Green Street

Asset-Backed Alert

THE WEEKLY UPDATE ON WORLDWIDE SECURITIZATION

End In Sight for Crisis-Era Case

Trustees including **Wells Fargo** are awaiting instructions on how to finish distributing proceeds from a $4 billion settlement between **J.P. Morgan** and investors who lost money on the bank's mortgage bonds amid the 2007-2008 financial crisis.

A **New York State Supreme Court** justice laid out a roadmap in February 2020 that cut through procedural disputes between holders of those deals' senior and junior securities. But senior investors appealed, with arguments heard on May 14.

At issue are so-called subordinate writeup provisions attached to about 25% of the 320 securitization trusts involved in the J.P. Morgan settlement. Those terms require paying agents to use certain recovered capital, including settlement proceeds, to reverse losses for subordinate bonds before — or in some cases, instead of — senior notes.

While such provisions are unusual today, they were fairly common in the early 2000s. That's because by reducing risk for subordinate bonds, the issuers could market them more easily to investors seeking to resecuritize the holdings.

And senior bondholders tended to overlook the provisions, relying more heavily on credit ratings instead.

The **U.S. Justice Department** approved the original settlement with J.P. Morgan in 2013, with a modification taking place in 2014. However, the agreement didn't become effective until the **IRS** supplied private guidance to the parties involved in 2017.

But instructions for distributing the settlement proceeds still conflicted with governing documents for some of the securitizations. Case in point: The settlement required that payments be allocated to bondholders in the reverse order of the way losses accrued.

That meant senior bondholders — or at least those that took any losses — would receive the first distributions

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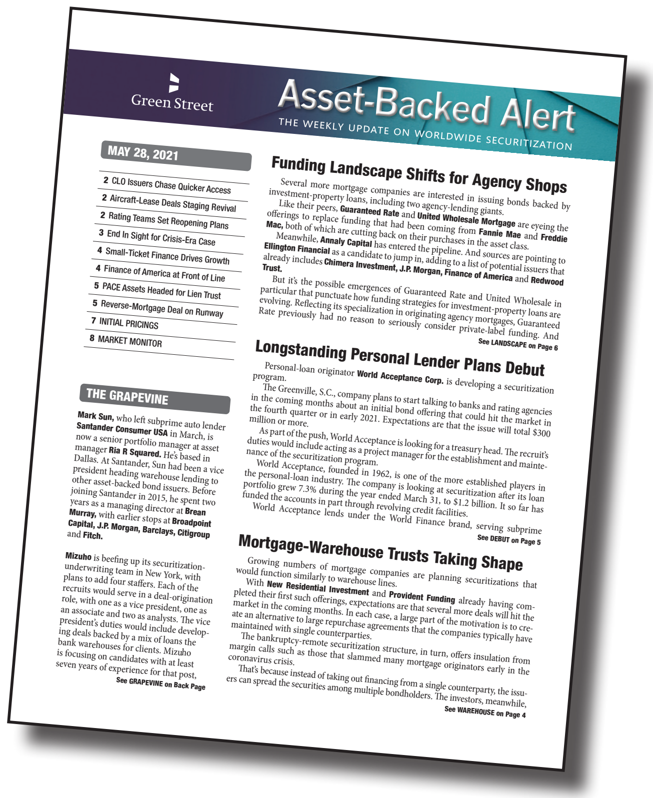

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MAY 28, 2021

THE GRAPEVINE

Mark Sun, who left subprime auto lender **Santander Consumer USA** in March, is now a senior portfolio manager at asset manager **Ria R Squared.** He's based in Dallas. At Santander, Sun had been a vice president heading warehouse lending to other asset-backed bond issuers. Before joining Santander in 2015, he spent two years as a managing director at **Brean Murray,** with earlier stops at **Broadpoint Capital, J.P. Morgan, Barclays, Citigroup** and **Fitch.**

Mizuho is beefing up its securitization-underwriting team in New York, with plans to add four staffers. Each of the recruits would serve in a deal-origination role, with one as a vice president, one as an associate and two as analysts. The vice president's duties would include developing deals backed by a mix of loans the bank warehouses for clients. Mizuho is focusing on candidates with at least seven years of experience for that post,

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Funding Landscape Shifts for Agency Shops

Several more mortgage companies are interested in issuing bonds backed by investment-property loans, including two agency-lending giants.

Like their peers, **Guaranteed Rate** and **United Wholesale Mortgage** are eyeing the offerings to replace funding that had been coming from **Fannie Mae** and **Freddie Mac,** both of which are cutting back on their purchases in the asset class.

Meanwhile, **Annaly Capital** has entered the pipeline. And sources are pointing to **Ellington Financial** as a candidate to jump in, adding to a list of potential issuers that already includes **Chimera Investment, J.P. Morgan, Finance of America** and **Redwood Trust.**

But it's the possible emergences of Guaranteed Rate and United Wholesale in particular that punctuate how funding strategies for investment-property loans are evolving. Reflecting its specialization in originating agency mortgages, Guaranteed Rate previously had no reason to seriously consider private-label funding. And

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Longstanding Personal Lender Plans Debut

Personal-loan originator **World Acceptance Corp.** is developing a securitization program.

The Greenville, S.C., company plans to start talking to banks and rating agencies in the coming months about an initial bond offering that could hit the market in the fourth quarter or in early 2021. Expectations are that the issue will total $300 million or more.

As part of the push, World Acceptance is looking for a treasury head. The recruit's duties would include acting as a project manager for the establishment and maintenance of the securitization program.

World Acceptance, founded in 1962, is one of the more established players in the personal-loan industry. The company is looking at securitization after its loan portfolio grew 7.3% during the year ended March 31, to $1.2 billion. It so far has funded the accounts in part through revolving credit facilities.

World Acceptance lends under the World Finance brand, serving subprime

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Mortgage-Warehouse Trusts Taking Shape

Growing numbers of mortgage companies are planning securitizations that would function similarly to warehouse lines.

With **New Residential Investment** and **Provident Funding** already having completed their first such offerings, expectations are that several more deals will hit the market in the coming months. In each case, a large part of the motivation is to create an alternative to large repurchase agreements that the companies typically have maintained with single counterparties.

The bankruptcy-remote securitization structure, in turn, offers insulation from margin calls such as those that slammed many mortgage originators early in the coronavirus crisis.

That's because instead of taking out financing from a single counterparty, the issuers can spread the securities among multiple bondholders. The investors, meanwhile,

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even if subordinate writeup provisions dictated that the opposite should happen. So in December 2017, trustees Wells Fargo, **BNY Mellon, Deutsche Bank, HSBC, U.S. Bank** and **Wilmington Trust** petitioned the New York court for instructions.

That request took place under Article 77 of New York's Civil Practice Law and Rules, which gives the Supreme Court jurisdiction over cases involving most trusts and speeds up the judicial hearing process. Next came last year's roadmap, in which the court held that the securitizations' pooling and servicing documents should be interpreted as written — placing junior bondholders first in line in some instances.

The senior bondholders' appeal, in turn, argues that the documents do not explicitly prohibit writeups of their positions. Among those seeking a reversal are **Aegon, BlackRock, Invesco** and **Voya Financial.**

Maya Cater Scheef, a partner at law firm **Kleinberg Kaplan,** says a reversal on appeal would upend more than 100 years of New York contract law while carrying broad ramifications to all types of securities contracts. That's because it would mean, in effect, that courts could alter the economics of those transactions.

"If courts tinker with cashflow provisions, it affects not only the price or value of the bond, but also the ability of any party in a transaction to hedge the risk," Scheef said. She plans to file a friend-of-the-court brief on behalf of a subordinate bondholder.

The brief urges the court to apply the contractual language as written, focusing on the market forces at play at the time the trusts formed and the reasons the parties and others would want to write up subordinate classes.

Others say the case is not so straightforward.

Joseph Cioffi, a **Davis + Gilbert** partner who also represents parties in mortgage-bond litigation, said the original deal documents weren't written with huge legal awards in mind. For some of the trusts, for example, the settlement proceeds could be so large that there would be money left over if the senior notes can't be written up.

That's partly a function of the scale of the bondholders' losses, which resulted in writedowns for senior notes. The parties also might have factored in prejudgment interest on those losses at New York's statutory rate of 9% a year. And there's the fact that the settlement agreement doesn't allow any proceeds to go toward residual interests.

Senior noteholders additionally can claim to be adhering to contract language. In spite of the subordinate writeup provisions, the securitizations more generally provide for the priority of the senior notes. And if any class is written up, they could make the case that the senior notes should be as well. "What the language means here is in the eye of the beholder, so both sides can claim to be on the side of adhering to the contract language," Cioffi said.

The court's instructions also are expected to address the order of operations, including whether writeups should occur before payouts and whether certificates that have unwound or that have zero balances can receive writeups.

There is also the matter of whether a settlement should override pooling and servicing agreements. That's bound to come up in other settlements involving multiple trusts due to variations in their pooling and servicing terms.

The trial component of the court initially held that the settlement controlled only matters the pooling and servicing agreements didn't address. "Given the world we live in today versus the expectation when deals were inked, the parties need the flexibility to negotiate settlement terms and have the settlement agreement control," Cioffi said. ❖