



The return of private MBS: a conundrum

Federal Reserve Bank of Chicago
50th Annual Conference on Bank Structure and
Competition

May 8, 2014

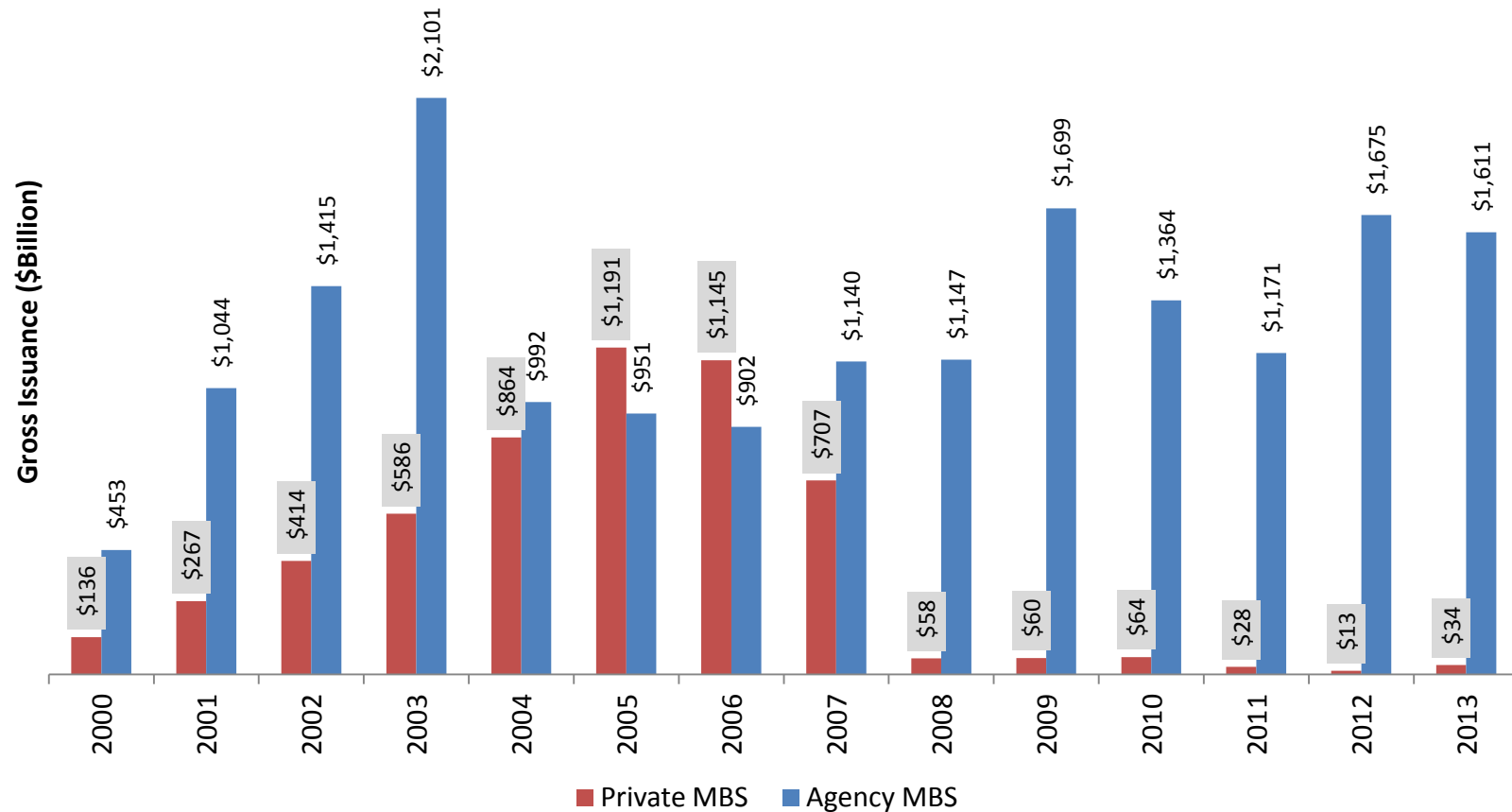
Passion to Perform

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The market for private MBS has largely disappeared since 2007

Agency MBS has largely replaced private MBS



Source: Deutsche Bank



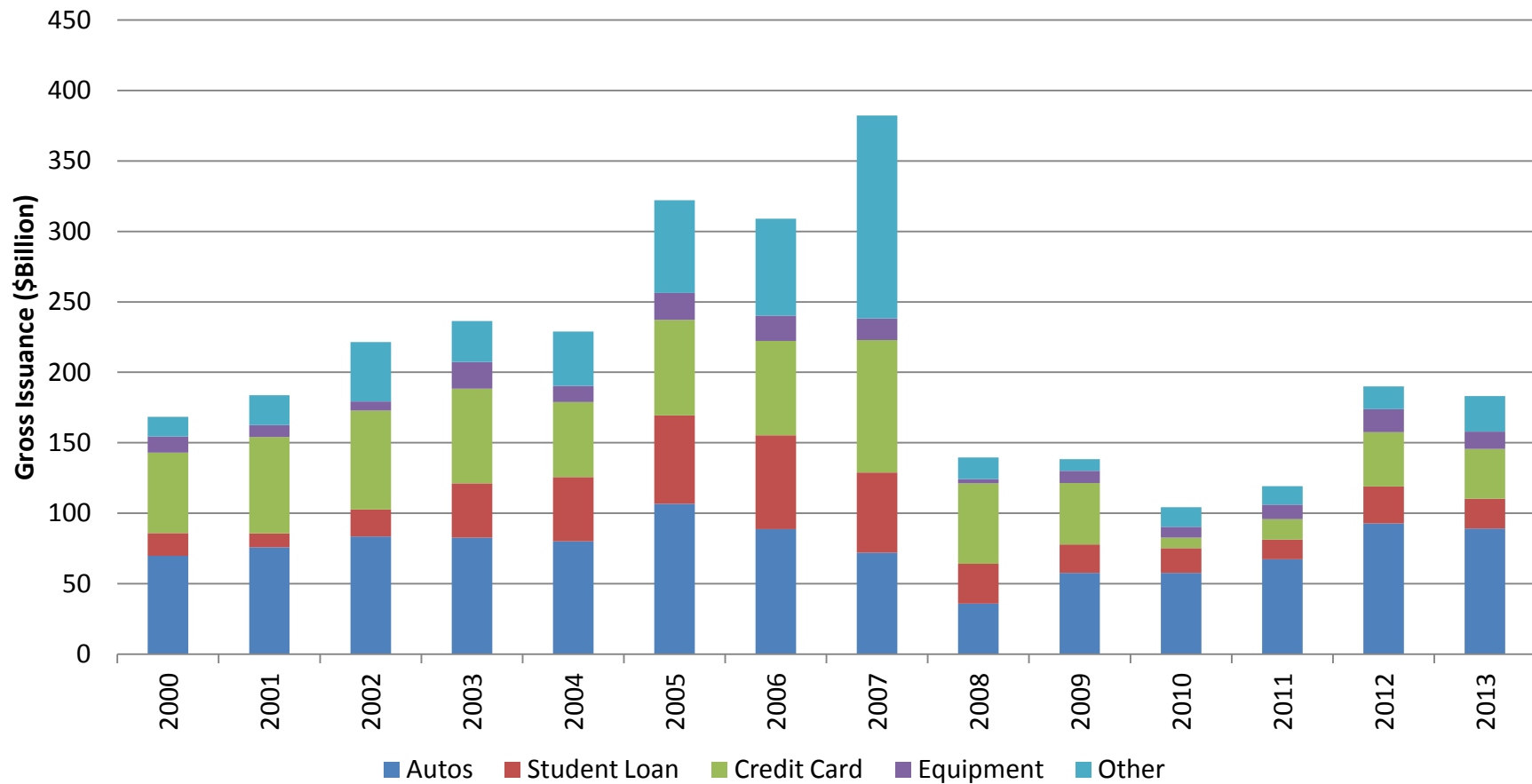
The list of possible explanations is long and ranges from principal-agent issues to competition

	Possible cause	Effect
Principal-Agent	Limited risk retention	Originator, investor incentives misaligned
	Diverse reps and warranties	Originator, investor incentives misaligned
	Diverse servicing standards	Servicer, investor incentives misaligned
	Poor trustee guidelines	No ability to resolve conflict between investors
Issuer Risk	Legal uncertainty	Hard to securitize before understanding grounds for put backs, foreclosure, eminent domain
	Regulatory uncertainty	Hard to securitize before resolving QM/QRM and servicing standards under Dodd-Frank
	Poor past performance	Lack of confidence in credit rating agencies and/or investors' own risk assessments
	Competition	Agency MBS and bank portfolio lending takes the business



The conundrum: securitization has rebounded in other assets like consumer loans...

Securitization of subprime auto loans has led the ABS rebound

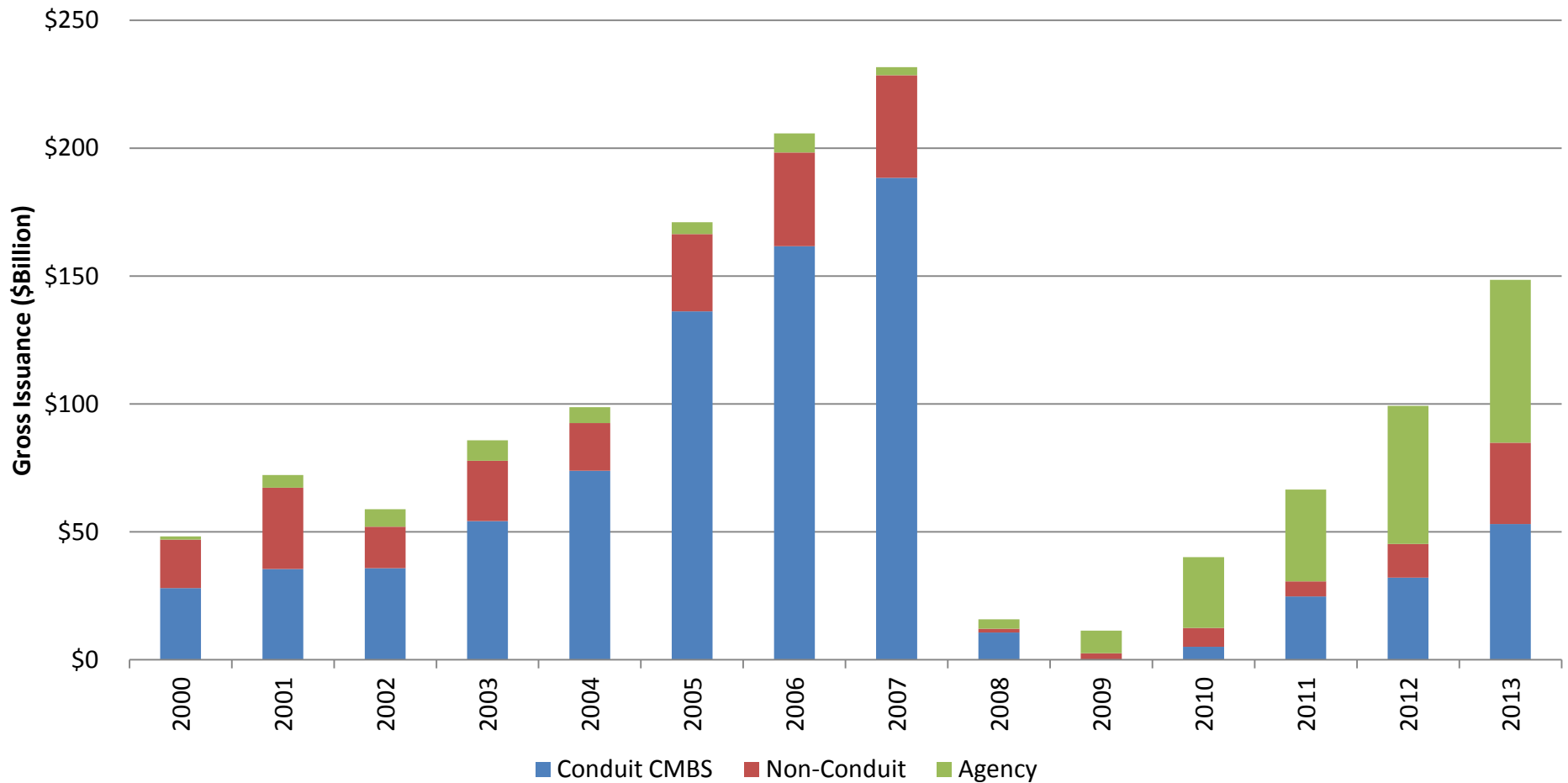


Source: Deutsche Bank



And in commercial mortgage loans...

Securitization of commercial mortgages has returned to pre-boom levels

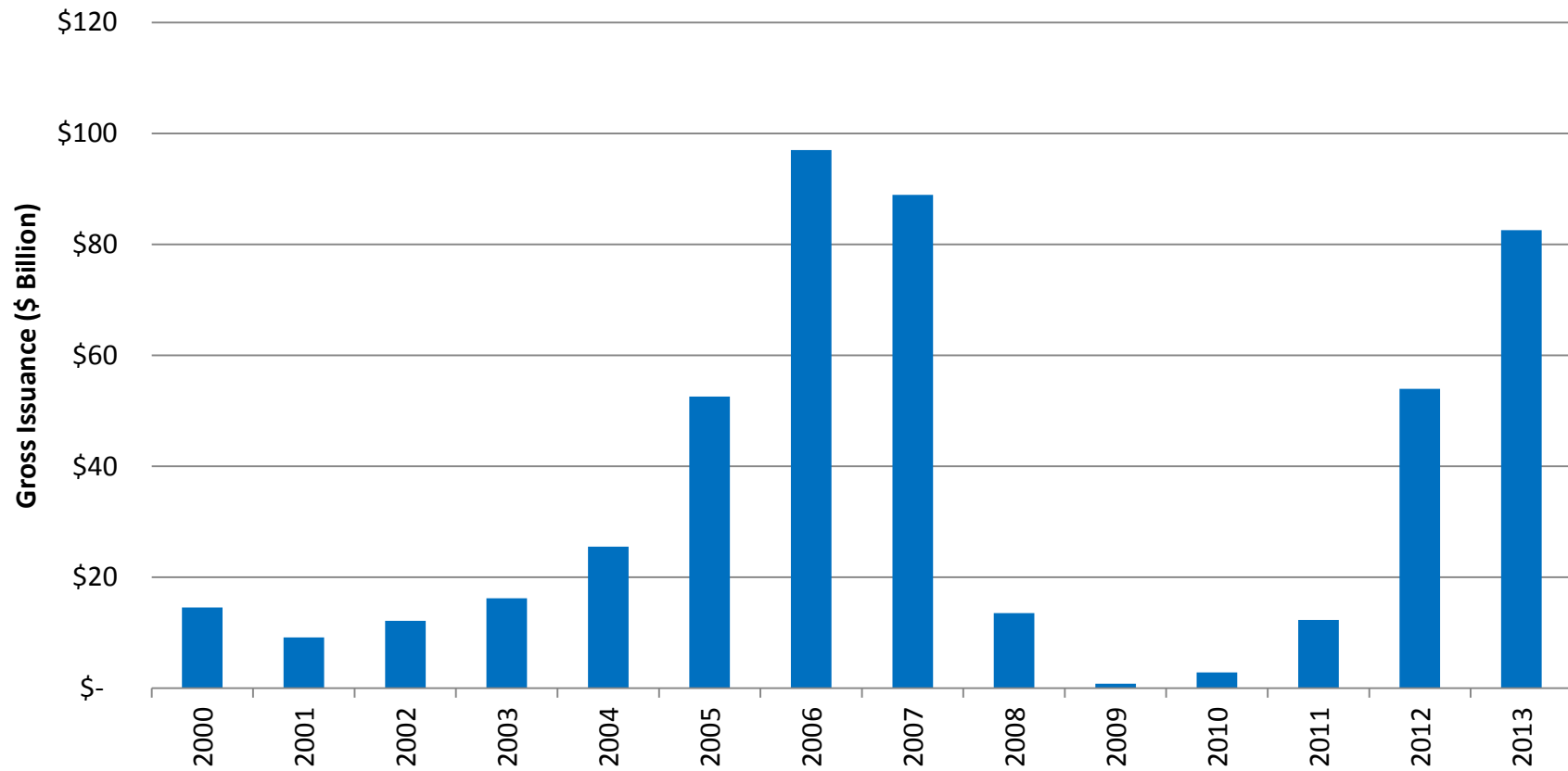


Source: Deutsche Bank



And in leveraged loans...

Securitization of leveraged loans has nearly returned to pre-crisis levels



Source: Deutsche Bank

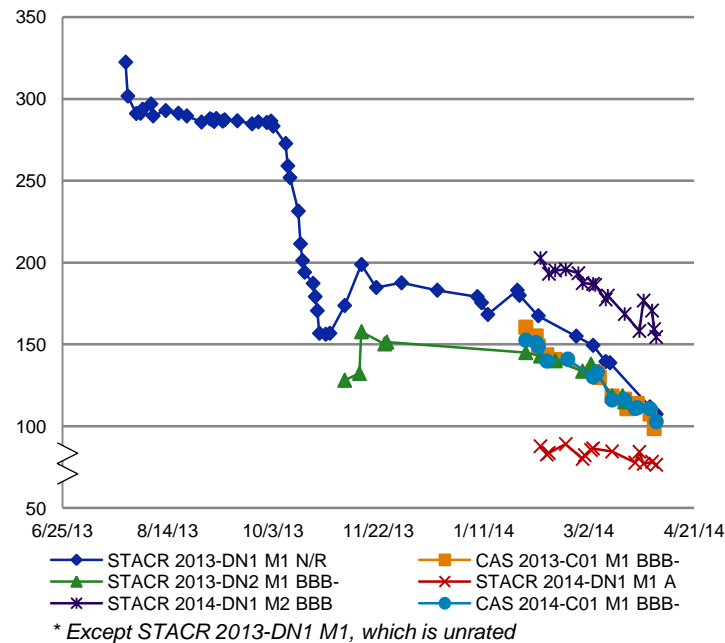


And even in the credit risk of loans guaranteed by Fannie Mae and Freddie Mac

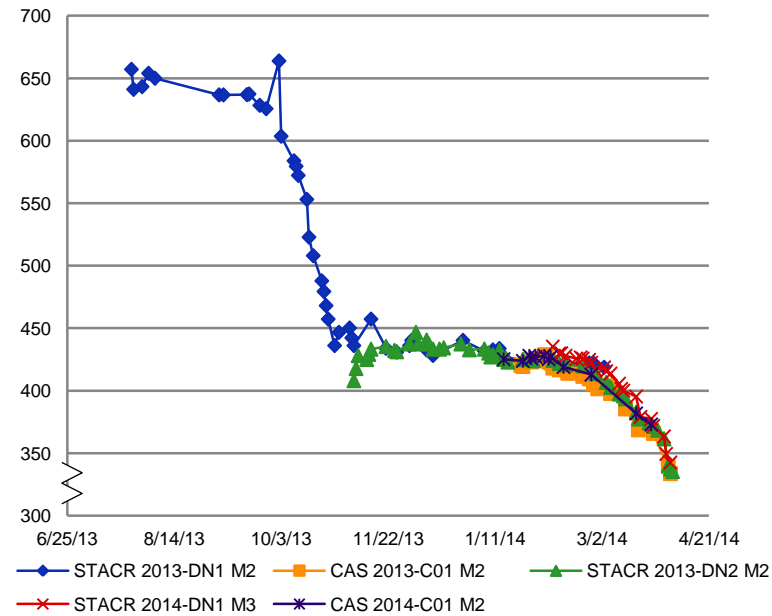
Agency risk-sharing transactions

Date	Transaction	Innovation
July 2013	STACR 2013-DN1	Inaugural risk share transaction
October 2013	CAS 2013-C01	First rated (Fitch) senior note
November 2013	STACR 2013-DN2	Multiple rating agencies rate the senior note
November 2013	STACR 2013-DN2	Exchangeable classes introduced
February 2014	STACR 2014-DN1	Sold above 3.00%, introduced 3 note structure
February 2014	STACR 2014-DN1	Single A ratings

Spreads – Rated Tranches*



Spreads – Unrated Tranches



Source: Deutsche Bank

7



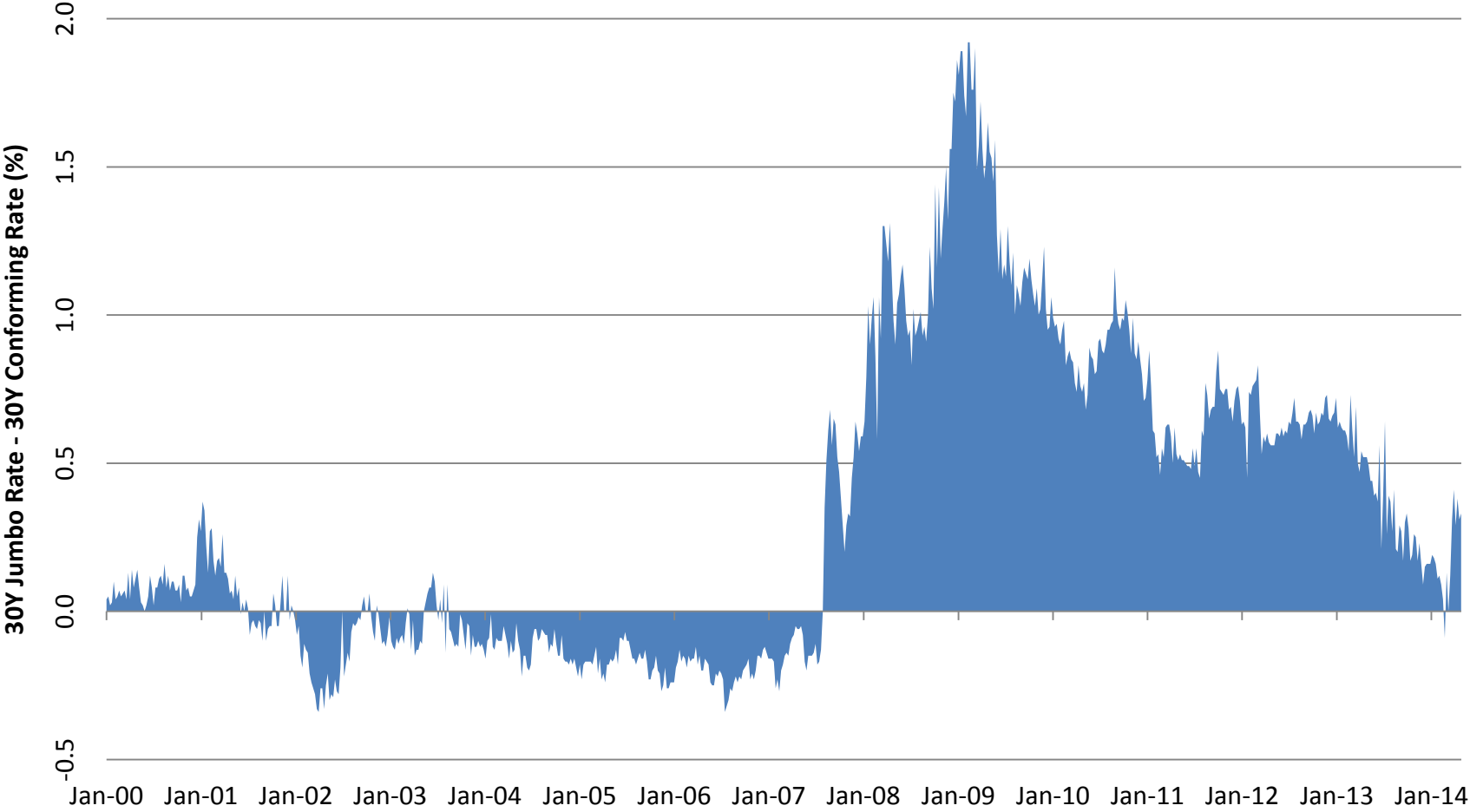
The rebound in other markets frames the prospects for private MBS

	Possible issue	Selected evidence from other securitized markets
Principal-Agent	Risk retention	None required in auto ABS, CMBS, CLOs
	Reps and warranties	Made in ABS, CMBS, CLOs but not standardized
	Servicing standards	Applicable in ABS, CMBS, CLOs but not standardized
	Trustee guidelines	No new mechanisms in ABS, CMBS, CLOs to resolve investor conflicts
Issuer Risk	Legal uncertainty	Less in ABS, CMBS, CLOs
	Regulatory uncertainty	Less in ABS, CMBS and possibly CLOs
	Past performance	Strong in most ABS and CLOs, weaker in CMBS; very weak in MH (1990s), aircraft ABS (early 2000s), subprime cards (late 2000s), private student lending (late 2000s), which never recovered; no obstacle to GSE risk transfers
	Competition	Competition in CRE from insurers, competition in student lending from government, competition in aircraft lending from EU banks



Primary suspect: competition

Agency securitization and bank lending has offered better economics than private MBS



Source: Bankrate.com, Freddie Mac



Agency securitization and bank portfolio lending have competitive advantage in capital, funding, information

Source of funds	Advantage
Agency securitization	<ul style="list-style-type: none">• Low implicit capitalization• Sizable liquidity premium
Bank portfolio lending	<ul style="list-style-type: none">• Low cost of funds• Better information



Implications: a little daylight

- Markets remain willing to price private securitizations
- Private MBS can return under limited circumstances
 - Demand for loans exceeds government and bank willingness and capacity
 - Government and bank willingness or capacity shrinks, or
 - Both



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A large, three-dimensional graphic of the Deutsche Bank logo is positioned on the left side of the slide. It consists of a blue square frame with a red diagonal line, set on a red base. The graphic is placed on a cobblestone path that leads towards a city skyline in the background. Two small figures of people are visible standing on the path near the logo.

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Appendix 1

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Steven Abrahams

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