CHAPTER IV
LEGISLATIVE PROPOSALS

Legislators have introduced a number of proposals in the 103rd Congress to encourage small business loan securitization. Many of these proposals differ fundamentally in their diagnosis of the market's slow development and, therefore, in their approach to promoting its growth. The four bills summarized here would provide for the creation of a new tax entity to issue securities backed by loan assets; modify a number of securities, banking, pension-protection, and tax laws; certify various entities as secondary market "facilitators" and exempt them from laws and regulations to be identified as obstacles to secondary markets; and create a new GSE to purchase small business loans. 30/

Create a New Tax Entity

H.R. 2065, the Financial Asset Securitization Investment Trust Provisions of 1993, focuses on the current tax code as a cause of the slow development of some secondary markets. The proposal is intended to facilitate the issuance of asset-backed securities by creating a new tax entity for the securitization of loans, called a financial asset securitization investment trust ("FASIT"). If enacted, this bill would provide issuers of all asset-backed securities with a

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30/ Another category of proposals attempts to increase lending to small business without developing a secondary market. It is not treated here, but see, for example, S.479, and Katherine A. Samolyk and Rebecca Wetmore Humes, "Does Small Business Need a Financial Fix?" *Economic Commentary*, Federal Reserve Bank of Cleveland (May 15, 1993).

tax-exempt vehicle similar to those that real estate mortgage investment conduits ("REMICs") afford issuers of mortgage-backed securities.

In the Tax Reform Act of 1986, the Congress exempted from corporate income tax the income of certain entities, called REMICs, through which mortgages are securitized. In this case, income passes through to the investors and is taxable to them. The REMIC is not a taxable entity. One justification for this policy is that these entities are more like bookkeeping arrangements than active businesses. REMICs are unique entities because they hold a fixed pool of mortgages, which are relatively standardized instruments that require little portfolio management. Before 1986, the courts had not decided on the proper tax treatment of these mortgage pools, although the Internal Revenue Service had held that they were taxable entities. The tax status of non-REMIC SPVs remains uncertain.

The FASIT proposal would follow the REMIC example and generally allow entities that pool nonmortgage assets to avoid income taxation at the SPV level. Such entities would have to meet certain requirements, including holding almost all of their assets as loans. The proposal would allow the FASIT to issue "qualified debt instruments" that would be treated as debt for federal tax purposes as long as they did not have yields of more than five percentage points above those of Treasury securities with comparable maturities. The interest on the debt would be deductible in computing the FASIT's taxable income, which would then flow through to the owners of the FASIT's equity interest and be taxable income to them. The legislation would permit other real estate mortgage investment

conduits and domestic corporations to hold equity in REMICs. The corporations could not use net operating losses to offset any taxable income from this source.

The legislation would grant the institutions that originate the loans different tax and financial accounting treatment, essentially permitting the originators to sell the loans to investors and remove them from their balance sheets, even though for tax purposes the investors purchase debt securities, not an equity interest.

Supporters of H.R. 2065 argue that the FASIT rules would lead to an increased availability of credit at reduced cost, make loans more liquid, and broaden the field of actual and potential providers of credit. The benefits are not assured, however; and if they are achieved, the U.S. Treasury will lose some tax revenue. Furthermore, the FASIT proposal does not specifically address small business loans. In fact, its primary advantage is that it would apply to the entire asset-backed securities market, which is developing under a cloud of uncertain tax treatment.

For securitization to be economically attractive, transactions must be designed so that the trust is not subject to federal income tax. In the absence of the FASIT vehicle, taxation of issuer and holder interests requires a case-by-case evaluation and leads to uncertainty and complexity. It is possible that FASIT would be used first to reduce the securitization costs of credit card debt and auto loans, rather than small business loans.

Modify the Securities Pension, Banking, and Tax Laws

The approach, embodied in the Senate passed version of Title II of H.R. 3474, assumes that the accelerated development of a secondary market in small business loans requires changes in several statutes. Accordingly, the Small Business Loan Securitization and Secondary Market Enhancement Act of 1994 would modify the Securities Exchange Act of 1934 and override some state securities and investment limitation laws; and amend federal banking and pension law and regulation. The bill uses the definition of a small business found in the Small Business Act. 31/ By this definition small business includes (1) manufacturers with fewer than 1,500 employees, (2) service firms with sales of less than $13.5 million, (3) wholesalers with fewer than 100 employees, and (4) construction firms with less than $17 million in receipts.

The bill would amend the securities and banking laws and regulations to require that securities related to small business, which must be of investment grade, be treated the same as mortgage-related securities under SMMEA. It would therefore liberalize the regulatory treatment of small business-related securities for such purposes as margin requirements, extensions of credit by broker-dealers, and borrowing in the ordinary course of business by broker-dealers. It would also ease the limitations on purchases of small business-related securities by federally chartered depository institutions. The same override of state securities laws is provided for small business-related securities as was afforded mortgage related securities in SMMEA.

31/ 15 U.S.C. 631 et seq.

The bill also modifies banking law to ease the capital and reserve requirements applicable to qualified depositary institutions with respect to small business loans and leases of personal property. The bill also provides the Secretary of Labor, in consultation with the Secretary of the Treasury, with the authority to grant exemptions under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code to allow employee benefit plans to invest in small business-related securities.

Aspects of this bill that warrant further study include the effects on federal revenues; the possibility that the loans securitized are those that would have been made anyway, rather than new small business loans; and its imposition of a regulatory outcome on banking agencies that are charged with responsibility for maintaining the safety and soundness of the banking system. In fact, federal banking agencies are currently reviewing the capital requirements for asset sales with some retained liability for credit losses.

<u>Certify Secondary Market Facilitating Organizations</u>

This approach also appears to assume that a number of current laws and regulations have caused the slow development of a secondary market in small business loans, as well as parallel markets for community development loans and equity investments in small business enterprises. It is different from the previous approach, however, in that the laws and regulations that are hindering development are not specifically identified in this legislation.

H.R. 2600--the Business, Commercial, and Community Development Secondary Market Development Act--would authorize the Secretary of the Treasury to certify any person or government unit which meets requirements as a Secondary Market Facilitating Organization ("SMFO") for business, commercial or community development related securities.

In order to obtain and retain the SMFO certification, the entity would have to meet eligibility standards established by the Secretary. These standards would include provisions related to capital requirements; qualifications for directors, officers, and employees; conflicts of interest; and reporting requirements. Secondary market facilitating organizations that do not meet these standards could have their certifications revoked. SMFOs would guarantee, underwrite, buy and sell, or serve as principals in the placement of securities backed by or representing an interest in debt or equity. They would also seek to promote community development, support enterprises in low- and moderate-income areas and enterprises owned by minorities and women, and address credit dislocations. H.R. 2600 was ordered reported by the House Banking Committee on March 9, 1994.

Aspects of this approach that deserve further study include the need to identify those specific provisions of current law that have inhibited the development of secondary markets in debt and equity investments and doubts expressed by members of the financial community that the benefits of SMFO certification would be sufficient to outweigh the costs of complying with regulations issued by the Secretary of the Treasury. These doubts are fueled in part by Section 16 of the bill which states that, "No provision of this Act shall be

construed as affecting the authority of any Federal regulatory agency to supervise or regulate any . . . secondary market facilitating organization."

Create a New Government-Sponsored Enterprise

The Business, Commercial, and Community Development Secondary Market Development Act applies the FNMA/FHLMC/Federal Agricultural Mortgage Corporation ("Farmer Mac") model to small business loan securitization. As detailed in S. 512 and H.R. 660, the Small Business Credit Availability Act of 1993, this alternative would establish a federally chartered but privately owned corporation called the Venture Enhancement and Loan Development Administration for Smaller Undercapitalized Enterprises ("Velda Sue").

Velda Sue would contribute to the development of a secondary market for small business loans either by purchasing the underlying paper, using it to form pools, and issuing its own guaranteed securities backed by these pools, or by guaranteeing securities issued by other certified loan poolers. A small business loan would be defined as an extension of credit to a small business that meets Small Business Administration loan standards or has a net worth of less than \$18 million and annual net, after-tax income of less than \$6 million. The federal government would provide up to \$300 million in temporary capital to Velda Sue, at the request of the corporation and after it has sold \$30 million in common stock. These funds would be repayable by Velda Sue over 10 years, beginning 15 years after the date of purchase, and would bear interest based on the average yield on U.S securities with 15-year maturities. As a part of this capital

transaction, the Secretary of the Treasury would also receive warrants to buy nonvoting Velda Sue stock at favorable prices. There is no requirement that Velda Sue request federal capital. Velda Sue would also have a $1.5 billion line of credit at the Treasury to cover losses. This line of credit is the same as Farmer Mac's.

Velda Sue's Board of Directors would specify minimum standards for loans to be purchased by Velda Sue, including a maximum principal amount, a maximum term not to exceed 30 years in the case of land or facilities and 10 years in the case of equipment, and requirements that the loan be fully amortized and that the loan-to-value ratio not exceed 90 percent.

If these conditions were met, Velda Sue could buy 80 percent of the loan with the originating lender retaining 20 percent. In addition, the Secretary of the Treasury would supervise the financial safety and soundness of Velda Sue. In essence, the Secretary would regulate its operations. Any paper issued by Velda Sue or guaranteed by it would not be explicitly guaranteed by the federal government, although its issuance would be subject to the approval of the Secretary of the Treasury.

Velda Sue would be authorized to charge guarantee fees, but these fees are capped at 2 percent of any loan guaranteed, and one half of one percent of any security representing an interest in a pool of these loans. Finally, Velda Sue would be prohibited from providing guarantees or incurring more obligations than 30 times the amount of its capital. This amounts to a required capital-to-asset ratio of 3.2

percent and is less than half the capital requirements for a commercial bank specializing in small business loans.

One disadvantage of such a GSE is that it would use the massive financial resources of the federal government to absorb, as well as to reduce, the uncertainty and credit risk of small business loans. The backing is based on much less historical information than was available to support the federally-financed development of a secondary market for single-family mortgages. Even so, recent experience shows that a government-sponsored enterprise does not necessarily ensure an active secondary market. Farmer Mac has been in operation since 1988, but by the end of 1992 only about $650 million in securities guaranteed by Farmer Mac were outstanding.

In both types of GSEs, statutory restrictions limit the portion of a loan that the GSE can purchase from the originator. This limit reflects the conviction that the originator must be required to assume a substantial credit risk in order to assure sustained high-quality credit extension and servicing. A second disadvantage is that the federal government's contingent, but unrecognized, liability would be increased by the use of a GSE in this instance. A third drawback is that the development of standardized underwriting criteria could harm those businesses that cannot meet them. It is also likely that the businesses that would receive the benefits of a GSE are the ones that currently receive bank loans without government support. Finally, the creation of a GSE could stunt competition and innovation in the marketplace, because if it succeeds, it is likely to become the dominant firm in the secondary market.

APPENDIX A - THE SBA GUARANTEED LOAN MARKET

There is a flourishing market for the government guaranteed portions of small business loans which was made possible in 1959, when SBA obtained permission from the Comptroller General to utilize procedures to be followed in purchasing guaranteed portions of loans from SBA participating lenders. In 1972 lenders commenced trading SBA guaranteed portions of loans between and among themselves for a total of $50 million.

In a series of opinions issued in 1972, 1974, 1976, and 1978, the Comptroller General addressed issues dealing specifically with the operations of the SBA secondary market. In effect, these opinions authorized the unconditional guarantee of the SBA obligation to the secondary market investor, the use of a private fiscal and transfer agent ("FTA"), and the SBA guarantee that the FTA would forward to the investor any payments received from the borrower.

By 1978, secondary market volume was $500 million. In 1979, SBA offered investors and lenders the option of using the services of an FTA. This reduced the paperwork and provided SBA with accurate and up to date oversight capability. It also allowed institutional investors to receive one monthly check covering the payments from a number of loans, instead of the earlier practice of receiving a check for each loan owned by the investor. In 1984, Congress enacted the Small Business Secondary Market Improvements Act (Pub. L. 98-352) which authorized a secondary market loan pooling program and required the use of an FTA as a central registry.

Since that time, the secondary market has grown rapidly. In calendar year 1992, SBA participating lenders sold the guaranteed portion of 8,272 7(a) loans for $2.1 billion. In dollar terms, this represents approximately 50% of the guaranteed portion of all 7(a) loans made during 1992 with an additional $1.3 billion in retrades of loans already held by investors. The aggregate amount of SBA guaranteed portions of 7(a) loans in the secondary market at the present time is approximately $7 billion, and this represents 35,000 loans. Virtually all of these purchases of SBA individual loans and pools are by institutional investors.

Under Section 7(a) of the Small Business Act, SBA has the authority to guarantee up to 90% of the principal amount of a 7(a) loan made by a bank or other lending institution to an eligible small business. An SBA guaranteed portion may be sold directly to a third party investor on the secondary market or it may be pooled with similar guaranteed portions in which case certificates backed by such pools are sold to investors.

SBA's secondary market activities involve a number of participants. Under the Small Business Secondary Market Improvements Act, SBA has promulgated regulations which prescribe rules and procedures for the operation of the secondary market for the guaranteed portion of 7(a) loans. Originating lenders may sell individual guaranteed portions directly to investors or may use the services of a securities dealer who re-sells to the ultimate investor. Such an investor purchases the entire guaranteed portion of a specific loan. In addition, there is an active network of pool assemblers (including lenders) who acquire the guaranteed portion of 7(a) loans

of similar maturities and interest rates which are then grouped or pooled for sale to investors. The investor may then purchase SBA guaranteed certificates which represent an interest in a pool of guaranteed portions of 7(a) loans.

Under SBA's regulations, a lender can earn fee income for servicing its entire small business loan portfolio even though it has sold the guaranteed portions of the 7(a) loans and has retained only the remaining unguaranteed portions. In addition, the lender may receive a premium on the sale. That premium is an amount, paid by the investor, in excess of the principal balance, which adjusts the yield to market rates. Thus, the yield on the lender's investment in the SBA guaranteed loan could be increased when it sells the guaranteed portion. Further, the lender obtains greater liquidity by selling the guaranteed portion, and with that increased cash flow, the lender can make additional loans (SBA guaranteed or conventional) to other businesses. This allows a lender to increase market share and it provides opportunities for the lender to sell other financial services to its business customers. Except for certain specific situations which require prior SBA approval, lenders which sell the guaranteed portions of 7(a) loans must retain ownership of the unguaranteed portions. The retention of this risk helps to ensure that the lender makes a thorough credit analysis and that it properly services each 7(a) loan. Because the lender retains servicing responsibility for a 7(a) loan, the guaranteed portion of which is sold in the secondary market, the small business borrower continues to make its monthly payments to, and thereby creates a valuable long term relationship with, its lending institution.

SBA utilizes the services of an FTA to monitor all 7(a) loan guaranteed portions sold in the secondary market. The FTA is the central registry for all paperwork involved in the secondary market. It creates the sale record when the guaranteed portion is sold in the secondary market, creates the file for a pool of guaranteed portions of 7(a) loans, tracks all subsequent sales, processes borrower payments made to it from the lenders, and forwards those payments to investors in individual guaranteed portions and investors in pools of guaranteed portions. The FTA receives payment for its services through transaction fees and not through government funds.

When a participating lender and an investor negotiate the terms of a sale of an individual guaranteed portion of a 7(a) loan into the secondary market, they and SBA execute a Secondary Participation Guarantee and Certification Agreement. This agreement, together with a copy of the borrower's note and a confirmation of sale letter, is sent to the FTA which reviews the documentation and establishes a computer record for the sale. On settlement day, the purchaser wires money to the FTA which forwards these funds by wire to the lender on the same day. Within two business days, the FTA issues a certificate of ownership to the purchaser.

The original investor in a guaranteed portion sold on the secondary market may resell that guaranteed portion. When the investor resells the guaranteed portion of a 7(a) loan, it endorses and delivers the certificate to the new purchaser.

As mentioned above, many guaranteed portions are sold in the secondary market as part of a pool of guaranteed portions of 7(a)

loans. Under the pooling program, private sector pool assemblers, which have been approved by SBA, purchase guaranteed portions of 7(a) loans from lenders and aggregate them into pools. Pool assemblers can only pool loans whose terms and conditions are similar and they must ascertain that the borrowers are current on their obligations when the pools are formed.

An investor who purchases an individual guaranteed portion of a 7(a) loan receives SBA's unconditional guarantee to pay principal and interest, accrued to the date SBA honors its guaranty if such loan goes into default. An investor who purchases an undivided interest in a pool of guaranteed portions of 7(a) loans in which an underlying 7(a) loan goes into default will be paid its proportionate share of the principal and interest of the guaranteed portion of that loan when SBA repossesses the guaranteed portion from the pool. In addition, SBA guarantees to pay into the pool any unpaid principal and interest which accrued, after an underlying 7(a) loan defaults, so that the schedule of principal and interest payments continues without interruption until SBA actually purchases the guaranteed portion of the defaulted 7(a) loan. As a result, the payment stream to a pool investor is predictable. In this way, SBA's guarantee has contributed to the success of the pooling program. Also because of the unconditional guarantee, these securities are exempt from the registration requirements of the Securities Act of 1933 (the "Securities Act").

<u>APPENDIX B - THE PROCESS OF SECURITIZATION</u>

<u>What is Securitization?</u>

"Securitization" refers generally to the issuance of securities representing an interest in a segregated pool of financial assets which convert into cash over finite time periods. The purpose of segregating the financial assets, by use of a trust or other SPV, is to isolate those assets from the risk of bankruptcy of the originator. This may be effected by establishing a "bankruptcy-remote" SPV (i.e., one that is protected from bankruptcy under various structural and legal criteria). The securitization is effected in several essentially simultaneous transactions involving a "true sale" of the financial assets to the SPV, with the source of payment for such assets deriving from the proceeds of the issuance of the security interests to investors. The security interests in such SPV represent either an ownership in, or an obligation of, such SPV. In either instance, payments on the security interests are supported primarily by the payment streams generated by the pool of financial assets.

Stated more simply, and for example, a pool of mortgage loans, producing periodic payments of interest and/or principal, are assembled and transferred to an SPV. Pursuant to the terms of operative documents, the stream of interest and principal payments is "carved up" for distribution to classes of security holders, each of which has different priorities to, and allocable interests in, such payment streams.

Credit Enhancements

To compensate for uncertainty relating to asset performance, credit enhancement mechanisms are included which enhance asset quality by providing monies which supplement the cash flow generated by the underlying assets. Such enhancement mechanisms are drawn upon to cover delinquencies, defaults or other losses on the underlying assets. Most asset-backed financings include some form of credit enhancement. The amount of credit enhancement needed for a particular asset pool depends upon the historical performance of the assets, the structure of the transaction, and the credit rating necessary to sell the securities.

There are two categories of credit enhancements -- external and internal credit enhancements. External forms of credit enhancement, such as bank letters of credit and financial guaranty insurance, may be provided by third parties with an investment-grade credit rating. These instruments obligate the issuing bank or insurer to pay up to a specified percentage of the pool assets in default. The percentage is usually far below the full dollar amount of a pool's outstanding principal amount, but is above the historical default rate of a similar portfolio of assets. Also, the sponsor of a pool may provide a guarantee or agree to extend recourse to cover any losses up to either a fixed dollar amount or fixed percentage of the declining principal balance of the financing. These forms of external credit enhancement may be used alone or, more commonly, in conjunction with some other form of credit enhancement.

Over the past several years, there has been a decrease in the use of external forms of credit enhancement due to downgrades in the credit ratings of the third-party providers. 1/ This decline in credit quality has led sponsors to turn to internal forms of credit enhancement. Internal credit enhancements are structural protections inherent in the design of the financing. For example, a sponsor can use "subordination" to provide credit enhancement to investors by issuing senior and subordinated classes of securities out of the same pool, with the former having priority to the cash flows from the underlying assets. The subordinated class bears the brunt of any credit losses before any amounts are charged to the senior class. The sponsor or its affiliates also may retain an equity or residual interest in the pool, thus subordinating its own interests to the interests of investors. 2/

1/ See, United States Securities and Exchange Commission, Division of Investment Management, "The Treatment of Structured Finance under the Investment Company Act," *Protecting Investors: A Half Century of Investment Company Regulation* (May 1992) note 1, at p.60. Noting that, until recently, most LOCs have been provided by foreign commercial banks, primarily because of the limited number of AAA-rated United States banks; however, recent downgrades in the ratings of these foreign banks have caused sponsors to turn to other forms of credit enhancement.

In 1988, bank letters of credit accounted for 58% of the credit enhancements in asset-backed financings. By 1991, that figure had dropped to 15.3%, and by the first half of 1992, letters of credit accounted for 4.4% of the credit enhancements provided. The use of surety bonds as a form of credit enhancement over the same five-year period fluctuated between 7.4% and 17.2%, demonstrating no discernible trends. Dean Witter, "Asset Backed Securities Reference Guide," A-19 (1992) ("Dean Witter Guide").

2/ Residual interests are typically unrated and highly volatile in nature, with payment depending in part on the effects of prepayments on the underlying assets and/or changes in interest rates on the cash flow. These interests are usually the first class of securities to bear any

Another common form of internal credit enhancement is "over-collateralization" which results when the sponsor places an aggregate principal amount of assets in the pool which exceeds the aggregate principal amount of securities issued. The cash flow from the excess collateral is intended to offset defaults or delinquencies on the assets.

Other internal forms of credit enhancement, typically employed in conjunction with other enhancements, include "reserve funds" (also called "cash collateral accounts") where cash is placed in a segregated account maintained by a trustee for the benefit of security holders and may be drawn upon by the trustee or servicer over the life of the financing, as needed. A "spread account" may also be used to hold funds in escrow which represent the difference between amounts earned on the assets in the underlying pool and amounts needed to pay servicing fees and interest on the securities.

Typically, multiple forms of these internal credit enhancement are used by sponsors in structured financings. By 1991 and the second half of 1992, some form or combination of internal enhancement was present in over 80% of the credit-enhanced financings. 3/

To obtain a AAA rating from one of the rating agencies it has been estimated that the amount (expressed as a percentage of the aggregate principal pool balance) of internal credit enhancement (e.g.,

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losses in the event of insufficient cash flow. See Investment Company Act Release No. 18736 (May 29, 1992).

3/ Dean Witter Guide, supra note 1.

over-collateralization, reserve funds, subordination) necessary for revolving small business loans is 18% to 25%. SEC staff experience in reviewing registration statements involving asset-backed securities confirms that internal credit enhancement levels may vary between 5% and 37% of the aggregate principal pool balance depending upon the nature and structure of the asset-backed transaction.

Master Trusts

A further market development which has facilitated the expansion of asset-backed securitization is the development of the "Master Trust." Master Trust arrangements involve the transfer of a relatively large volume of financial assets (in this case, small business loans) to a trust entity. From time to time thereafter, the master trust will issue "series" of certificates representing an undivided fractional interest in the pool of financial assets ("Investor Interest"). The stated principal amount of any such series typically represents only a portion of the aggregate principal amount of financial assets transferred to the master trust. A "residual" interest in the pool of assets is retained by the transferor ("Transferor Interest") and, while initially such Transferor Interest may be considerably larger than the Investor Interest(s), such Transferor Interest is subject to reduction as additional series of Investor Interests are issued. 4/

4/ Note that the terms of any additional series will not be subject to the prior review or consent of holders of certificates of a previously issued series. The terms of such additional series may include different methods for determining such series' allocable interest in the pool and provisions for other forms of credit enhancement. Typically, it is a condition to the issuance of any additional series that the creation of the new series will not result in the rating agency which rated outstanding series reducing or withdrawing its rating on such outstanding series.

Any particular series will typically provide for a period of time after issuance when only interest payments are made on the certificates; principal payments on the certificates either are paid in a single "bullet" payment at maturity (perhaps with a provision for accumulation of principal collections on the underlying assets in a segregated account controlled by either the sponsor or the trustee), or are paid over an "Amortization Period" which commences two or more years after issuance of the certificates. During the period from issuance until commencement of such an Amortization Period (frequently called a "Revolving Period"), collections of monies on the underlying assets, to the extent available after application to required payments on other series outstanding, may be utilized by the sponsor/originator of the trust to generate additional loans securing the certificates.

Because series of certificates may be issued from time to time, one series may be in a Revolving Period while another series may be in its Amortization Period. Master Trust arrangements will usually provide for the accumulation of finance charge/interest collections and principal collections on the underlying assets in separate accounts and allocation of such collections to any series outstanding which, pursuant to such series' terms, is at such time entitled to interest or principal payments.

The development of the Master Trust arrangements serves at least three significant purposes. First, by establishing a pool which is significantly larger than the pool size for a single, discrete securitization, the sponsor attempts to create a pool which more closely replicates the performance of the sponsor's portfolio. For

example, in the Fremont deal, a substantial majority of the loans originated by Fremont were transferred to the master trust. As a result, loan performance information which Fremont maintained on its portfolio was more likely to be replicated in the master trust than if a single, smaller pool of loans was securitized to effect one discrete deal.

Second, the master trust facilitates 'parity' in spread protection for series issued at different times. One source of protection against poor asset performance for certificate holders is the protection "built-in" to a securitization which results from the spread in yields between the underlying assets and the publicly-offered certificates ("yield spread"). Frequently, a "spread account" will be established in a securitization which is partially or fully funded at the time the trust is established and serves as the first source of funding in the event of delinquency or loss experience on the underlying assets. The spread account is funded and, as draws are made upon it, is replenished from interest payments on the underlying assets in excess of that necessary to meet the payment obligations on outstanding certificates. Thus, a larger yield spread conveys more assurance that such credit enhancement feature will be maintained. Because series offered from time to time must be priced competitively, the yield on the certificates of one series will likely differ from the yield on another series. Through the master trust's mechanism whereby finance charge/interest collections are aggregated and then allocated to the interests of all series outstanding, a 'parity' in spread protection is created for all such series.

Third, as compared with the single offering/single pool deals, the master trust arrangement is a lower cost means of effecting securitizations because it allows a sponsor to form a single trust from which it can effect multiple securitizations while retaining maximum flexibility in the structure and terms of the series issued.