STRUCTURED FINANCE ASSOCIATION

SFA Research Corner

Consumers May Find Themselves Between a Rock and a Hard Place

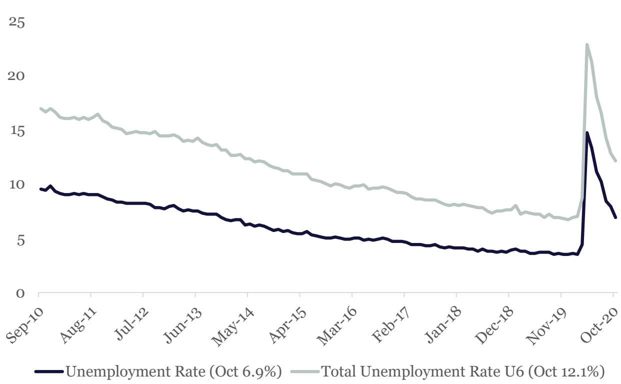
November 10, 2020

WHAT WE'RE WATCHING

The combination of payment relief programs and unprecedented support through stimulus payments have kept loan delinquencies and defaults low despite elevated levels of unemployment. New data shows that while deferral programs were readily available and utilized at the onset of the pandemic, this is not the case today. Without a doubt the much-improved labor market and stronger economy have contributed meaningfully to this change. With improved macro metrics, however, we have also seen a reduction in lender accommodations. If recent labor market gains slow with rising COVID-19 cases, and the likelihood of a generous stimulus package may remain elusive with a split Congress, some borrowers may find themselves caught between a rock and a hard place. Are consumers ready to lose the bilateral support provided by payment relief programs and government stimulus? And to what extent have some consumers been able to stay current on their loans solely because they have a payment holiday on one or more of their loans? Impacted households forced to reprioritize their wallets may leave some lenders unpaid, a trend appearing in auto loans. For some securitized pools of consumer loans, this could mean rising delinquencies in early 2021, followed by rising defaults later in the year.

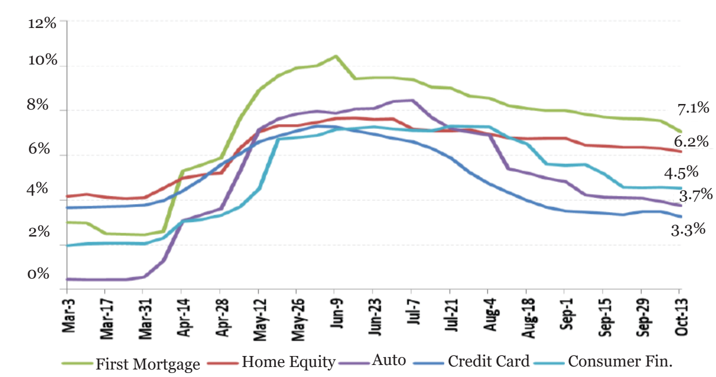
New data from Equifax shows loans reported as possible accommodations "have fallen off the highs of early June, but remain elevated." Possible accommodations are defined by the credit reporting agency as any form of relief that lenders offer to a borrower in times of hardship. Credit cards and student loans are the exceptions as credit cards are reporting lower accommodations today (3.3% of balances) than in March (3.7%). The rate of possible accommodations on student loans has been near 88% since May, from 47% in March, driven by specific guidance in the CARES ACT for federal student loans.

Unemployment Rate Drops To 6.9% in October as 638,000 Jobs Are Added To the Economy



Source: *U.S. Bureau of Labor Statistics*

Balances Under Accommodation Have Fallen off the Highs of Early June, but Remain Elevated



Source: *Equifax Consumer Loans Reported Under Possible Accommodation, October 19, 2020*

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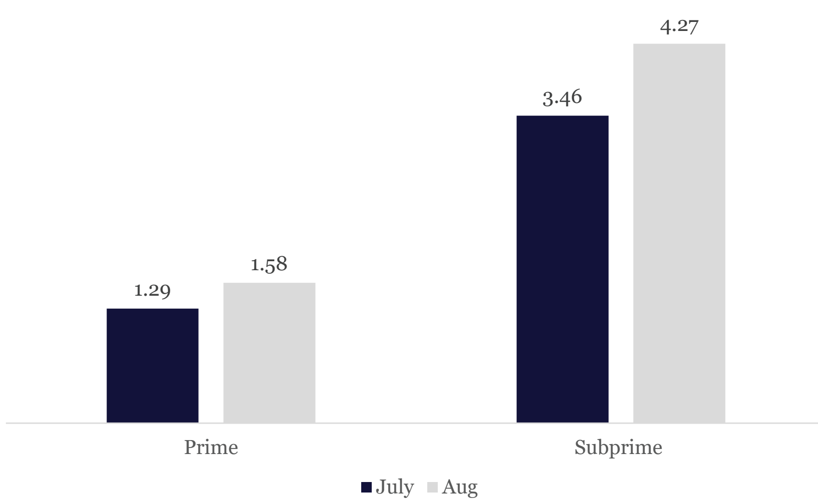
Lenders that have reported third quarter earnings echo this trend. For example, Bank of America provided deferrals to a total of 6.8 million accounts so far representing $162 billion in balances. Deferrals in September totaled $9 billion compared to $39 billion in May. Capital One reported 2.4% of their card accounts and 16.1% of their auto accounts had been extended assistance. Of these only 0.3% of card accounts and 2.6% of auto accounts remain enrolled as of September month-end. American Express reported that their Consumer Pandemic Relief Program, which was created in the first quarter of 2020, is "no longer widely available with immaterial balances remaining in the program as of September 30, 2020." JPMorgan Chase reported $29 billion of loans were enrolled in their payment deferral programs at September month end, down from $62 billion in June. Additionally, almost all of the loans currently in the bank's deferral programs are residential mortgage loans as credit card and auto loan customers have mostly exited the deferral programs. JPMorgan noted that 92% of accounts that exit their deferral are current.

The impact that these customer assistance programs have had is not lost on the securitization markets, as evidenced by auto ABS. S&P Global Ratings reports the extension rate of ABS backed by prime auto loans was down for the fourth consecutive month in August, to 0.63%in August, after having peaked over 5% in April. (When an auto loan is deferred, the deferred payment is added to the end of the borrower's payment schedule, thereby extending the life of the loan.) The subprime extension rate, which peaked at over 15% in April, now stands at 3.22%. Although "the vast majority of loans that have come out of extension status--80% in the prime sector and 59% in subprime--continue to perform and remain current, " the rating agency has also noted "rising delinquency levels on previously deferred loans indicate that many of those who received temporary forbearance are still struggling to make their monthly payment obligations (more so in the subprime segment)." To the extent that rising delinquencies translate into higher losses, the most impacted segments may see a higher cost of credit and lowered access to credit.

Rising Delinquencies on Previously Deferred Auto Loans Indicate That Many Borrowers Are Still Struggling (60+ Day Delinquency Rates for S&P-Rated Auto Loan ABS)



Source: S&P Global Ratings

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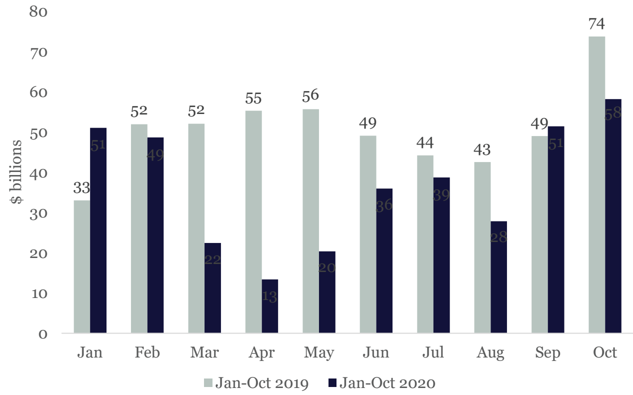
MARKET SUMMARY

With $58 billion of new bond offerings, October became the strongest issuance month for securitization year-to-date. Activity in September and October combined neared $110 billion, almost $20 billion more than the activity recorded for months March, April, May and June combined. Year-to-date issuance now stands at $369 billion. Bonds backed by consumer and commercial loans contributed 44% to that total, or $161 billion, as bonds backed by non-agency mortgage loans added $81 billion or 22%. CLOs represented 19% with $72 billion in offerings and CMBS, 15% with $55 billion. Strong demand for benchmark ABS products held bond prices steady in the face of record supply. With a still-benign credit environment, the search for yield continued to push prices higher, and bid-ask spreads tighter, for higher-yielding ABS products.

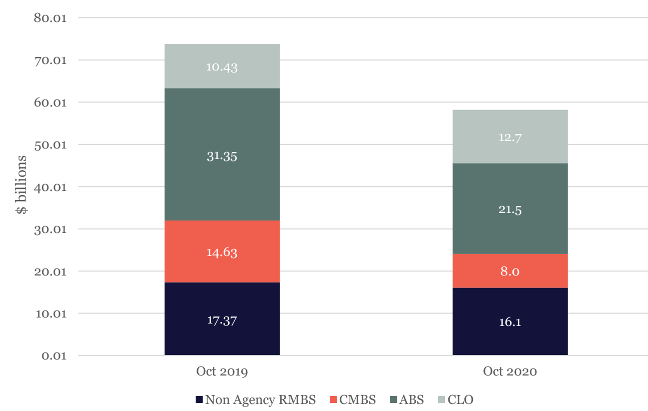
NEW ISSUE ACTIVITY

2020 YTD Issuance at $369 Billion
Down 27% From 2019's Volume at This Time



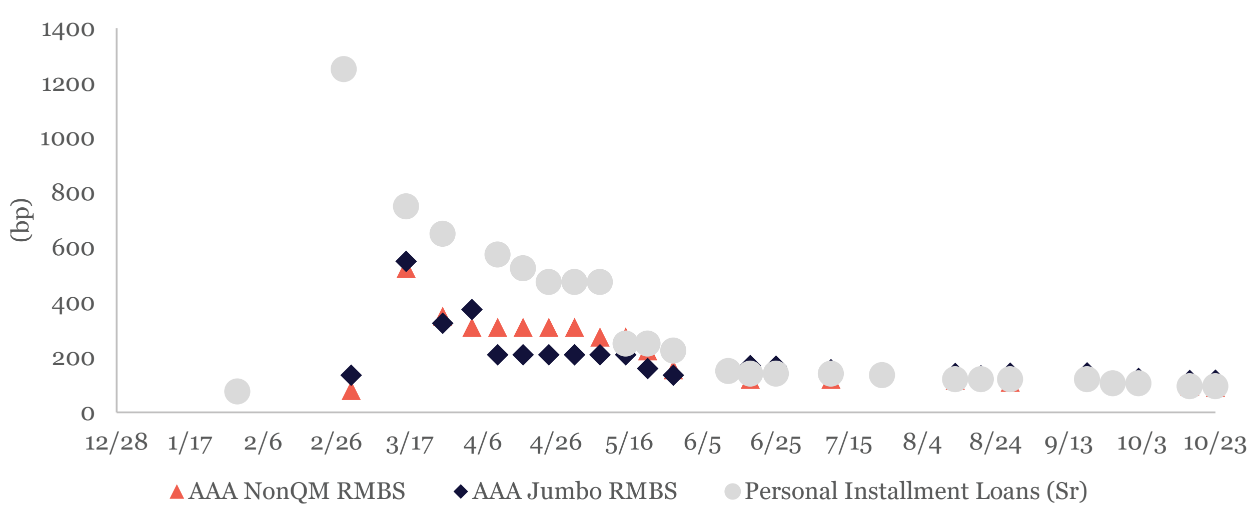
Source: Bloomberg, Deutsche Bank Research

October Activity
2019 vs 2020 by Sector



Source: Bloomberg, Deutsche Bank Research

SECONDARY MARKET SPREADS



Source: Market Compilation