

ABS Panelists: Leverage A Thing Of The Past 10/20/2008 02:54 PM

--Katy Burne

Investor confidence will return within the next 12-18 months so long as lenders scale back on the leverage they offer market participants and stay conservative in their underwriting strategy. That was the message of this morning's general session: "ABS 2009 and Beyond: Will The Market Adapt, Evolve and Survive and How?"

"The types of leverage that were extended will not be extended going forward," said **Paul Colonna**, president and cio of **GE Asset Management**, adding, "I think there will be a lot of uncertainty...and investors will be demanding risk premiums for years." Part of the battle, he said, is addressing the ratings paradigm and trying to accurately predict how ratings can change.

Andrew Peisch, managing director and head of ABS Banking for the Americas at **Deutsche Bank**, agreed. "There was relatively naive low correlation assumptions that allowed for leverage...We'll probably roll back to the mid-90s and maybe that's a good thing," he said. "But it will take time to rehabilitate the market...Issuers will need a stake in the game to guard against lax underwriting standards and investors will need to do their own due diligence."

What caused the pricing collapse that has led to the rapid unwinding of trades had a lot to do with inaccurate valuations and the sheer volume of supply, said **John Devaney**, ceo/trader at **United Capital Markets**. "The 15 trading desks that are out there, they just couldn't handle it in my opinion." Credit default swaps contributed to the problem, he said, noting the market should be regulated. "The guys going long [corporate bonds] might only put down 3% [for the protection]. That's what bankrupted [**American International Group**]."

Devaney predicted the next wave of downgrades will result in a bailout of the insurance industry. "I'm one of the people that gorged in an orgy of leverage," he said. "As painful as it is, the process of de-leveraging I believe right now is just starting...There is yet to come some very unfortunate events." Whole loan mortgage bonds that have not been backed by government agencies will begin to default, he said, and insurers that are significant holders of those securities will not have adequate capital to cope with the mark-to-market losses and new capital requirements.