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MarketWatch

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Fed's AIG Bond Sale Stirs Action in Subprime Market

By Anusha Shrivastava

A flurry of activity swept through the subprime-mortgage market Tuesday as the Federal Reserve Bank of New York prepared the market's biggest test since the credit crisis, a sale of \$1.5 billion of mortgage-backed bonds from the bailed-out insurer American International Group (NYSE:AIG) Inc.

The Fed's sale—announced Monday and set for Wednesday—has banks and others that own subprime-mortgage bonds wondering what they can learn about the state of the market and the value of their assets.

A few have chosen not to wait for the Fed to finish its sale. Several firms have circulated "bid lists" of residential-mortgage securities they have for sale; many bonds on the lists are of similar quality and vintage of the ones the Fed will sell Wednesday through its agent, a unit of BlackRock (NYSE:BLK) Inc.

"We had been seeing \$700 million on average per day, but over the past two days, we will have seen about \$2 billion each day," **Dan Nigro**, chief executive of Warfield Consultants in Montclair, N.J., said of mortgage-bond supply. "Most of the recent supply comes from legacy sellers, hedge funds and other liquidations in order to raise cash to bid for Wednesday's auction."

The 52 bonds on offer from the Fed, which was acquired in 2008 as part of the bailout of AIG, represent a wide range of credit quality and will attract prices accordingly.

A bond dubbed BALTA 2006-6, indicating a bond backed by 'Alt-A' loans from 2006, for instance, is likely to attract bids around mid-40 cents on the dollar, according to one trader. Another bond, named WFHET 2006-3, may not draw bids above the "low teens," the trader said.

The price range reflects the quality of the loans underlying the bonds: subprime bonds made to borrowers with shaky credit will be cheaper than Alt-A bonds where the borrowers had higher credit scores, indicating a better ability to make their payments.

The private bid lists circulating Tuesday had similar collateral and are from the same time.

"There's definitely guys trying to get ahead of this because they think the prices will go down" after the Fed sale, said **Jesse Litvak**, a managing director who focuses on nonagency mortgages at Jefferies & Co. in Stamford, Conn.

That said, Mr. Litvak says the Fed auction has been "an orderly trade" so far.

While some are assessing the quality of the \$1.5 billion in bonds the Fed is selling, others are waiting to see how the auction goes in terms of the prices paid and number of participants.

"We want to see how first round goes," said **Paul Norris**, head of structured products at Dwight Asset Management Co. in Burlington, Vt., who said his firm was evaluating the bonds and was likely to bid on them.

"Most of the stuff is what we are really not interested in because the collateral is poor quality." Mr. Norris added. "We are interested in better collateral. This could be a good play for hedge funds."

Mr. Litvak said it would be "interesting to see how many accounts participate and how many dealers buy for themselves. It will also be interesting to see how much of the list actually trades."

The Fed doesn't have to sell all of the bonds and could hold them for future auctions. The timeline for these auctions is yet to be announced and industry participants believe the central bank is also likely to see how Wednesday's proceedings go before they take the next step.

The \$1.5 billion on offer this week gives an indication of the pace at which the New York Fed intends to dispose of the assets in a vehicle known as Maiden Lane II. It holds roughly 800 securities with a total fair market value of \$15.9 billion, according to Fed data, and a total face value of roughly \$30 billion.

Last week, the Fed rejected a \$15.7 billion offer from AIG to buy back all the securities in Maiden Lane II and said it would instead gradually auction off the assets in the market to maximize their value for taxpayers.

BlackRock Solutions, the New York Fed's investment manager, will handle the sales of portions of the portfolio and individual bonds over time.

In its release last week, the Fed said it would provide monthly updates on portfolio holdings and a list of securities sold within the prior month. It will also provide quarterly updates on total proceeds from the sales and the total amount purchased by each counterparty.

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