JSF the Journal of STRUCTURED FINANCE

VOLUME 19, NUMBER 3 FALL 2013

We begin this issue with a summary of the "Assessing the Effectiveness of Global Regulations" panel discussion at the June 2013 Global ABS conference in Brussels co-written by Jason Kravitt, the panel moderator, and his panel members Jim Ahern, Alexander Batchvarov, Kevin Duignan, Christine Lang, and Frank Meijer. Complexity and overreach were two of the prominent themes in the panel members' discussion of regulatory capital and other regulatory developments. Mr. Batchvarov notes that the December 2012 Basel proposal on the regulatory capital framework for securitization took the market by surprise, indicating potentially a significant increase in regulatory capital for securitization, which the securitization industry and specialized investors consider excessive and unjustified based on the historical performance of the securitization market. He does not think the proposed framework achieves the stated goals of risk sensitivity, simplicity, and transparency but instead addresses the concern of cliff risk by artificially boosting overall capital for securitization.

"While European and North American Regulators repeatedly say that securitization is a necessary financial tool to finance growth and hence a financial recovery, they consistently adopt regulations that go too far in attempting to cure the financial crisis' past mistakes and that do not fit together with each other, particularly in the case of the regulations adopted by the United States on the one hand and by the European Union on the other," Mr. Kravitt observes. "This is not to say that reform was neither desirable nor necessary—it is necessary and desirable—but rather that the right touch in reform is what makes all of the difference," he adds.

In his article, John Ryan explains how long-term, high-yield project finance loans can meet the needs of both project sponsors looking for stable funding sources and institutional investors, such as pension funds, insurance companies, endowments, and foundations looking for good yields and long maturities. Those institutional investors are expected to assume an increasing share of infrastructure financing because the financial crisis and its associated regulatory changes have exposed the real cost of the mismatch between commercial banks' relatively short-term funding and the long-term tenor of project finance loans. We revisit infrastructure finance in the collateralized loan obligation (CLO) section of this issue.

Laurie Goodman, Lidan Yang, and Brian Landy analyze the first government-sponsored enterprise (GSE) risk-sharing transaction,

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Freddie Mac's STACR (Structured Agency Credit Risk) 2013-DN1, in which private investors bear some of the credit risk. "One of the goals of the FHFA's Strategic Plan is to shrink the GSE footprint, allowing for a larger role for private capital," Ms. Goodman notes. "One of the major channels through which this is to be accomplished is credit risk sharing between the GSEs and the capital markets," she explains. "The STACR deal is very important, as it creates a blueprint for the many risk-sharing deals to come."

In the first of eight articles in our section on CLOs, Brian Juliano and Edwin Wilches focus on identifying and analyzing the differences that exist among CLO structures and their collateral managers and how those differences can influence the pricing of a CLO. "The alpha realized by CLO tranche investors will, in large part, be driven by covenants, or lack thereof, that were negotiated in the offering documents," Mr. Juliano observes. "An important aspect of the CLO assessment process is ensuring the CLO indenture and structure are appropriate for the manager's capabilities and experience," Mr. Wilches adds.

In their article, Serhan Secmen and Batur Bicer explain why an astute CLO investor needs to analyze the manager as well as the collateral and the structure, and they recommend factors investors should consider in evaluating and investing in CLO managers. CLOs have proven to be a unique securitized product compared with their asset-backed peers, especially because of their significant outperformance during and after the past crisis, the authors observe. CLO managers, who are the most important factor in this performance, need to be analyzed carefully as part of a sound CLO investment decision. To do that, investors should not only focus on quantitative measures available through managers' track records but also on understanding the qualitative characteristics of those managers. They should make sure that whatever conclusions they draw with respect to managers are consistent, explainable, and repeatable.

Saffet Ozbalci explains all the variables that determine CLO equity returns, including the spread on assets, the weighted average cost of liabilities, the arranger fee, the management fee, deal stipulations, and leverage. He explores why the CLO manager's style and performance are among the most important determinants of equity performance. Mr. Ozbalci contends that a buy-and-hold approach to investing in CLO equity no longer works in today's market and instead recommends an actively managed portfolio that includes junior parts of the capital structure.

David Yan observes in his article that as demand for leveraged loans has outpaced supply, managers of recent CLOs have invested in increasing amounts of loans from the same issuers—a concern for CLO investors seeking diversification. He measures the overlap of issuers in recent-vintage CLOs in several ways.

Erica Gut, Debra Rappoport-Bigman, Rebecca Lee, Dominick Dell'Imperio, Kara Friedenberg, and Louis Bennett explain the basics of the U.S. Foreign Account Tax Compliance Act (FATCA), the need for a CLO to become tax compliant to avoid the requirement for the issuers of U.S. debt to withhold certain interest and other payments, and industry efforts under way to carve out exceptions for existing CLOs and new CLO vehicles. Newly formed CLOs can be established as FATCA-compliant from the outset, but there are more issues for outstanding CLOs, which the authors explain in detail.

Martin Sharkey reports that this year has seen a reopening of the CLO market in Europe. He explains that this new breed of European CLO 2.0 transactions follows the path forged by their U.S. counterparts, having learned the lessons of the first generation; they contain features that are attractive to debt investors but also grant greater flexibility to collateral managers and equity investors in certain situations.

Jay Grushkin and Dan Bartfeld write that we have seen a remarkable resurgence in the CLO market in the past two years, although the choppiness of the U.S. and global M&A markets (and consequently the leveraged loan market) has limited the supply of loans in which CLO managers may invest as Mr. Yan observes in his above-cited article.

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Meanwhile, there is a serious call for project finance loans to fund exponential growth in infrastructure development needs, traditional bank project lenders are looking for balance sheet relief in the wake of Basel III, and project loans are perhaps the largest class of commercial loans that have not taken an active role in the CLO market. In the authors' view, these three phenomena suggest that the stars may be in alignment for the comeback of the project finance CLO. They discuss numerous attributes of project finance loans that make them attractive for CLOs as well as those that pose challenges to their securitization.

Finally, James Richards and Conor Houlihan explain the benefits of Ireland's extensive double tax treaty network, its tried and tested common law system, its prompt and user-friendly listing regime for debt instruments, and its special tax regime for special purpose vehicles, including those for CLOs. They also point to possible major changes that could result in Ireland becoming a platform for loan origination by investment funds.

We will have more articles on CLOs in future issues.

Henry A. Davis
Editor