

# U.S. Structured Finance Newsletter

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## EMERGENT TREND IN RE-REMICs FOR CAPITAL PRESERVATION

The substantial downgrade rating actions of late have triggered an emergent trend in RMBS Re-REMICs (or re-securitizations). After losses start to erode bonds towards the top of the capital structure, some investors turn to re-securitizations to mitigate the capital charges on their portfolios (including smaller FDIC-regulated banks that currently hold top-rated mortgage-backed securities).

In previous newsletters, DBRS introduced the concept of AAA Re-REMICs as a restructuring tool. These Re-REMICs, frequently backed by AAA-rated underlying certificates, often employ a simple A/B (or senior/subordination) structure, with Class B providing additional credit support to Class A via subordination. The surge in Re-REMICs has primarily been motivated by the desire to create securities with increased credit support, to ensure rating stability and improved liquidity.

In addition to rating stability, this new trend in Re-REMICs is mostly driven by the need for more favorable regulatory capital treatment for the originally AAA-rated bonds. These bonds have either been downgraded or may face such threat imminently. Once downgraded, the issuers would have to bolster significantly more capital reserves with respect to these positions.

For FDIC-regulated banks, the risk-based capital guidelines include a ratings-based approach that sets the capital requirements for asset-backed and mortgage-backed securities according to their relative risk using ratings from credit rating agencies. In general, under the ratings-based approach, the capital requirement for a security is computed by multiplying the face amount of the position by the risk weight appropriate for the external credit rating of the position.

For example, a BB-rated security carries a risk weight of 200% while an AAA- or AA-rated security has a risk weight of only 20%. This means that through the use of Re-REMICs, banks carving out an AAA-rated senior class from an existing BB-rated security will preserve a considerable amount of capital overall. For more details on the FDIC risk-based capital guidelines, [click here](#).

Re-REMICs done for capital purposes can be substantial in size, often comprising 50 or more underlying RMBS bonds of similar characteristics. In addition to Alt-A bonds, which have been the primary candidates for Re-REMICs this year, DBRS has also noticed some prime positions re-securitized for capital purpose as performance in the prime sector started to deteriorate. Transaction structures can vary from a simple A/B structure described above, to a more complex one of three- or four-class sequential pay structure aimed at preserving rating stability for the most senior class(es).

These Re-REMICs may not work for everyone. For banks that have owned the mortgage bonds since issuance and have not recognized any other-than-temporary impairments, executing such Re-REMICs may cause impairment charges on the underlying securities. In this case, while issuers may receive better capital treatment on the re-securitized bonds, the impairment charges may be too severe for the overall economics to make sense. In addition, the banks generally will not get any improved risk-based capital treatment if they choose to retain all of the newly re-securitized bonds.

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