model – a complete spinout of the business, a formation of an independent manager legally and operationally separate from the legacy manager.

Forming and raising capital for CMV is an expensive undertaking, both in time and effort, and forming a new operating company like this usually involves raising significant amounts of capital from third-party investors, and such third party investors are attracted to the structure due to the fact they have a direct say on who and how the company is run and operated.

Sean Solis

On the other hand, the people who choose to do an MOA model usually have access to internal capital, which in that case is very simple: just do a majority owned affiliate, acquire the requisite retention securities and you go from there.

For those managers that want to solve for EU risk retention we have the CMOA option, which involves setting a manager that is an MOA for US risk retention purposes and an entity of substance for EU risk retention purposes. This is an attractive option for many investors as such investors who are materially interested in investing in a manager, even if it's controlled by a legacy manager. CMOA checks that box.

There is an option for lead arrangers to take the reins of risk retention, so why has that not been widely adopted by CLO managers?

That's one where the regulators – notwithstanding the industry's comments that it's never going to work in practice – allowed the lead arranger agenting the loans to hold a certain percentage of them and act as the risk retainer. Given that most of these loans are agented by large bulge-bracket banks, such banks are not in the business of managing CLOs. The last thing they would want to do is retain securities in those CLOs that they do not manage.

It was never a really natural fit, and they would never want to hold something that illiquid; in fact, they get awful capital treatment under the bank regulatory rules.

It's never been seriously considered by anybody to my knowledge, and I seriously doubt it gets considered in the future.

Have some unforeseen complications arisen with any of the options, especially regarding costs?

It depends. I don't think there is anything unforeseen, but the cost and complexity is a byproduct of the investors that are exploring and negotiating the applicable structure. The refreshing thing has been the amount of capital that's come into risk retention structures from entities who traditionally have not been CLO investors. We're hopeful that's going to be positive for the CLO market overall.

Where is that financing coming from?

You mostly see large institutional investors, insurance companies, pension funds, sovereign wealth funds, investors of that type.

So it mirrors the investor classes for the CLO notes themselves?

It mirrors them, but they've been different actors. You see those types of entities invest, but my point is we've seen those entities that have not traditionally invested in CLOs.

Is the manner in which these managers finance the risk-retention piece driving the decision on which vehicle structure to use?

There's not any really financing for the horizontal structure. But for the vertical, financing is very much driving the strategy. In order to attract third-party capital to a vertical-strip strategy, you need to be able to source financing for that because you likely need it to make the returns work.

Long story short, if you're doing a vertical strip strategy and you're trying to raise third-party capital, it's likely you're going to need to contemplate financing to make the whole structure fit together.

Why are financing providers not interested in retaining equity stakes in the horizontal structure?

It's obviously the riskiest tranche in terms of being the most subordinate, and it's not rated. So the people who provide the financing often need investment grade collateral, and therefore CLO equity just does not fit that bill.

What types of managers prefer CMV to those that choose MOA or hybrid CMOA structures?

The nice thing about these structures is they've proven to be adaptable to managers of all shapes and sizes. As they become more commonplace and the investor community understands them better, even the smaller middle-size managers will have success in effectuating them and raising capital.

There may be a better opportunity for some investors to go with a smaller manager because they are willing to give up certain economics or be more flexible in certain terms.

The nice thing is some of the bigger guys have come out and put structures in place and everyone's gotten familiar with it and given the opportunity for smaller managers to adopt those new structures and attract significant capital.

"The refreshing thing has been the amount of capital that's come into risk retention structures."

So is the variety of these options showing that risk retention is not the roadblock to CLO creation that some had feared?

Obviously the constraint is the amount of capital out there. There's been a decent amount of capital raised, but managers are going to be conservative on when they deploy such capital as it is valuable and it is finite.

My feeling is that once we get through this infancy stage of the risk-retention cycle, and the market fully gets their arms around all of the issues of first impression that are being worked through in each new deal, that the main focus will shift back to where it always should have been and that is mutual beneficial outcomes that abound when the market is functioning optimally.

Blockchain Aces Loan Prep Test

Advocates say a 90-minute trade demonstration involving 19 buy-side and sell-side institutions shows how ready the shared-ledger concept may be for securitization efforts.

By Glen Fest

Coordinators of a financial-industry backed blockchain project say they have successfully demonstrated that the distributed ledger technology can be used to syndicate, trade and make payments on leveraged loans.

The 90-minute demonstration was carried out in March by Synaps Loans LLC, Credit Suisse and financial services consortium R3.

There was no actual transaction, rather, the demo was a “proof-of-concept” involving a simulated end-to-end leveraged loan trade. Proponents say it validated the premise that blockchain can be used to speed up interaction in the secondary loan market, from back-office functions like settlement and documentation to agent-bank duties like managing votes on loan amendments.

“This was months of work,” involving more than 100 participants from 19 institutions, said Caitlin Long, president and chairman of Symbiont.io. “We had a large number of parties involved” in the demonstration, she added, “and we had to turn away some participants because there are only so many you can sit at the table like this.”

Long, a former managing director for global capital markets at Morgan Stanley, joined up with Symbiont in August after years as a champion of adapting blockchain to the securitization market. Symbiont is a joint venture partner with business process services firm iPreo behind the Synaps platform, and is one of several technology firms competing to recruit banks and funds to its proprietary blockchain platform.

Participating institutions included Barclays, BBVA, Danske Bank, Royal Bank of Scotland, Scotiabank, Societe Generale, U.S. Bank and Wells Fargo on the sell-side; and firms such as Alliance-Bernstein, Eaton Vance Management, KKR and Oak Hill Advisors on the buy side, according to the release.

Also participating was custodial bank State Street Corp. and the Loan Syndications & Trading Association trade group for the leveraged loan and collateralized loan obligation industry.

The test showed Synaps has “the majority of the functionality needed” for using blockchain in a large-scale manner with the loan market, and is ready for the final stages to show a platform can carry a loan from “origination to payoff,” said Emmanuel Aidoo, head of the distributed ledger and blockchain effort at Credit Suisse, in a release.

Blockchain is the digital ledger technology behind cryptocurrency bitcoin. The blockchain formats proposed for financial services differ in that the aim is to develop the use of shared digital ledgers – or smart contracts – that can include all parties in a loan trade for simultaneous views and interactions with data. Users, for example, could verify ownership of a loan automatically without needing an agent-bank query.

Interest in applying blockchain technology for capital markets, including

Photo Credit Symbiont

Caitlin Long

leveraged loans, has surged in recent years. Loan buyers and investors are eager to speed up and automate trades that still involve large amounts of paper and can take weeks to settle. Many also want these trades, which can involve several parties exchanging contract documents back and forth through agent banks, to be more transparent.

Research into blockchain services for securitization efforts have been kicked into gear by the Structured Finance Industry Group, which announced a partnership with the Chamber of Digital Commerce at SFIG’s ABS Vegas industry conference in February.

Rival consortiums to R3 (which has 84 bank participants) include the 122-member Linux Foundation’s Hyperledger blockchain standards group (with BBVA and Wells Fargo), IBM (Northern Trust) and Microsoft (JPMorgan). JPMorgan, which recently left the R3 consortium, is also developing an in-house blockchain solution.

How Tech Allayed SLABS Crisis

Navient and Nelnet avoided downgrades on $18 billion in FFELP Bonds by extending their maturities. Recent innovations helped them get the required consents from investors.

By Allison Bisbey

Generous repayment plans soured many investors on bonds backed by federally guaranteed student loans. But it could have been worse.

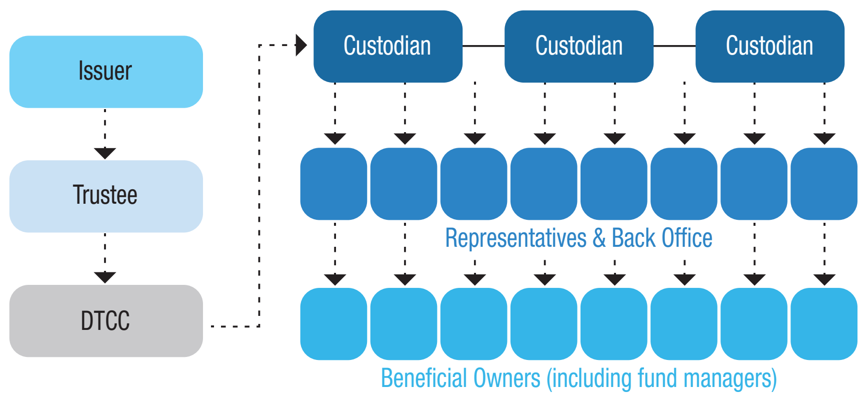
These programs slow the rate of repayment on Federal Family Education Loans, putting the bonds they back at risk of technical default if the securities fail to pay off at maturity. When Moody's Investors Service and Fitch Ratings raised the alarm early in 2015, eventually putting some $100 billion of bonds under review for downgrade, the market sold off heavily. New issuance ground to a halt.

Yet Navient and Nelnet, the two largest student loan servicers, avoided downgrades on some $18 billion of FFELP bonds. They did so using a strategy that, at first, did not seem promising: extending the maturities of the bonds. While simple in principle, this solution was complicated by a requirement that 100% of investors in a tranche approve the change. Without consent from every single holder, no matter how small, an amendment cannot pass.

Their efforts were aided by DealVector, an online registry of asset ownership and messaging platform, which helped the two servicers identify holders and collect votes. Over the past year, the two servicers have sent about 165 tranches out for consent; some 60% of those were successful, and about 10% are still in process. The total original face value of tranches passed to date exceeds $18 billion.

Coordination problem

Bonds are held "in street name," obscuring their true ownership and imposing large costs on an issuer soliciting investor consents to amend deals



Source: DealVector

This undoubtedly helped restore confidence in the sector, allowing Navient and Nelnet to resume issuing FFELP bonds, even though some investors, including banks and credit unions, continue to view the asset class skeptically.

"If we hadn't been able to extend maturities, it definitely would have been harder to sell FFELP bonds," said Greer McCurley, executive head of capital markets at Nelnet.

The market revival, in turn, encouraged banks to resume unloading FFELP portfolios. In April, Navient (which did not respond to a request for interviews) reached a deal to acquire $3.7 billion of FFELP from JPMorgan Chase. So far this year, it has issued nearly $3 billion in FFELP bonds. Nelnet completed a single, $426 million FFELP securitization in October; it has yet to come to market this year. The company also completed a private student loan securitization, in December.

Like other kinds of financial assets, FFELP bonds are held "in street name" by a brokerage firm, bank, or dealer on behalf of a purchaser, obscuring their true ownership. This isn't just a problem for consent solicitations; it also imposes large costs on determining an appropriate price for a security, forming creditor classes, and many other events requiring communication among deal participants.

This is how the consent process normally works: An issuer sends consent forms to the trustee, which needs to log onto the Depository Trust Company and complete a form, which then goes out through different systems to the custodian. The custodian must process it and send it to the beneficial owner's back office, which then needs to deliver it to the appropriate portfolio manager.

There are multiple opportunities for delays.

"I talked to one portfolio manager who didn't see a consent sent through the normal channels for five days, and that was quick," said DealVector co-founder and CEO Michael Manning. "Ten to 13 days is the typical lag time. Some didn't even receive it until the day before the deadline, at which point it became a huge fire drill."

By comparison, when investors register directly with DealVector, "on the same day that Navient provides consents to trustees, they give it to DealVector. We load it into the system, and it's in a portfolio manager's inbox within 20 to 25 minutes."

Investors who register their holdings can also download documents and see what other holdings are registered. When they vote, DealVector can prepopulate information, and it allows them to use an electronic signature.

"From an investor standpoint, it's been a fairly simple process," said Tim Sustak, chief credit officer at Vizo Financial, a corporate credit union that has been involved in 10 or 12 consents to extend the maturities of FFELP bonds it holds.

Sustak said that Vizo gets consent solicitations from its third-party custodian as well as from DealVector, and was informed about what was happening to FFELP bonds and why. Still, using an online platform "put some extra grease on the wheel," particularly for deals that were not extended on the first try.

"It's another check and balance," he said.

As in other walks of life, technology offers a bird's-eye view of the situation.

"For a given deal, I can see how much each custodian has under custody, so I can call one and say, 'we're missing [consents on] $100 million, can you send reminders to the beneficial holders?'" Manning said. "These tools allow us to work the investor end, the brokers and custodians all at the same time."

Navient was the first to partner with the vendor and its first consents went out around March 2016, Manning said. Nelnet did its first consents some four months later, in July 2016, he said.

DealVector contacted numerous other FFELP issuers to offer assistance; however, no other firms retained its services. "For some other issuers, issuance has diminished greatly, some aren't issuing anymore, and they are less inclined to go through the process of extending legal final maturities," he said.

It's not clear how much more FFELP bonds might have sold off if Navient and Nelnet hadn't been able to extend the maturities of so many bonds, avoiding, or in some cases reversing, downgrades. The servicers took other actions to avoid downgrades, including repurchasing bad loans from securitization trusts and calling bonds at risk of not paying off at maturity. However, neither Fitch nor Moody's looks at these other strategies as favorably as it does maturity extensions.

And there was another mitigating factor, according to several industry participants: The lengthy process of revising rating criteria and reviewing billions of dollars of FFELP bonds gave investors plenty of time to get "credit comfortable" with the possibility of a technical default. Many were able to tweak their investment guidelines, allowing them to hold on to the bonds in the event of a downgrade, since the underlying loans are guaranteed by the U.S. government.

"If we hadn't been able to extend maturities, it definitely would've been harder to sell FFELP bonds."

The lengthy ratings review process also gave Navient and Nelnet plenty of lead time soliciting consents. By the time the first downgrade was announced in September 2016, Navient had already extended the maturities of $6.8 billion of bonds.

Nevertheless, McCurley said that Nelnet would not even have tried to extend the maturities of bonds without a platform like DealVector. "They really made an unmanageable process very manageable."

Moody's concluded its sector-wide review in December; it ended up downgrading roughly $46.6 billion of FFELP bonds, or about half of 504 tranches of 194 transactions that it originally had under review; most of the securities downgraded were originally rated Aaa; some were cut to below investment grade.

In February, Fitch said it had downgraded 105 of the 629 tranches it had placed under review. It affirmed another 620 tranches, and upgraded 42; another 45 remained under review.

Mixed Signals on Debt Servicing

Supreme Court Justices appeared exasperated with both sides in a case that would define whether companies that buy distressed debt are covered under a federal statute.

By John Heltman

Justices on the Supreme Court appeared exasperated with both sides during oral arguments in April for a case that would define whether companies that buy distressed debt and attempt to collect on it are covered under a federal statute setting limits on their activities.

Several justices on the high court criticized the plaintiffs' expansive definitions of which entities might be considered debt collectors under the Fair Debt Collection Practices Act of 1978, which bars certain kinds of abusive, deceptive or aggressive debt collection practices. But some of those same justices also seemed to think that purchasing distressed debt could be used as a loophole that financial services firms could exploit to get around that law.

The outcome of the Supreme Court hearing could have sweeping impacts for banks, many of whom have some exposure to the secondary market for defaulted debt. The Consumer Financial Protection Bureau has been increasingly focused on the debt collection business, and issued a reform plan last year that largely spared banks from consideration, but a favorable ruling for the plaintiffs could change that calculation. Banks have also been increasingly subject to lawsuits alleging violations of the FDCPA in recent years, a costly prospect that the high court's ruling could impact.

Photo Credit Bloomberg News

"If I accept your definition… I have difficulties," Justice Stephen Beyer told the attorneys suing Santandar Consumer USA, in part over the definition of "owed."

Henson, et al. v. Santander is the consolidation of a series of cases in a number of circuit courts that have percolated through the appellate system over years. It specifically concerns Santander Consumer USA's acquisition of various auto loans from CitiAuto. The complaint alleges that Santander should be considered a debt collector under the 1978 fair debt collections law and be restricted in the methods and activities it may pursue to collect on those debts. But Santander maintains that the law doesn't apply to it in this case, but only to firms who are collecting debts owed by another company.

At issue is the law's definition of a "debt collector" as either someone whose "principal purpose" is "the collection of any debts" or one who "regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another." The law includes an exemption for creditors seeking to collect on debts they originated, that "generally are restrained by the desire to protect their good will when collecting past due accounts," according to the Senate report accompanying the original legislation. But the statute also says that a debt "which was not in default at the time it was obtained" can qualify for the creditor exemption.

Attorney Kevin Russell, arguing for the plaintiffs suing Santander, said the concept of "owed" can be interpreted to apply even if the company to whom the debt is owed has sold that interest to the collector. But Justice Elena Kagan said she couldn't find a way to make that definition work.

"My problem about this word is I can never get it to mean what you want it to mean no matter how I construct the sentence," Kagan said.

Justice Samuel Alito was similarly unpersuaded by the plaintiffs' interpretation of the statute.

"The degree of absurdity you have to show under [the statute] depends of the ambiguity of 'be owed or due,' " Alito said. "You're really going uphill on that."

Justice Stephen Breyer added that companies buy and sell other companies all the time, and that includes the purchased company's receivables — be they in arrears, in default, or any other condition. Applying the fair debt and collections law to a company in such a position is unlikely to be in line with Congressional intent, Breyer said.

What about companies that buy up other companies and sell them, Breyer asked. "They buy the receivables ... and there they are, those receivables once owed to the company they bought. If I accept your definition ... I have difficulties."

Russell argued that if the countervailing interpretation — that if a debt is sold or assigned prior to being in default, the FDCPA does not apply — is adopted, it generates an absurd result, namely that debt-servicing companies are suddenly exempt from the law by virtue of the timing of their assignment.

"That interpretation suggests that any debt collector who is assigned a debt that is not in default — maybe only in [arrears], which happens a lot — is entitled to this exemption, and there is nothing ... to believe that Congress intended to provide them with that exemption," Russell said. "A debt buyer is much more like a debt servicer than a [creditor]."

Attorney Kannon Shanmugam, representing Santander, said the question of assignment is not the issue before the court, arguing that the question is simply whether the company in question bought the debt and is therefore granted the creditor exemptions granted in the law, or it has entered into some other arrangement that may not grant it that exemption.

"Assignment is neither here nor there with respect to this exclusion," Shanmugam said. "I think the dispositive consideration is whether the servicer or party acquires complete ownership or something less than that."

But members of the court were critical of that question as well. Kagan suggested that if the same company could alternatively be a debt collector or not a debt collector simply by virtue of whether they bought the debt from the originator, that renders little practical distinction.

"The [defendant] services this debt and was considered a debt collector. Then they purchased it and all of a sudden [they're not]?" Kagan asked.

Chief Justice Roberts similarly was skeptical of the defense's assertion that companies who buy the distressed debt of an originator inherit the goodwill that creditors are assumed to wish to preserve between themselves and the borrowers. "You're in an entirely different business" from the debt originator, Roberts said. "What I don't see is how you have the same incentives to maintain goodwill."

Shanmugam said the idea that the court is considering a case of a rogue buyer of distressed debt is far from accurate — in this case, Santander bought another bank's portfolio of auto loans after it decided to exit that market.

"My problem about this word [owed] is I can never get it to mean what you want it to mean."

That included performing and non-performing loans, he said, and represents a circumstance more similar to Justice Breyer's hypothetical scenario than a predatory debt collector finding a way around the law. And distressed debt is not a hot commodity that investment banks or capital markets are eager to purchase, he said.

"There simply is no evidence that the Goldman Sachses or BlackRocks are moving into the business of debt collection," Shanmugam said. "What Santander was doing is not buying distressed debt. Citi got out of the auto lending business ... and Santander purchased their entire portfolio."

Not all of the justices tipped their hands as to how they might rule. Justice Neil Gorsuch — who was only confirmed to the court earlier this month and heard his first oral arguments on Monday — did not speak at all during the oral argument. Neither did conservative Justice Clarence Thomas or Justice Anthony Kennedy, who is seen as a swing vote on the court.

Auto Lenders Put on Notice

A $26 million settlement by Santander Consumer is shining a light on the problem of auto dealer fraud, while also raising questions about lenders' efforts to combat bad behavior.

By Kevin Wack

Inside Santander Consumer USA, alarm bells were ringing over a list of auto dealers that were sending rapidly souring car loans to the subprime lender.

The speedy defaults were seen internally as a warning sign that the dealerships might be inflating customers' incomes in order to qualify them for loans, Massachusetts authorities later alleged.

Santander Consumer conducted audits of high-risk auto dealers. At one particular Bay State dealer, the company looked at 11 loans and found seven that inflated borrowers' incomes by $45,000 or more per year, according to the authorities. Nonetheless, the lender allegedly made hundreds more loans through the dealer.

Deceptive tactics

Lenders can be defrauded by either auto dealers or car buyers. Here is a look at some common ways it happens

Income fraud: Misrepresenting a borrower's income to fool lenders into thinking the borrower can afford the loan

Collateral fraud: Inflating the value of the car beyond what it is worth to get more money from the lender

Employment fraud: Lying about the borrower's job title or place of employment or fabricating pay stubs to support fictitious income

Identity fraud: Using a stolen identity to apply for or receive a car loan

Straw borrower: A person who lets their credit be used to facilitate a fraud scheme for someone else

Source: PointPredictive Inc.

These accusations, which date from 2009 to 2014, were detailed in March in a $26 million settlement that the U.S. auto-lending unit of the Spanish banking giant Banco Santander reached with the Massachusetts attorney general's office. Santander Consumer neither admitted to nor denied the allegations.

The settlement's eye-popping charges are shining a light on the hard-to-measure problem of auto dealer fraud, while also raising questions about the adequacy of lenders' efforts to combat bad behavior.

Such fraud often involves fitting unqualified subprime loan applicants into the underwriting standards established by lenders. That can be accomplished either by inflating the borrower's income, which makes the loan appear easier to pay off than it actually is, or by overstating the value of the consumer's purchase, which leads lenders to approve larger loan amounts.

Industry critics allege that subprime auto lenders have little incentive to police the malfeasance aggressively because — in a parallel to the subprime mortgage bubble of a decade ago — they often package the loans into bonds and offload them quickly.

More than 78% of the loans that Santander Consumer originated through Massachusetts auto dealers were sold to third parties, according to the March 28 settlement agreement. The lender allegedly told state authorities that requiring borrowers' proof of income often put it at a competitive disadvantage in the market.

"That was the exact excuse that lenders were making about why they had to look the other way when mortgage brokers were sending them increasingly risky and increasingly fraudulent loans," said Chris Kukla, executive vice president at the Center for Responsible Lending.

"The one who's going to be hurt the most is the person who bought the car and then can't hold onto it," he added.

There is no comprehensive data on the extent of loan fraud perpetrated by auto dealers, in part because much of it goes undetected.

"Most of the fraud is slipping through," said Frank McKenna, chief strategist at PointPredictive, a San Diego firm that sells fraud-prevention services to auto lenders.

Of course, dishonest car dealers are not a new phenomenon. But at a time when car sales are leveling off, dealers may be tempted to go further to close sales than they did in the recent past. Meanwhile, underwriting standards have loosened substantially in a market that is showing signs of overheating.

PointPredictive estimates that $4.2 billion to $6 billion in fraudulent U.S. auto loans will be originated in 2017, which is twice as high as the firm's estimate from two years earlier. The estimate, which amounts to slightly more than 1% of the car loans made annually, includes fraud perpetrated by auto dealers as well as cases of identity theft and other illegal schemes by car buyers.

Today's subprime auto lending industry is much smaller than the subprime mortgage market was 10 years ago, and the more recent spate of fraud seems unlikely to impact the nation's financial stability. Still, there are a number of ways in which the situations are similar.

Auto dealers play an analogous role to mortgage brokers, profiting from loans without shouldering the risk of default. Lenders frequently fail to require that borrowers' income be verified, which makes it easier for the dealers to perpetrate fraud.

And securitizations are structured so that losses must hit high thresholds before bond investors take a financial hit, so the investors do not have a strong incentive to demand effective fraud-prevention measures. "It is not unlike what the mortgage industry experienced between 2003 and 2008," PointPredictive argued in a recent report.

In a March administrative case brought by New York City's department of consumer affairs, a Queens-based car dealership chain was accused of inflating borrowers' incomes and car values.

The city's complaint described the experience of one woman who visited the chain, Major World, and bought a 2013 Nissan Quest. The woman earned $41,600 per year in salary and paid 46% of that amount in rent. But the loan application stated that her annual income was $76,000, and her rent was $0, according to the complaint. The loan, which carried an annual percentage rate of 23.12%, was approved.

"It does seem that opportunities to connect the dots are not being taken."

Major World did not respond to requests for comment. New York City's complaint did not identify the lender.

Some observers said that auto lenders should be doing more to ferret out patterns of misconduct in the dealerships. "It does seem that opportunities to connect the dots are not being taken," said Peter Lane, a consumer protection lawyer in Northampton, Mass.

But others said that allegations against Santander Consumer are not representative of the auto lending industry as a whole.

"I think that the good operators, of which there are many, don't have any significant problem with fraud," said Christopher Gillock, managing director at Colonnade Advisors LLC, which advises auto finance companies.

Some auto lenders monitor not only the dealerships with which they do business, but also individual employees who have a track record of bad behavior and have moved from one dealership to another, Gillock said. Nonetheless, he said that cases of fraud appear to be on the rise. "As auto sales flatten out, and dealers are trying to move the metal, they try to figure out: How can I put the customer into the car?" he said.

In the Massachusetts case, Santander Consumer did take some action after flagging certain dealers as suspicious, according to the settlement agreement. For example, the lender demanded that the suspect dealers repurchase certain loans that had gone into early default.

But Massachusetts authorities say that the lender's response was inadequate.

The settlement states that Santander Consumer only counted loans as having income inflation if the borrower's pay was boosted by $500 or $1,000 per month.

The company also waived proof-of-income requirements for some dealers that had been flagged as representing a high risk, according to the document.

Santander Consumer expects that roughly 42% of all subprime loans originated at Massachusetts dealers on the high-risk list between 2009 and 2014 will eventually default, according to authorities. The predicted default rate is the same in Delaware, which was also a party to the settlement.

In a statement to ASR sister publication American Banker, Santander Consumer noted that it has a new management team, and said that it has taken steps over the last 18 months to strengthen its business practices and controls.

Relief for Construction Lending

A bipartisan bill would clarify rules that critics say have caused banks to pull back from construction lending, hurting credit availability and driving loans to unregulated sectors.

By Allison Bisbey

Photo Credit Adobe Stock

The Trump Administration's initial tax plan may be short on details, but a bipartisan bill introduced April 26 offers some very specific relief for the commercial real estate industry.

The bill, sponsored by Congressman Robert Pittenger (R-NC) and Congressman David Scott (D-GA), would clarify rules that critics say have caused banks to pull back from construction lending, hurting credit availability and driving loans into risky, unregulated sectors.

Under Basel III requirements that went into effect in January 2015, regulators introduced a 150% risk weighting for a new category of acquisition, development and construction loans called High Volatility Commercial Real Estate. Previously, regulators used to put all construction loans in the 100% risk based capital bucket.

The new capital rules are designed to force borrowers to have more skin in the game. In order to avoid the HVCRE designation, they must meet a 15% equity requirement. The leverage on the loan also cannot exceed 80% of the estimated completed value of the project.

The problem, according to lenders, is that these rules don't recognize the way construction lending works. For example, developers often purchase parcels of land and sit on them for several years; yet the requirements do not recognize the appreciated value of the land in determining how much equity the developer has to bring to the table.

Since the higher capital requirement is reflected in the price of loans, it puts banks at a competitive disadvantage to nonbank lenders.

"Despite attempts by federal banking regulators to clarify the rule, lenders still have concerns that the criteria are overly inclusive and unclear, resulting in a broad swath of loans defined as HVCRE loans; thus, the rule serves as a disincentive to even prudent loan-making in some circumstances," the bill's authors said in a press release.

The proposed legislation would address this by better defining HVCRE loans. It would also count the appraised value of any real property toward the 15% contributed capital requirement, and allow internally-generated funds to be withdrawn from the project.

The bill also defines the conversion from HVCRE status to permanent loan status prior to the end of the loan. Currently, the Basel III requirements restrict reclassifying a high volatility construction loan to a permanent CRE credit. And loans considered as high volatility must be held for the full term. The Mortgage Bankers Association, for one, has been urging the regulators to allow reclassification earlier, once the loan meets the bank's internal underwriting standards.

And loans made prior to January 2015 would be exempted from the rule.

The bill, H.R. 2148, is supported by more than a dozen trade associations, including the MBA and the Commercial Real Estate Finance Council.

Help for Ocwen from Top Client

Ocwen Financial is in talks to sell a nearly 5% stake to its biggest client, New Residential Investment Corp., as part of a deal that would finalize the sale of mortgage servicing rights.

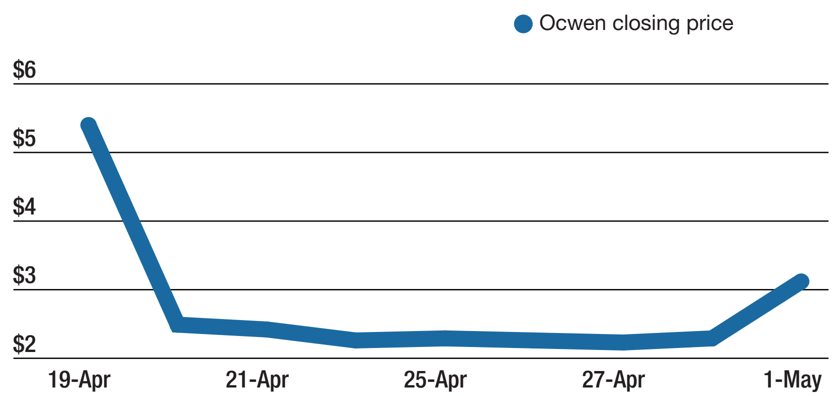
By Austin Kilgore

Ocwen Financial Corp. is in talks to sell a nearly 5% stake to its biggest client, New Residential Investment Corp., as part of a deal that would finalize a long-expected sale of mortgage servicing rights.

The deal would seem to put to rest questions about whether New Residential would pull its massive $117 billion subservicing portfolio from Ocwen and move it to another servicer — such as Nationstar Mortgage Holdings, which like New Residential, has ties to the private equity firm Fortress Investment Group. With an equity stake in Ocwen, New Residential would have an incentive to ensure the servicer remains in business.

Extending a lifeline

Ocwen shares plunged amid more regulatory scrutiny but rebounded on news of cash infusion from New Residential



Source: Source: Google Finance

"From a liquidity perspective, this gets Ocwen on the right track and the sinister view of 'us versus Ocwen' no longer exists as a result of this deal," Michael Nierenberg, New Residential's chairman, president and CEO, said May 1 during the company's first-quarter earnings conference call.

In an ominous echo of the rescue deals of 2007 and 2008, Nierenberg framed the transaction as something undertaken to benefit the entire industry. "Having Ocwen as a healthy counterparty to the mortgage servicing system is something that we think is extremely important," he said.

New Residential, a real estate investment trust that's been very active in the MSR market, would pay $425 million for full ownership of the MSR portfolio, which accounts for nearly 60% of the loans that Ocwen services. It currently owns just a portion of the MSRs, acquired when New Residential purchased the assets of a former Ocwen affiliate, Home Loan Servicing Solutions. Ocwen would subservice the portfolio under the terms of a new, five-year contract.

In addition, New Residential would pay $13.9 million for about 6.1 million shares of Ocwen common stock, or about a 4.9% stake.

The deal is expected to close at the end of the second quarter or early in the third quarter, Nierenberg said. It would give Ocwen a much-needed cash infusion as it mounts a defense against a recent Consumer Financial Protection Bureau lawsuit and regulatory orders from more than 20 state attorneys general, all alleging widespread errors in its handling of mortgages.

During New Residential's earnings call, Nierenberg sought to assure investors that the real estate investment trust would be adequately protected from Ocwen's regulatory problems.

"We'll have standard rights in our servicing agreements with them that protect us from anything that, quite frankly, would or could go potentially wrong with the regulators," he said, adding later, "I know Ocwen's in the middle of a little bit of a storm, but in conversations with Ron [Faris, Ocwen's CEO] and his team, they are doing everything they can to right their ship."

New Commercial Realty Hedge

Global Index Group has developed a synthetic product that allows investors to go long or short a leading U.S. benchmark, the NCREIF Property Index.

By Allison Bisbey

Hedging commercial real estate is difficult. You can short real estate investment trust and commercial mortgage bond indexes, but both REITs and CMBX offer exposure to a limited portion of the market. And prices of both types of securities are influenced by a number of other factors besides commercial real estate prices.

Global Index Group has developed a new product based on the NCREIF Property Index, which measures the performance of some $525 billion of apartments, hotels, industrial, office and retail properties held on behalf of tax-exempt institutions. The synthetic securities, called duETS (Down/Up Equity Trust Securities), allow investors to both go short, or bet on a decline in the index, or long.

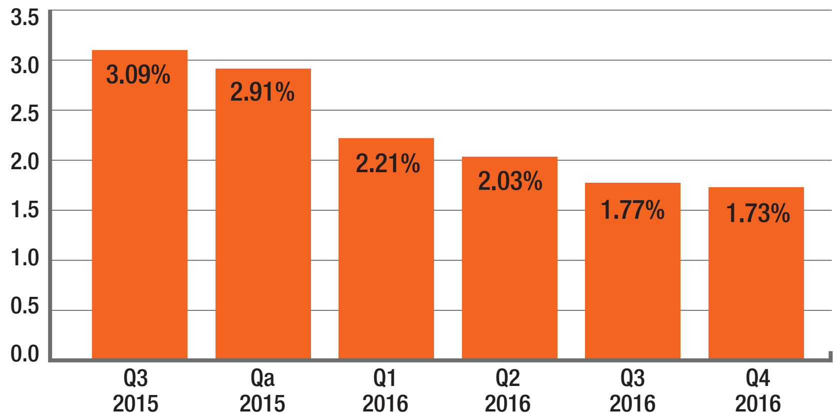
In fact, equal numbers of Up and Down securities will be issued. Proceeds are deposited in a trust account with the Bank of New York and invested in Treasurys for two years. At the end of that period, the securities will be valued based on the index level, and funds from the trust account will be used to redeem them.

The product has yet to launch; CBRE Capital Advisors, the exclusive brokers, will issue the first series once it identifies a sufficient number of investors who can agree a price for the securities.

GIG Chief Executive Kelly Haughton believes the timing is good, given the diversity of opinions about the direction of commercial real estate prices.

Headed South?

Total returns in the NCREIF Property Index, which includes 7,364 operating properties, have been moderating over the past two years



Source: National Council of Real Estate Investment Fiduciaries

The quarterly total returns of the NPI, which includes 7,364 properties across the United States, have moderated over the past two years as the real estate cycle has matured. (For 2016 as a whole, the total return was 7.97%, consisting of a 4.74% income return and 3.10% appreciation.)

Possible changes in tax policy, an important driver of investment in commercial real estate, add to the uncertainty.

Wall Street has also learned some important lessons from the financial crisis. Because duETS are fully funded securities, there is no counterparty risk, which proved the undoing of the nascent swaps contracts linked to commercial real estate prices during that period.

There are also no restrictions on trading duETS, assuming investors can agree on a price. Once the securities are issued, CBRE Capital Advisors, the investment banking arm of CBRE, will match buyers and sellers in the secondary market, and transactions and pricing will be posted on GIG's website. The broker can also create or redeem securities from an existing series to meet demand.

And the index itself cannot be gamed, according to Haughton. The NPI goes back to the fourth quarter 1977 and is comprised exclusively of operating properties acquired, at least in part, on behalf of tax-exempt institutions and held in a fiduciary environment.

Bram Smith Retiring from LSTA

Charles Citro joins Morningstar Credit Ratings as a managing director for CMBS ratings and ratings analytics; Hunton & Williams adds structured finance partner John Dedyo.

By Glen Fest

Bram Smith is retiring as executive director of the Loan Syndications & Trading Association effective at year's end, the trade group announced.


Bram Smith

Smith has been with the LSTA for nine years, joining as interim executive director in September 2008 before being installed permanently in December 2009. He is a 40-year veteran of the U.S. loan industry, with previous stints as a senior managing director at Bear Sterns and managing director/ partner in Morgan Stanley's loan capital markets business. Citro also spent 18 years managing loan syndications, sales and trading at Bankers Trust.

During his tenure at the helm of the LSTA, he steered efforts to aid in the recovery in new issuance of collateralized loan obligations after the financial crisis brought deals to a halt. One of his chief missions was also to reduce the time it takes to settle loan trades in the secondary markets – periods that, at their peak, lasted up to three weeks.

Smith also led the LSTA's efforts to shield CLOs from Dodd-Frank Act regulations, but ultimately lost on that front. The LSTA, for example, pitched a battle against applying the Volcker Rule to CLOs, but regulators ultimately enforced Volcker against CLOs in 2014 that required them to divest of high-yield bonds, which put them off limits to banks (important investors in senior tranches of CLOs).

The rules took effect last December on new-issue CLOs, but regulators decided to grant an exemption grandfathering managers of existing deals.

Charles Citro to Morningstar

Charles Citro joined Morningstar Credit Ratings in April as managing director for mortgage-backed securities ratings and ratings analytics.


Charles Citro

He replaces Ken Cheng, who has taken on a new, senior-level position as analytical project manager.

Citro is responsible for the rating agency's CMBS ratings and other commercial real estate ratings initiatives, including the management and ongoing development of analytical staff, and development and maintenance of CMBS and CRE ratings methodologies, criteria, and models. He reports to Vickie Tillman, president of Morningstar Credit Ratings.

Most recently, Citro served as a senior managing director at Cushman & Wakefield. Prior to that, he was a managing director at Macquarie Group.

Cheng is now responsibility for developing new ratings capabilities, including methodology and model development. Morningstar currently rates CMBS conduits and single-asset/single-borrower deals, and is considering additional products in the commercial real estate space. In addition, Cheng joined the firm's criteria committee and model governance group. He continues to report directly to Tillman.

Hunton & Williams Adds Structured Finance Partner

Hunton & Williams added a corporate partner, John J. Dedyo, in the firm's New York office.

Dedyo represents issuers, underwriters, asset managers, credit enhancers, rating agencies and investors in all aspects of privately placed and publicly offered securitizations.

Prior to joining Hunton & Williams, he was a partner at Weil, Gotshal & Manges.

His practice includes the securitization auto loans, unsecured consumer receivables such as credit card receivables, U.S. and foreign trade receivables, factoring receivables, commercial loans, high-yield bonds, equipment leases, health care receivables, residential and commercial mortgages, insurance broker commissions, life settlements, cross-border electronic money transfers, rental car fleets, mutual fund fees, structured settlements, repurchase agreements and residual interests in securitizations.