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ESOTERIC ABS: PUSHING THE ENVELOPE

Sponsors and underwriters repeatedly push the envelope to introduce new asset classes into the market, some of which join the lower-yield world of commoditized ABS while others disappear. After a prologue describing the general features of the esoteric ABS market, the author discusses in detail cell phone contract securitizations by Verizon; wireless spectrum securitization by Sprint; solar power securitizations by several companies; and Property Assessed Clean Energy programs under state and municipal laws. He closes with discussions of marketplace lending and whole business securitizations.

By Ronald S. Borod *

PROLOGUE

Most discussions of esoteric asset-backed securities¹ begin with a definition. Esoteric ABS, however, cannot be given a tidy definition but rather is identifiable by the presence — or the absence — of certain characteristics. One characteristic that is normally absent from esoteric ABS is collateral that has been “commoditized” in large and repetitive securitizations that attract AAA or AA ratings and are issued at tight spreads to the applicable benchmark rate due to the familiarity and relative safety of the collateral. (However, as we will see later in this article, some esoteric ABS are also sometimes issued at tight spreads, even when new to the market.) The

volume of assets supporting esoteric ABS is also generally smaller and the data regarding the performance of the assets is generally less available or robust, and thus the ratings tend to be in the A/BBB categories. Also, some of the structural features and documents are bespoke and thus the investors must take more time to review the transactions; and the deal sizes tend to be smaller, and thus less liquid. Consequently, the securities are priced at wider spreads, at least during the earlier stages of the asset class’s life cycle. (However, there are also exceptions to this rule, as illustrated below.)

Two other features common to esoteric ABS are structural innovation and heightened rating agency scrutiny: As each new asset class makes its debut in the capital markets, new deal features are required to address risks and credit deficiencies associated with the assets, and the transactions are subjected to vigorous analysis and stress testing by the rating agencies. Another feature of esoteric ABS is a lengthy gestation

¹ Most esoteric ABS are sold pursuant to the exemption from registration under SEC Rule 144A and are therefore not registered with the SEC. Thus, the transactions discussed in this article are generally not available for detailed review by those not actually participating in these transactions.

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