

# In Conversation With



ANNA H. GLICK



STUART N. GOLDSTEIN



PATRICK T. QUINN

Eric Berman of Practical Law Company sat down with Anna Glick, Stuart Goldstein and Patrick Quinn, Partners at Cadwalader, Wickersham & Taft LLP, to discuss their views on developments in the securitization market.

**PLC: What is the current state of the securitization market and where do you think the market is headed?**

**Quinn:** The securitization markets have started up again. In the case of ABS, TALF has had some of its intended effect. I would not call it robust, but there has been a steady stream of ABS transactions — credit cards, auto loans, and so on. We are at the point where we are starting to see non-TALF ABS transactions, which is a great sign for the securitization market.

**PLC: What about the MBS market?**

**Quinn:** The residential mortgage market, for securitization at least, is still frozen, other than agency deals which are happening with a fair amount of frequency. The agency market is quite robust, which is perhaps the explanation for why the private label market has not really recovered yet.

**PLC: What are some of the issues that this market has presented for practitioners?**

**Glick:** There is a different strategy for bondholders at different levels of the capital structure. The triple-A bondholders paid close to par if they bought at initial issuance. Then there are the junior bondholders, who may get wiped out if servicers foreclose on a defaulted loan and liquidate the property. And then there are the bondholders who bought senior bonds more recently in the secondary market at a discount and who would do very well if the servicer foreclosed, sold the property and applied the proceeds as required by the securitization documents to payment on the senior bonds. The situation is much more complicated than the traditional bank mortgage lender of the '90s who had to deal with declining values. Now we have different "lenders" within the capital structure, with different motivations.

**PLC: There has been much concern about the CMBS refinancing cliff. How do you think this is going to play out?**

**Glick:** In the beginning we were all focused on maturity defaults because borrowers could not refinance but were able to make their monthly debt-service payments. However, that trend may change. We are hearing that servicers are now seeing properties that are unable

to make their monthly debt service because of falling revenues either because business is falling off (for example, hotel properties) or because tenants are defaulting on rent payments or cancelling leases. This means that we are going to start seeing more term defaults, which cannot be solved by an extension. Special servicers have seen a significant increase in the number of loans in special servicing and tell us they are expecting many more loans to head their way, particularly large complex loans.

**PLC: With multiple layers of servicing that you often see in securitization deals, many times it is impossible to even get a servicer — or the proper servicer — to discuss these issues. How responsive are servicers in the current market?**

**Quinn:** The servicers are trying to be as proactive as possible, given market conditions. But we do hear from the borrowers that it is difficult to get the attention of some servicers.

**Glick:** It also depends on the type of borrower. There is the borrower who is stressed, unable to pay its balloon and acknowledges there is a problem and comes up with a plan. In contrast, there is the borrower who you might call opportunistic — who knows that it is now acceptable for borrowers to come in and ask for modifications, even though their loan is five years away from maturity. Many of our clients were surprised that entities which owned properties with debt with over five years to maturity were put into bankruptcy as part of the GGP case. If you are a borrower and you have a loan that has five years to go, servicers are probably not going to talk to you.

But special servicers who become involved when the loan becomes troubled have said that if properties are otherwise doing as well as can be expected but the borrower just cannot refinance the loan, they will be receptive to extending the loan because there is no purpose in foreclosing and then having the trust fund own real estate it cannot sell because of depressed pricing and lack of financing options for prospective purchasers. If a borrower is doing all that can be done with the property and it is just lack of financing that is the issue, servicers seem to be inclined to recommend one or two-year extensions.

**PLC: What are your thoughts on some of the transaction structures that we are starting to see more frequently — so-called smart securitization or repacks?**

**Quinn:** You read the press coverage that says, “Wall Street is at it again”. But these transactions are not just smoke and mirrors. The newly issued securities in re-securitizations, for instance, are higher quality assets than the underlying securities. You are creating more security for the top tranche, so why should you not receive better capital treatment? It is a better piece of paper. And you have not done anything that is hocus pocus — it is just solid economics. There are a lot of ways to improve the credit quality of what you own.

**PLC: Do you expect the newly implemented FAS accounting changes, FAS 166 and 167, to significantly impair the securitization market?**

**Quinn:** The new rules will not prevent securitizations. Of course, deals will have to be structured to comply with the new rules. The rules may also change the demand for certain types of securities by certain types of investors.

**Glick:** But it is going to be a hurdle. There will need to be some restructuring. Companies will have new assets on their books as a result of the accounting rules. Therefore disclosures and financial statements are going to have to make clear why their balance sheets have swelled up with these assets.

**PLC: More specifically, what are some of the issues that arise from these accounting changes?**

**Quinn:** Every structure is going to have to be examined. There is no grandfathering. It will require looking at all of the outstanding securitizations to decide if they need to be consolidated. It may not be the originators that have to consolidate. It may not be the sponsor. The result might be that the holder of the lower tranche who hired the servicer may have to consolidate.

**Goldstein:** And that is important in terms of some of these consolidation issues with the non-transferors that may have to consolidate. Particularly in connection with entities that have financial covenants or other leverage issues. Another question is what that does to their balance sheet and if it will cause them to inadvertently default on their financing facilities.

**PLC: Do you think some of the proposed federal regulations will be enacted even though they might not facilitate the return of the securitization markets?**

**Goldstein:** It is likely that some regulations will be enacted that the market will view as suboptimal from an efficiency standpoint. The question is how the market will adapt to that. And in large part that will depend on how the various regulators and the various institutions coordinate their efforts. The market can adapt to most anything, as long it makes some degree of sense. What would be problematic is if we get programs that move in different directions.

**PLC: What are your thoughts on the increased capital cushion requirements?**

**Goldstein:** Credit will develop over time based on people’s appetite for risk. That is not going to be a function so much of what is legally dictated as what the market demands. In terms of the delineation of the regulatory regimes and the requirements from accounting standpoints, that will be promulgated the same way that Sarbanes-Oxley and Regulation AB were promulgated — it will be digested and people will do deals that make economic sense. The risk is that if things get too convoluted, too subject to interpretation, if you try to kill the fly with the sledgehammer, people will not have a sense of how to do deals and then people will opt out, at least for the near term. I do not think that is what the government’s intention is, if they want credit to begin flowing.

**PLC: Some question whether the securitization market should even be striving to return to its prior form. Do you have a response to these criticisms?**

**Quinn:** Securitization has dramatically improved the standard of living in developed economies. That is why it has been the envy of the developing economies for years. There has been a tendency to villanize the concept of securitization because of what has happened in the markets. But it is not securitization that has caused the problems. Problems were caused by overleveraging, poor underwriting of the underlying assets, and so on. Maybe the existence and the availability of securitization made it easier for lenders to do that. But that does not make securitization itself a bad thing. With rational controls in place, securitization will be key to resumption of normal credit markets.