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Executive Summary

For the purpose of this primer, consumer asset-backed securities (ABS) are structured finance securities collateralized by pools of auto loans and leases (auto ABS), credit card receivables (credit card ABS) or student loans (student loan ABS[SLABS]).

- o Auto loans, leases and credit cards are typically segmented into three credit sectors: prime; mid-prime; and subprime.
- o Auto ABS, credit card ABS and SLABS accounted for 29% of ABS issuance in 2017.
- o Auto ABS have residual value (RV) risk that is not found in credit card ABS or SLABS



Chart 1: ABS as Percentage of U.S. Fixed Income Outstanding (Q2 2018)

Auto ABS are backed by auto loan or lease receivables. Auto loans and leases typically are:

Fixed simple interest. Level-pay installments. Payable monthly over a predetermined time frame. Structured with terms that typically range from 12 to 84 months. Secured by an automobile.

Each installment of an auto loan includes a portion of principal repayment plus interest and fees amortized over the life of the loan. The monthly installment on an auto lease is not for the repayment of principal; rather, it is the difference between the price of the vehicle and the RV of the vehicle at lease end plus interest and fees. RV is the expected fair market value of a vehicle at the end of the lease term.

In addition, the auto finance sector (also applicable to credit cards) is typically segmented into three credit sectors: prime; mid-prime; and subprime (see Table 1). According to Fitch Ratings, a prime borrower has a credit score of at least 680, a mid-prime borrower has a credit score of 640 680, and a subprime borrower has a credit of less than 640. Mid-prime and subprime credit sectors may be consolidated, thereby creating two sectors: prime; and non-prime (or subprime).

Table 1: Auto ABS Summary of General Collateral Characteristics

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The securitization of credit card receivables first began in 1987. Credit card securitizations are the primary funding vehicle for unsecured revolving consumer credit. Credit card ABS are backed by credit card receivables (or payments). The receivables amount is typically based on:

Roating rate interest.

Minimum payment installment loans (determined by the credit card issuer) and payable monthly until the credit card balance is reduced to zero. Unsecured credit.

For credit card receivables, the maturity is determined by the amount paid by the borrower. The borrower may pay the statement balance, current balance or a minimum amount at the due date. The option taken determines the maturity of the credit card loan.

SLABS are securities backed by either the U.S. Federal Family Education Loan Program (FFELP) or private student loan ABS (PSLABS). FFELP SLABS are guaranteed against default by a third-party guarantor for 97% to 100% of principal and interest (PI) depending on the loan disbursement date, which is reinsured by the U.S. Department of Education (ED). In addition, FFELP lenders benefit from the allowance payments (SAPs) and interest subsidy payments (ISPs).

The SAP is the difference between the amount of interest the lender receives from the borrower or the government (in the case of subsidized loans) and the amount that is provided under requirements in the federal Higher Education Act of 1965. The SAP amount, paid quarterly, is calculated as a percentage of the average unpaid principal balance of a loan. ISPs are interest payments made by the ED on behalf of borrowers to lenders during a deferment period or while the borrower is enrolled in school.

FFELP student loans are considered defaulted after 270 days of delinquency. Claims due to reasons other than defaults such as death, disability and bankruptcy are eligible to receive a reimbursement of 100% of outstanding

representations or warranties, receivables either will be repurchased or replaced with receivables that meet the eligibility criteria.

Risks of Asset-Backed Securities

The main types of risks inherent in ABS (as well as other fixed income securities) are:

Credit risk (also known as default risk), which is the risk of a financial loss if an obligor does not fulfill its financial obligations according to agreed-upon terms. Prepayment risk, which is the risk of an early, unscheduled return of principal on a loan. Counterparty risk, in a multi-party transaction, which is the risk that the counterparty (such as a swap provider) will not meet its contractual obligations according to agreed-upon terms. Counterparty risk such as that related to a swap provider is transaction-specific. Auto ABS and SLABS, unlike credit card ABS, experience low prepayment risks. For auto ABS, the relatively short-term auto loans (usually 36 60 months) and decreasing RV

Key Terminology

Charge-

Legal Final Maturity

In reference to a bond, legal final maturity is the date before which the bond must be retired in order not to be in default.

Pass-Through

Pass-through occurs when a security that provides for the distribution of collections or proceeds from specific underlying assets to investors. The collections or proceeds are said to be "passed through" to the investors.

Principal Balance

Weighted-Average Life

Weighted-average life is: 1) used instead of maturity for pricing amortizing securities; and 2) with respect to a security, the weighted-average time to the return of principal on a security. In calculating a security's WAL, each payment date is expressed as the interval (in years) between the time of calculation and the payment date. Each interval is weighted by the amount of principal that will be distributed on the corresponding payment date.

Weighted-Average Maturity

The weighted-average maturity (WAM) date of loans backing a securitization is calculated by weighing the balance of each loan's maturity (expressed in years from the time of calculation).