Angel Oak and SS&C Discuss Insurance Company Demand for Residential Loans

Members of Angel Oak's Institutional Client Group recently sat down with SS&C Technologies to discuss the proliferation of insurance companies seeking exposure to residential mortgage loans. Angel Oak is a leading originator and asset manager of non-agency residential mortgage loans with a long history of managing separately managed accounts for insurance companies. SS&C provides insurance companies with solutions for accounting, reporting, and regulatory filings with 70 out of the top 100 insurance companies utilizing SS&C software. Both groups share their views in this Q&A discussion.

Q: What are the firms' histories, specifically regarding their insurance solutions businesses?

Angel Oak: Angel Oak Capital Advisors currently manages approximately $16.4 billion of assets across public, private, and separately managed accounts as well as permanent capital vehicles. Angel Oak has been investing in residential mortgages since its founding in 2008, and its affiliated mortgage lender, Angel Oak Mortgage Solutions, started non-QM lending in 2013. The firm has invested in approximately 40,000 mortgages on behalf of institutional investors with virtually no credit losses. Since 2016, it has been a consistent issuer of securitizations on the Angel Oak Mortgage Trust shelf, and it has retained bonds from these transactions in strategies managed by the firm for investors.

Angel Oak has taken a consultative service approach to its Insurance Solutions business and offers direct partnerships with its affiliated mortgage originator, coupled with the asset management firm. It's the firm's belief that this holistic solution and partnership with its insurance company clients offers the most compelling offering for companies wanting to access mortgage credit. The benefits of the integrated approach include control, customization, and full transparency into the manufacturing process of non-agency collateral. The firm also utilizes correspondent or third-party sourcing to complement in-house origination on an opportunistic basis.

SS&C: SS&C was founded in 1986 with one piece of software dedicated to insurance investment accounting. Since then, the firm has expanded its solutions and services, mainly through acquisitions, and now it covers the entire life cycle of a transaction—that includes trade capture, middle- and back-office services, accounting, regulatory, risk, and all aspects of reporting for investment solutions, all particularly tailored for the insurance business.

Q: What kind of interest have you seen from insurance company clients over the past several years in terms of onboarding residential loans? What is driving that interest?

SS&C: There has definitely been interest across insurance and private fund clients to increase their asset allocations to the residential mortgage space. Traditionally, commercial real estate mortgages have been the asset class of insurance companies, and now the companies are diversifying into residential.

Angel Oak: Historically, insurance companies have looked to investment-grade corporate credit and commercial real estate as two big areas of allocation. Residential credit has not traditionally been a large part of their investment programs, but that is changing as a result of a supportive macro environment for the housing market—i.e., the supply shortage in U.S. housing—low levels of unemployment, and the lack of mortgage credit available to certain cohorts of borrowers coming out of the Global Financial Crisis, the GFC. When you throw in the potential benefits from a diversification perspective and then the capital treatment—the low capital charges on the collateral—along with the ability to pledge the assets to the Federal Home Loan Bank, these factors have made it attractive for insurance companies to allocate capital to the sector.

SS&C: From a risk-based capital perspective, within the past year, life companies have changed the percentage that will be applied to that risk-based capital factor. It's down to 68 basis points, bps; while that may not sound like a lot compared to what a property casualty or a health company would have to do, it is 5%. So if you are at a good threshold on your capital, it is something worth looking into and potentially bulking up on, as there is potentially a lot of upside for a life company.

Additionally, in terms of operations, there has been much more standardization across the residential mortgage space since the GFC. Combining that standardization with advances in technology has enabled these loans to be processed much faster.

Q: What questions do insurance companies have when it comes to buying residential mortgage loans as compared to buying RMBS or bonds backed by residential mortgages?

SS&C: Let's start with the acquisition of the actual loans; in RMBS lingo, it would be a trade or purchase. With loans, it's still a purchase, but the underlying information comes in the form of a loan tape. If you had $100 million, for example, that could represent 200 individual mortgage line items of $500,000 each. Instead of a trade ticket, you're going to process a loan tape that's going to have 200 individual loans on it. The security master is contained in that loan tape, whereas in an RMBS bond, you can go to Bloomberg and look up the security master for that bond. Those are the main differences at purchase, and then throughout the life cycle, you're going to be dealing with a primary servicer that is going to generate what are called remittance files so the payments that are being received from the mortgage holders can be processed.

Q: Angel Oak has spent an enormous amount of time, energy, and resources dedicated to the non-agency mortgage sector. Tell us more about the characteristics of the collateral today.

Angel Oak: Coming out of the GFC, there was a lack of credit availability for self-employed small-business owners—people for whom you need to look at alternative income documentation to underwrite. Our affiliated mortgage company's Bank Statement Program was developed to help address that problem, and it's 50% to 60% of what they originate today. As a complement to that, they also originate loans to landlords via their Investor Cash Flow Program. These loans are backed by investment properties and make up 30% to 35% of what they originate today. They also have some odds and ends that round out its origination, but on average, it's about a 750 FICO score and a 68%–69% LTV, or loan to value. Generally, the rates have been anywhere from 150 to 250 bps above agency conforming rates, so today they are close to about 8.25%. On a loss-adjusted basis, we think that's a pretty attractive yield for institutions and insurance companies to hold, given the capital charges.

Q: Are there any new loan programs in the works?

Angel Oak: There's a tremendous opportunity today around second liens, and there are a couple of reasons for that. One, 90%-plus of Americans are locked into a mortgage below 4% and a LTV below 80%. That locked-in effect creates demand for a second lien mortgage when homeowners don't want to get rid of that first lien at a very low rate. Second, there has been significant home price appreciation. A lot of equity has been built up over the past few years that homeowners want to tap. Think about the homeowner who wants to renovate—put in a new kitchen, a new bathroom, or consolidate debt—and get that cash flow from monetizing the equity. As a result, the second lien market is a huge opportunity set, and Angel Oak is looking to do it in a responsible way, such as taking a 30% to 40% LTV up to a 70% to 75% LTV for a very high FICO score borrower.

Q: What are your capabilities with regard to risk-based capital reporting, specifically with loans?

SS&C: SS&C can provide forecasting on how much a client wants to go with residential and project it on the risk-based capital to see whether they are still above the threshold for total adjusted capital. Obviously, the higher they are above that authorized control level, the more they can put into that specific purchase, and SS&C can give direction on that.

Q: Talk about your dedication to intelligent automation. How is that translating into efficiencies?

SS&C: Over the years, SS&C has expanded the use of intelligent automation in this space. For example, ten years ago, we processed remittance files on a very manual basis, receiving PDF files. Today we deploy digital workers to use optical character recognition to scrape data off PDFs, or we go right to application programming interface, or APIs, with our counterparties. That enables much faster processing and creates structure out of data that is very unstructured. It also allows checks and balances; we use artificial intelligence to look for outliers that may be anomalies or incorrectly entered numbers. Overall, we're using intelligent automation to improve the straight-through processing of data, check the data for reasonableness, and make human intervention an exception.

Q: What is important to consider with regard to loan administration?

SS&C: Whether it's done by the investor or by a third party, loan administration is important for a number of reasons: one, to keep the servicers honest by independently verifying the calculations, the principal, the interest, the escrow amounts, etc.; two, to reconcile your cash, like any investment portfolio; and three, to make sure you have updated market values. Regulatory and NRBC components should be part of the loan administration process, too. All that comes together with either a robust back office, a middle office, or a third-party loan administrator.

Q: What is the competitive differentiator of Angel Oak's insurance company offering?

Angel Oak: First and foremost, it's our in-house origination model that allows us to source collateral through our affiliated wholesale mortgage originator, Angel Oak Mortgage Solutions. We also have the ability to source loans externally through third parties based on what's going on in the market and what's available, so not being held captive to one way to source loans is a huge advantage. Related to that is our geographic diversification that allows us to source loans outside California. We've often heard from clients that some of our competitors have as much as 40% to 70% of their collateral coming from California, and at that level, there is a lot of idiosyncratic risk.

There is also our ability to securitize and source financing through capital markets. Our AOMT shelf is widely regarded as a benchmark shelf in the non-agency, non-QM space. We have executed over 45 securitizations. When it makes sense and when it's attractive, we give clients the ability to securitize and get liquidity on loans. We also take a holistic approach to client service, particularly for insurance companies. We're flexible and can customize mandates. Our goal is to have the insurance company use us as an outsourced manager on the residential side. We have a deep team here in the U.S. and also a sizeable operations and support staff in India to support insurance companies with monitoring and reporting on a residential loan portfolio that can be sizeable in terms of line items.

We also have improved our systems as we continue to grow. An incredible amount of effort has been spent on the data science side to hone the models and not lose any credit characteristics, and this is a growth curve business. The volume of securitized products and non-QM should be at early 2000s levels—perhaps $150 billion to $250 billion a year—and we're not close to that at this time.

Looking at insurance company balance sheets, anywhere from 0% to 5% is allocated to this asset class, so there is certainly room to grow. We will continue to be that solution provider, and our partnership with SS&C—with regard to capturing remittance data and translating that into statutory reporting—is something we are excited about.

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