



Forging ahead

US ABS continuing to battle headwinds

The US ABS market continued its post-crisis recovery in 2011, achieving decent issuance despite some battering headwinds. Those same headwinds are expected to impact the market again in 2012, although issuance and performance should both remain strong, with more esoteric ABS set to prove popular.

Ongoing regulatory wrangling, legislative issues and macroeconomic factors, such as the European sovereign debt crisis, have impacted the US ABS market and will continue to affect it in 2012. Barclays Capital consumer ABS analysts calculate that non-mortgage ABS primary issuance stands at US\$108.4bn in 2011 and predict US\$100bn-US\$115bn in 2012, with more than half of that likely to be auto-related.

Theresa O'Neill, md at Bank of America Merrill Lynch, says that autos and credit cards both performed relatively well in 2011, with spreads widening far less than in other markets. She notes: "From an excess return perspective or from a spread perspective, we saw a lot less volatility in these markets than the non-agency RMBS or certain corporate markets. They are traditionally viewed as safe-haven markets and they have performed that way."

O'Neill believes performance in 2012 should also be positive. She says: "We continue to be overweight the ABS sectors, with a few exceptions. Given the volatility, we would anticipate that most investors are going to want to stay higher up in the capital structure and look for products that are going to have a fair amount of liquidity, but we expect performance will be relatively good."

The Barcap analysts expect US\$65bn-US\$70bn of auto issuance in 2012. Credit card and student loan ABS are each expected to contribute around US\$11bn, with equipment and other non-mortgage ABS each contributing around US\$9bn.

Non-prime is starting to account for a greater proportion of auto issuance and the sector as a whole remains solid. Credit card ABS activity is a long way down on pre-crisis levels, but has more than doubled year-over-year to US\$12bn in 2011.

Student loan issuance is down on 2010, decreasing from US\$19.5bn to US\$15.2bn. FFELP issuance is dwindling as there is a finite supply of loans available for securitisation, with private credit transactions increasing market share next year.

Equipment ABS volumes have been fairly stable around the US\$7bn mark since the crisis hit in 2008 and reached US\$7.4bn in 2011.

As with 2011, regulation is expected to be a major market driver in 2012. Although it is likely to be at least another year before the full effect of the delayed implementation of the Dodd-Frank Act is fully felt, the uncertainty that persists as the market waits is certain to have an effect.

Ron D'Vari, ceo at NewOak Capital Management, believes regulation is going to be a hindrance next year, particularly for RMBS. He says: "In general we are still fairly negative on non-agency RMBS securitisation. There are

still some big issues in terms of Dodd-Frank in representations, conflict of interest and skin-in-the-game, so those will remain a concern. Because of those issues the market is going to struggle to get going, as much as we wish that was not the case."

O'Neill agrees that the uncertainty that the pending regulation is causing is not helpful. She says: "There are a lot of costs associated with interpreting and implementing changes. Ultimately these costs will be passed along to borrowers."

Risk retention is a central issue, but it is not the only one. "There are also other aspects of Dodd-Frank that need to be interpreted. In the consumer space, that slows down the origination process. When the rules are finally written, people will have to think through documentation issues and operational aspects that have to change," O'Neill says.

She adds: "From our perspective, we would not anticipate the market shutting down. Auto companies continued to access the market even throughout the crisis. The TALF programme was important in kick-starting that, but as far as risk retention is concerned, for example, most of the issuers retained first loss positions. They might have to hold more in the future, but they will manage to do so quite easily."

Indeed, D'Vari is confident that sectors such as auto ABS should be fairly robust. He says: "The more standard ABS sectors should perform pretty well. Obviously, the European situation is a concern and there are fears that it could kill the golden goose over in the US. But fundamentals in the US appear to be OK for the time being – barring global financial dysfunction created by a euro break-up. Issuance in 2012 should resemble issuance from early 2011, as opposed to how it has been towards the end of the year."

Although regulatory uncertainty remains and macroeconomic influences are inescapable, the US ABS market should weather those storms. Previously niche sectors that are less impacted by Dodd-Frank requirements such as risk retention should prove particularly popular.

Esoteric ABS, where skin-in-the-game is generally not a pressing concern, could be a strong growth area, particularly as investors hunt for yield. Rental car ABS could be one such sector set to see increased activity.

"Rental car transactions would certainly be an option. In the commercial and consumer space, a lot of the issuers have skin in the game, including rental car companies. They are securitising their fleet, so it is almost whole-business securitisation. Those esoteric sectors will perform well," says O'Neill.

She continues: "However, if volatility declines and concerns about the wider economy subside, then you will not see the same incremental yield in esoteric ABS as you would in certain mortgage products."

O'Neill believes esoteric ABS should do well in the current environment, but the upside is more limited. While rental and other esoteric ABS might outperform auto loan ABS, they would not outperform a sector such as CMBS.

D'Vari agrees that rental car ABS could be attractive. He says: "We believe things like auto rentals may come because it is an issuer-sponsored transaction where they are looking for funding and keeping most of the first-loss risks. We are also seeing activity in the speciality finance area in the multi-lateral private transaction form, which is akin to a securitisation, but is actually a good way to address Dodd-Frank."

He continues: "It is not strictly a security, so the regulations do not all apply. We are seeing US\$50m-US\$300m sizes there. That is one area that is under the radar and we are seeing these are transactions being originated and put together by boutique firms like ours that are working with smaller issuers."

In RMBS, the market will be clearly split between investment grade and non-investment grade. Ankur Makhija, svp at Odeon Capital Group, believes US investment grade RMBS will fare well in 2012.

He says: "We anticipate robust demand for investment grade non-agency RMBS as the universe for quality investment bonds shrinks. US non-agency investment grade RMBS is a very good alternative to sovereign and other ABS bonds because of the upfront nature of cashflows in the pass-through structure. A lot of those bonds have very strong internal credit enhancement relative to delinquencies."

Non-investment grade RMBS is another matter. Fundamentals may have a negative impact on pricing, although technical factors will limit this.

Makhija explains: "We anticipate depreciating short-term cashflows in highly delinquent subprime, Alt-A and option ARM pools. The crux to valuation of these securities is to understand the nature and repercussions of restructuring of underlying pools."

He continues: "The underlying borrowers in those pools are going through restructuring in terms of modifications, delinquencies and liquidations of delinquencies. I think institutional investors are still grappling with the full repercussions of all of that."

The limited availability of non-investment grade RMBS should act to limit the downward pressure on prices. The increasing scarcity of non-investment grade non-agency RMBS should provide a level of pricing support.

Makhija says: "For the 2006/2007 vintage non-investment grade bonds, we expect cashflow challenges to continue in 2012. That may push the prices down, but we do not expect a strong downward price movement because of limited availability of this product."

Front-ended cashflows in highly delinquent pools has been decreasing and this trend is expected to continue in 2012. There may be a rally for non-investment grade bonds if the US economy shows a strong sign of recovery, but Makhija believes that this is very unlikely, at least for the first half of the year.

Ultimately, the US structured finance market in 2012 will face many of the same issues that it faced in 2011. Performance and issuance should also be similar. O'Neill is fairly optimistic for the market's prospects: while she expects consumer ABS issuance for 2011 to total US\$120bn, she believes 2012 will comfortably top that.

She says: "We expect US\$140bn of issuance for 2012. I would expect credit to continue to improve in the first half of the year, albeit at a slower pace than we have been seeing."

[JL](#)

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