APPENDIX C - COMPLETED SMALL BUSINESS LOAN SECURITIZATIONS

Fremont Small Business Loan Master Trust 1/

Fremont is engaged in commercial finance lending. Such loans are primarily revolving and short-term (two years), and are secured by assets including: accounts receivables, inventory, machinery, equipment, and, to a lesser extent, real estate. The majority of Fremont's customer base consists of small to medium size manufacturers and distributors.

Fremont, through its affiliate Fremont Funding, Inc. ("Transferor"), has established the Fremont Small Business Loan Master Trust ("Trust") and has transferred to such Trust a substantial majority of the loans in its portfolio ("Fremont Portfolio"). The primary trust asset is the right to repayment of loan advances ("Advances") generated from time to time in a pool of revolving commercial finance loans.

In April 1993 the Trust publicly issued $200 million triple-A rated Variable Rate Asset Backed Certificates, Series A ("Series A Certificates"), representing an undivided fractional interest in the Trust ("Investor Interest"). An interest in the Trust is retained by the

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1/ Fremont has made two public offerings of securities backed by small business loans; $200 million worth of such securities were offered in April 1993 and $100 million worth of such securities were offered in November 1993. Further, in June 1994 Fremont registered for offer and sale on a delayed basis up to $450 million worth of additional securities backed by small business loans. The description in this appendix relates to the April 1993 offering.

Transferor and represents essentially the right to repayment of Advances not allocated to the Investor Interest ("Transferor Interest").

Interest payments on the Series A Certificates will be paid monthly in an amount equal to the lesser of: (i) LIBOR (determined monthly) plus 0.47% per annum, or (ii) the weighted average of the finance charges that accrued on the Advances during the relevant monthly period, minus a 2% servicing fee percentage. Principal payments will commence three years after issuance [March 1996] and will continue for up to two years, until fully paid.

Credit support for the Series A Certificates is provided through a subordination feature whereby a portion of the Transferor's Interest, such portion equal to $46.914 million [19% of the aggregate principal balance of the Series A Certificates], is subordinated to the interest of the Series A Certificate holders in monies generated by the Advances ["Subordinated Amount"]. 2/ As loans become delinquent or are

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2/ To obtain a AAA rating from one of the rating agencies it has been estimated that the amount (expressed as a percentage of the principal pool balance) of internal credit enhancement (e.g., over-collateralization, reserve funds, subordination) necessary for a particular type of collateral generally is as follows:

residential mortgages	8 to 12%
commercial real estate	
- multi-family	10 to 20%
- mixed use	20 to 40%
small business loans	
- revolving	18 to 25%
- secured by real estate	20 to 35%
credit card receivables	10 to 15%
automobile loans	8 to 13%
computer leases	10 to 15%

charged-off as losses, the Series A Certificates will continue to be paid in full until such time as the Subordinated Amount is exhausted. In addition, in the event the Transferor's Interest does not represent an interest in the trust assets sufficient to achieve the Subordinated Amount, an Excess Funding Account will be maintained and funded (through the allocation of payments under the Advances in excess of amounts necessary to pay interest on outstanding series of certificates, and servicing fees) until, when aggregated with the Transferor's Interest, the Subordinated Amount is again reached.

Notable characteristics of the Advances transferred to the Trust include, measured as a percentage of outstanding principal balance: (i) 31.2% of the total Advances were to obligors located in California, and (ii) 58% of Advances were in the $1 million to $3 million range [see chart below].

Loan Size Range	Net Portfolio (in millions)	Percentage
Under $1 million	$27.2	13%
$1 million to $2 million	$64.2	32%
$2 million to $3 million	$51.7	26%
$3 million to $4 million	$27.1	13%
$4 million to $5 million	$21.5	11%

These ranges are necessarily broad due to the fact that the rating agencies do not apply a fixed formula based upon asset type -- numerous factors are applied to each individual transaction to take into account the specific structure of the transaction, the quality of its participants, and the particular credit quality of the assets pooled.

Overall, SEC staff experience in reviewing registration statements involving the above asset-backed categories 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.

TMS SBA Loan Trust 1993-1

The Money Store Investment Corp. and The Money Store of New York, Inc. (collectively, the "The Money Store") have originated SBA loans since approximately 1980. The Money Store has been the largest originator of SBA guaranteed loans since 1983, originating approximately $257 million during 1992 and, as of the 1992 year-end, servicing a portfolio of SBA loans aggregating approximately $1 billion. Loans are typically secured by owner-occupied commercial real estate, but additional collateral such as liens on all personal assets, personal guaranties, and/or machinery and equipment may be required.

The Money Store created TMS SBA Loan Trust 1993-1 ("Trust") and transferred to it the right to receive payments and other recoveries attributable to the unguaranteed interests ("Unguaranteed Interests") in a pool of loans partially guaranteed by the SBA. The guaranteed interest varies from SBA loan to SBA loan and is not included in the Trust assets; certificate holders have no right or interest in this component.

In April 1993 the Trust issued $69.353 million triple-A rated Class A Certificates and $6.859 million single-A rated Class B Certificates which evidence the entire beneficial ownership interest in the Trust. The Class B Certificates are subordinated to the Class A Certificates in right to receive both interest and principal payments. A "residual" interest is retained by The Money Store in that all monies generated monthly by the loans, which are not needed to pay fees associated with the servicing, certificate interest and principal, or for

reimbursement to the servicer or to reserves, are released to The Money Store.

Interest and principal on the certificates is payable monthly. Interest is payable at a floating rate (adjusted quarterly) indexed to the prime rate. Principal payments commence with the first month after issuance of the certificates. As the underlying loans are self-amortizing, no balloon (refinancing) risk exists.

Credit support for the Class A Certificates is provided through two sources: (i) a "Spread Account," and (ii) subordination of the Class B Certificates. The Spread Account will be partially funded by an initial deposit equal to 2% of the original pool principal balance. The Spread Account will thereafter be funded through excess spread 3/ until the balance is the greater of (i) 4% of the current pool principal balance, or (ii) the initial deposit. Additional excess spread will be deposited up to the amount of the aggregate balances of all loans delinquent 180 or more days. The subordination of the Class B Certificates has the effect of providing the Class A Certificates with additional protection against poor loan performance in an amount equal to 9% of the original principal balance of the Class A Certificates. The only credit support for the Class B Certificates is provided by the Spread Account.

3/ As discussed in Appendix A, there exists a well-established secondary market for the guaranteed portion of the SBA loan and such portions generally are sold in such market at coupons of approximately 100 basis points less that the underlying loans. As a result, the interest which accrues on the guaranteed portion of the principal balance of each SBA loan exceeds the sum of the interest payable to the holder of the guaranteed interest. Such "excess spread" is included in the Unguaranteed Interest and will be a source to fund a Spread Account.

A liquidity feature is included by means of the servicer's obligation to make advances (on a monthly basis) to the extent not covered by excess spread. However, such obligation is conditioned upon the servicer's determination that any such advances are recoverable in subsequent periods.

APPENDIX D - REASONS FOR THE SLOW DEVELOPMENT OF SMALL BUSINESS LOAN SECURITIZATION

While only two public securitizations of small business loans have come to market to date, they do suggest that the threshold question of the feasibility of such securitizations may be answered in the affirmative. However, both in absolute terms and as compared with growth in securitization of automobile loans and credit card receivables, the development of securitization in small business loans has been seemingly inhibited. This section of the appendix will address possible reasons for this slow development and suggest some solutions.

Difficulty in Estimating Expected Loan Loss and Predicting Cash Flow

One of the principal hurdles impeding the development of small business loan securitization is the difficulty of estimating expected loss on such loans. This is particularly difficult with respect to small business loans, as those loans are heterogenous in nature, with borrowers of differing credit qualities and a relatively wide variance in collateral, interest rate, amortization, covenants and documentation. With residential mortgage securitization GSEs reduce investors' high cost of information about borrowers by guaranteeing the timely receipt of principal and interest payments, thereby eliminating credit risk. In the context of small business loans, no comparable mechanism is in place to mitigate a credit risk which the market may perceive to be greater since loans have more individual characteristics.

The ability to estimate accurately levels of loan loss facilitates establishing asset quality and, hence, the level of credit support needed to make such asset-backed securities marketable. The less reliable the loan loss data, the more credit enhancement required, increasing the cost of securitization.

In The Money Store securitization investors and the rating agencies were able to assess the likely risk of loss because all the loans had been originated by the same affiliated lenders and those lenders had historical bad-debt data. In addition, the security for each loan was homogenous. Similarly, in the Fremont deal, the likely risk of loss could be estimated because Fremont had collection experience for its portfolio for the preceding three years. In addition, the loans were well diversified as to industry and no one obligor owed more than 3% of the total (no "borrower concentration").

A related hurdle -- the ability to predict levels and timing of cash flow on the underlying loans -- is a serious challenge because small business lending frequently takes the form of a line of credit which revolves. The amount of outstanding loan balances can vary widely from day to day making it difficult to predict when and how much the borrower will use its line and when it will pay down the borrowings it has made. This concern, however, is not unlike the situation with credit card receivables. As with credit card deals, if the lending institution is the originator of the SPV, the SPV could purchase an undivided interest in a pool of qualifying loans on the books of the lending institution, such that, although the total amount in the pool would vary from day to day, the SPV's investment would not change because the lending institution would absorb any daily fluctuations.

In the residential mortgage area, principal payment patterns, including prepayments, are not necessarily any more predictable. Models have been adopted which make certain basic assumptions, including constant rates of prepayment, but such models are primarily employed to exhibit the sensitivity to changes in prepayment rates of a particular class of certificates relative to another class of certificates representing interests in the pool of assets. Thus, while cash flow predictability will facilitate securitization efforts, the absence of reliable data is not as critical as data relating to loss experience.

These difficulties do not, however, seem to be an insurmountable hurdle. An industry trade association or the SBA could undertake this task. The SBA is well-positioned to collect loan payment data on a nationwide basis. The SBA already does this for its guaranteed loans and technological advancement is reducing the cost and enhancing the possibilities in this area.

Absence of Standardization

As used herein, the term "standardization" refers to the application of established and pre-determined industry-wide underwriting criteria and loan documentation procedures in connection with loan originations. This concept should be distinguished from the term "uniformity," used in this report to refer to loan originations from a single lender applying its own underwriting guidelines, whether or not standardized. Both the Fremont and The Money Store small business loan securitizations involved "uniformity" in loan originations since all loans in their respective pools were originated by a single lender or

group of affiliated lenders. Commentators have noted that this uniformity facilitated securitization of the loan pools notwithstanding the absence of national standards to which such underwriting criteria and loan origination procedures conformed.

A threshold question is whether or not standardization of small business loan underwriting criteria is necessary for securitization to take place. As discussed previously, securitization of residential mortgages was facilitated by the presence of GSEs which imposed national underwriting and loan documentation standards on loan originators as a condition to GSE purchase or guarantee of such loans. Such standardization reduces the cost and effort necessary to evaluate the quality of the asset pool because inspection or review of each lending arrangement can be replaced with verification that adherence to preset standards for loan origination has been maintained.

However, representatives of both investment banks and rating agencies have expressed the view that virtually any type of financial asset can be securitized, whether or not such assets were originated pursuant to standardized criteria and procedures. And this view is supported by actual experience. In the years since residential mortgages were first securitized, the market has seen more and more instances of securitizations involving pools of assets of which were not originated pursuant to standardized underwriting or loan documentation criteria, examples being the securitization of non-conforming residential mortgage loans, of commercial mortgage loans and, most recently of small business loans.

Another threshold question is whether or not standardization is appropriate for small business lending. Some commentators have expressed the view that small business loans are "character loans" involving many non-quantifiable and subjective factors which are not susceptible to standardization. Standardization would, therefore, be inappropriate since meaningful underwriting criteria may require significant subjective elements. Efforts to standardize underwriting criteria could, therefore, have an adverse effect on the availability of credit to small business borrowers because lenders would not make loans outside the parameters of the standardized underwriting criteria even if other factors suggested that the financing was suitable.

Another challenge to the idea of standardizing small business loan underwriting criteria relates to the nature of the lending arrangement and its ongoing servicing. Commentators experienced in small business lending assert that restructuring the terms of the lending arrangement, including the payment terms, is a common and necessary aspect of the such lending, as the economic conditions in which the borrower finds itself change. They suggest that the necessary flexibility to renegotiate the lending terms does not harmonize with the notion of securitization. This basis for challenging the idea of standardization is less persuasive in light of the Resolution Trust Corporation's ("RTC") successful public securitizations of commercial mortgage loans where discretion to "re-work" the loan terms is retained by the RTC in its capacity as receivor. While this aspect of small business lending may not be a theoretical impediment to securitization, it may be a factor that influences market perception of small business loan securitization and, therefore, may be a practical impediment.

Assuming standardization is both necessary and appropriate, the benefits which flow could include: (i) assuaging public concern over credit quality of underlying loans; (ii) decreasing due diligence costs (and, therefore, the costs of securitization) associated with evaluating credit quality of the loans; (iii) a means by which to statistically analyze the asset pool; and, (iv) a means by which to develop a ratings structure for small business loans.

Standardization could be established through several forums, including the SBA, or through a trade association of industry participants. The SBA could use its nationwide presence to encourage and facilitate the use of standard forms and underwriting criteria. If a GSE were created, it could be the source of such standards.

Level of Loan Demand

Excess demand from creditworthy borrowers and insufficient capital supplies were factors which accelerated the development of securitization in the residential arena. Whether these factors are as significant in the small business loan market, on a nationwide basis, is an open question, particularly in the case of depository institutions. 1/

Finance companies (such as Fremont and The Money Store), on the other hand, depend in large part on the capital markets to fund their loan portfolios. With the tremendous growth in their business loan portfolios, securitization of their portfolio of small business loans

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1/ See Chapter 1.

could be an important source of funding that would support increasing growth in loans. The majority of SBA guaranteed loans sold in the secondary market are those made by non-bank lenders. A viable secondary market in non-guaranteed loans could provide financial companies with additional funding sources, possibly increasing competition for small business loans. In turn, this increasing competition to bank financing could not only expand sources of funds, but also lower costs of such loans. Depository institutions may then look at securitization as a means to lower the cost of small business loans.

Absence of Asset Homogeneity

Loans to small businesses are heterogenous in nature, with borrowers of differing credit qualities and a relatively wide variance in collateral, interest rate, amortization, covenants and documentation. Early experience with asset-backed securities relied heavily upon the pooling of similar assets to limit transaction costs. The market has, however, developed methods to reduce this reliance upon asset homogeneity. The benefits of diversity in loan assets, including reduction of volatility of loan income, also have been recognized. In light of these more recent developments, an absence of asset homogeneity with respect to small business loans is of decreasing significance as a barrier to securitization. For a more complete discussion of the declining importance of asset homogeneity in securitization, see Chapter III.

Economic Incentives to Securitize

As noted above, the precipitating factors which gave rise to development of securitization in the home mortgage market may be distinguished from those which gave rise to the development of securitization in the automobile loan and credit card receivables markets. In the home mortgage market insufficient supply of capital and excess demand from borrowers contributed to the development of a secondary market. In the auto loan and credit card receivables markets the primary catalyst appears to be that securitization offers a less expensive financing option for business operations. The extent to which these factors exist in the context of bank lending to small business is not clear. Creation of a liquid, secondary market alone will not increase bank lending; economic incentives to lend must exist. In the case of non-depository institutions, these factors are present.

The SBA may be in a position to decrease the cost of securitization by developing a mechanism which would overcome the small size of any one lender's portfolio. A computerized market place could be set up that would allow lenders to sell one loan at a time to various entities that assemble pools.

Particular Characteristics of Small Business Loans That Effect The Cost of Securitization

The costs of securitizing small business loans are, in many cases, substantially higher than other financial assets, due to the combination of a variety of factors. Combined with heterogenous nature of small

business loans and absence of standardization, securitization may not be a less expensive vehicle for funding lending operations.

Further, some commenters have noted that the unique relationship between small business borrowers and lenders, both through the level of information conveyed in the origination process and through the ongoing maintenance of the loan, creates an imbalance in information relating to loan/borrower quality between lenders and the secondary market. Although the nature of the lender-borrower relationship in small business loan origination may be more intensive than in other loan origination contexts, concern relating to asymmetric distribution of information potentially could be a concern in almost any securitization. Yet the flourishing marketplace for asset securitization has not seen this concern materialize. Several safeguards seem to explain why asymmetric distribution of information has not emerged as a distinctive problem:

First, a lender's status as a reputable participant in the secondary market will directly affect its ability to access on a continuing basis the public markets as a financing source.

Second, the lender, or perhaps a purchaser from the lender, who pools the loans of several lenders to effect the securitization, is subject to liability under the securities laws for misleading disclosure in connection with the offer and sale of the securities.

Third, the process of securitization involves many participants independent of the lender who have economic and other incentives to ensure loan quality, including: third party credit enhancement

providers whose exposure is heightened when loan quality erodes; underwriters in connection with distribution of the securities who perform "due diligence" activities to determine loan quality and are subject to liability under the securities laws if they are negligent; rating agency involvement assessing and applying numerous factors toward the end of establishing loan quality and, ultimately, the quality of the securities being distributed.

Fourth, in connection with the securitization transaction, lenders provide certain standard representations and warranties regarding loan performance which require loan substitution for a limited period of time in the event a pooled loan or loans fail to conform to such representations.

Some have suggested that the lender retain some risk on the performance of the assets, by guarantee or retention of an interest in the assets. This retention of liability for loss eliminates incentives that a lender might have to sell poor quality loans. A current impediment to use of such a structure, in the case of depository originators, is the requirement that, if any risk is retained by such depository originator, the depository's capital requirements are not reduced by the sale. When a depository originator has no excess of capital it will not be able to sell existing loans to finance additional lending. 2/

2/ Charles T. Carlstrom and Katherine Samolyk, "Securitization: More than Just A Regulatory Artifact," *Economic Commentary*, Federal Reserve Bank of Cleveland (May 1, 1992).

APPENDIX E - SECURITIZATION UNDER THE FEDERAL SECURITIES LAWS

General

Offerings of asset-backed securities are subject to the federal securities laws and must either be registered under the Securities Act or effected in reliance on an exemption from registration, for example in a private placement. In either event such offerings are subject to the general antifraud provisions of the federal securities laws which provide that offering materials shall not contain an untrue statement of a material fact or omit to state a material fact necessary to make the statements in such offering materials not misleading.

Investment Company Act of 1940

Until 1992, a significant barrier impeding small business loan securitization was the Investment Company Act. Many structured financings fall within the definition of investment company under the Investment Company Act, but are unable to comply with many of its requirements. Therefore, structured financings generally had to rely upon specific exemptions under that act (section 3(c)(5)), or be sold only in private placements (section 3(c)(1)) or overseas--depending solely on the assets securitized. (Certain securitizations sponsored by government-sponsored enterprises may be exempt from the act by section 2(b)). In addition, the SEC has issued over 125 exemptive orders, primarily for mortgage-related financings.

In November 1992, the SEC adopted Rule 3a-7 which exempts structured financings that meet the rule's conditions from the Investment Company Act, without regard to the assets involved. The conditions are intended to identify the operational distinctions between registered investment companies and structured financings, permit the continued evolution of the structured finance market, and address any investor protection concerns. The rule is designed to codify the current attributes of the structured financing market.

To rely on the rule, issuers must be in the business of acquiring and holding eligible assets (broadly defined to encompass all types of assets that can be securitized), and may not issue redeemable securities. Issuers may sell to the general public only fixed-income securities that are rated at least investment grade. The rating requirement is intended to address the structural integrity of the financing.

Fixed-income securities that are rated below investment grade or that are unrated may be sold to so-called "institutional accredited investors" (defined in rule 501(a)(1), (2), (3), and (7) under the Securities Act). Other securities issued by a structured financing vehicle (including residual interests) may be sold to qualified institutional buyers (defined in rule 144A under the Securities Act) and to certain persons related to the financing. Issuers must use reasonable care to ensure that securities not eligible for sale to the public are resold only to the appropriate category of sophisticated investors.

The rule does not permit financings to engage in active management of assets, a typical practice of most management investment companies, but does allow limited flexibility to acquire or dispose of assets. Acquisitions and dispositions of assets may not result in a downgrading of the rating of the financing's outstanding fixed-income securities. Also, issuers may not dispose of assets primarily for the purpose of recognizing gains or preventing losses resulting from market value changes.

Finally, the rule requires issuers (excluding asset-backed commercial paper programs) to take reasonable steps to cause an independent trustee to have a perfected security interest in the primary assets being securitized.

Securities Act of 1933

To provide significant cost savings, efficiency and flexibility for many issuers, the Commission also expanded the availability of Form S-3, the short-form registration statement under the Securities Act, to additional issuers and classes of transactions. The expanded availability of Form S-3 also extended the benefits of Rule 415, the shelf registration rule, to a greater variety of offerings, including investment grade asset-backed securities offerings. Changes to the prospectus filing rule, Rule 424, were adopted to accommodate the special timing constraints in connection with offerings of mortgage-related and other asset-backed securities.

Three principal changes to the Form S-3 eligibility requirements were made. First, the reporting history necessary to register on Form S-3 was reduced from 36 to 12 months for most issuers. Second, the aggregate market value of the issuer's voting stock held by non-affiliates (referred to as the "public float") qualifying an issuer for use of Form S-3 for any of its securities was reduced from $150 million to $75 million, and the 3 million share trading volume test was eliminated. Third, Form S-3 was amended to specifically permit registration of investment grade asset-backed securities without regard to whether the issuer or registrant has a reporting history.

Because shelf registration is available for offerings registered, or eligible to be registered, on Form S-3, 1/ these changes to Form S-3 also extend shelf registration to these newly eligible issuers and offerings. Thus, Rule 415 shelf registration is now available for offerings of investment grade asset-backed securities whether registered on Form S-3 or one of the SEC's other registration forms, such as Form S-1 or Form S-11. In addition, a proposed revision to the prospectus filing rule has been adopted as proposed to accommodate the special timing constraints present in asset-backed securities offerings. Under this revision, prospectus supplements containing price and other offering information for asset-backed securities offerings may be filed within two business days following first use, rather than two business days following the earlier of pricing or first use as was previously required.

1/ See Rule 415(a)(1)(x).

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