

# A European Perspective on the Role of Securitisation (from Spawn of the Devil to Economic Saviour) and Thoughts on the Australasian Product (a More Stable Cousin)

ASIFMA Structured Finance Conference

17<sup>th</sup> September 2014

Robert Plehn

Head of Capital Markets  
GE Capital International



## Table of contents

---

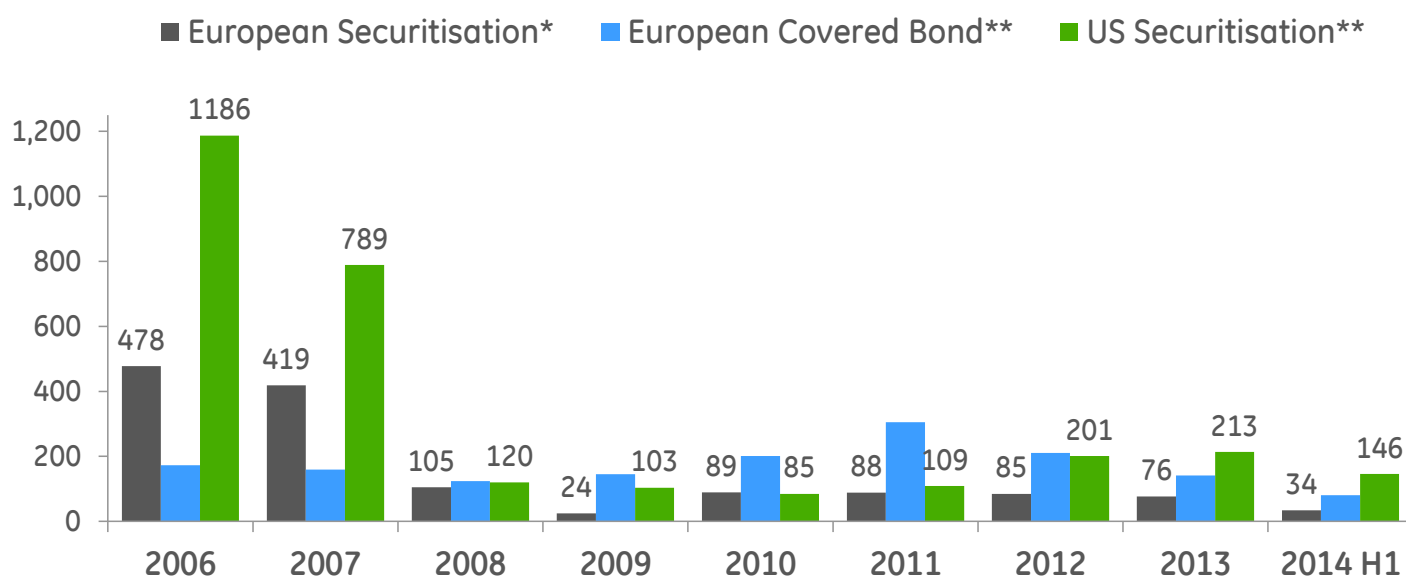
• STATE OF THE MARKET IN EUROPE	3
• WHY SECURITISE ? A REFRESHER	6
• POST CRISIS TRENDS IN EUROPE	12
• WHATS HOLDING THE MARKET BACK IN EUROPE?	16
• REGULATORY REVERSAL?	22
• OUTLOOK FOR THE FUTURE IN EUROPE	26
• THOUGHTS ON AUSTRALIASIA	30

---

## STATE OF THE MARKET IN EUROPE

# Secured Funding Market Volumes

## Issuance of Securitisation and Covered Bonds (€B)



Source: \* AFME \*\* J.P. Morgan International ABS & CB Research. European CB volume includes issuance above €500m only. US ABS excludes Agency RMBS



GE Capital

# European Securitisation Market Update

---

Market continues to function albeit at subdued volumes – lowest YTD since 2009

- General spread compression means that most investors are searching for yield and hence looking to deals with better pricing – peripheral paper, CLOs, CMBS, non-prime RMBS, etc.
- Spreads on prime RMBS, cards and autos have come in dramatically, but must be viewed in relative value terms explaining a general lack of issuance by big banks
- Most deals are coming from
  - a) institutions without deep multiple funding sources (e.g. challenger/smaller banks, non-bank FI's and PE houses off the back of acquisitions) or that have a strategic reason to securitise (i.e. showing liquidity for an IPO or deleveraging),
  - b) peripheral jurisdictions,
  - c) arbitrage players (e.g. CLO managers or bank underwritten CMBS), and
  - d) the auto sector where spreads are very tight
- Positive sign that September started with a bang with deals from Virgin Money, Daimler, Volkswagen, GMAC UK and a CMBS that was pulled from the market in September
- Incremental new/returning investors are appearing but depth of investor base still shallow
- Positive political, regulatory and Central Bank statements /actions are sending the right messages but is it enough?
- Announced ECB ABS purchase programme receiving lots of publicity but potential impact is still unclear

---

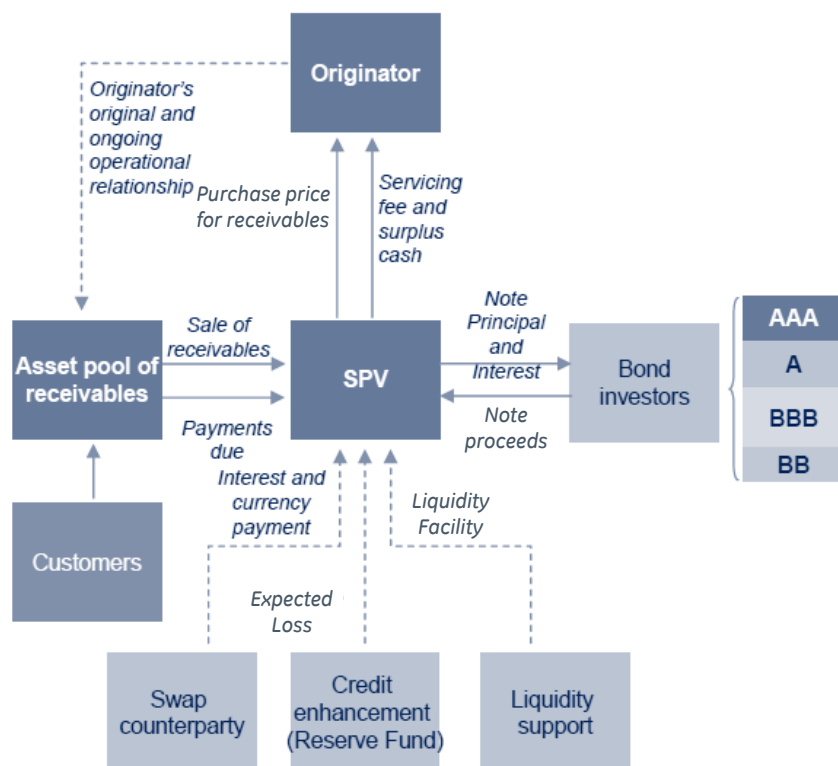
## WHY SECURITISE ? A REFRESHER

# Traditional Funded Securitisation

## Features

- Reliance on asset performance (and not the credit quality of the originator)
- Liquidity and hedging facilities to eliminate cash flow disruptions
- Formal credit rating of the transaction but de-linked from the credit rating of the originator

## Structure



Source: Lloyds Bank



## Securitisation Objectives

---

### Funding

- Diversification of investor base (more and different)
  - Potentially a cheap wholesale alternative
  - Primarily sale of senior tranches
- 

### Risk Transfer Reg. Capital Relief

- A tool to shift economic risk to Capital Markets investors
  - If structured properly may allow for regulatory capital relief at an attractive relative cost
  - Often undertaken through “synthetic securitisation” and sale of junior/mezz tranches
- 

### Deleveraging

- An alternative to whole loan portfolio sales
- Allows for an accounting sale where different portions of risk can be sold to different investors
- Allows for accounting derecognition (but not easy) and optionality for originator to retain servicing

# Funding Structures

## Comparison of Funding Structures

- Covered bonds, Securitisations and Term Repo securitisations offer different benefits to an originator / issuer
- A presence in all markets enables issuers to take tactical advantage of supply / demand driven issuance windows and different markets
- Headline spreads may not always tell the full cost of a transaction

	Covered Bonds (Mortgages)	Securitisation (Mortgages)	Securitisation (Repo)
Headline Pricing	✓✓	✓	✓✓
Collateral Efficiency	✗	✓	✗
Stability of funding / credit enhancement	✓	✓✓	✗
Tenor of debt	✓✓	✓	✓
Diversification from unsecured investor base	✗	✓✓	✓
Ratings Volatility / MTM risk for issuer	✓	✓✓	✗

\*Pricing dependant on issuers relative senior unsecured pricing

✓✓ = very attractive    ✓ = satisfactory    ✗ = less attractive

Source: Lloyds Bank

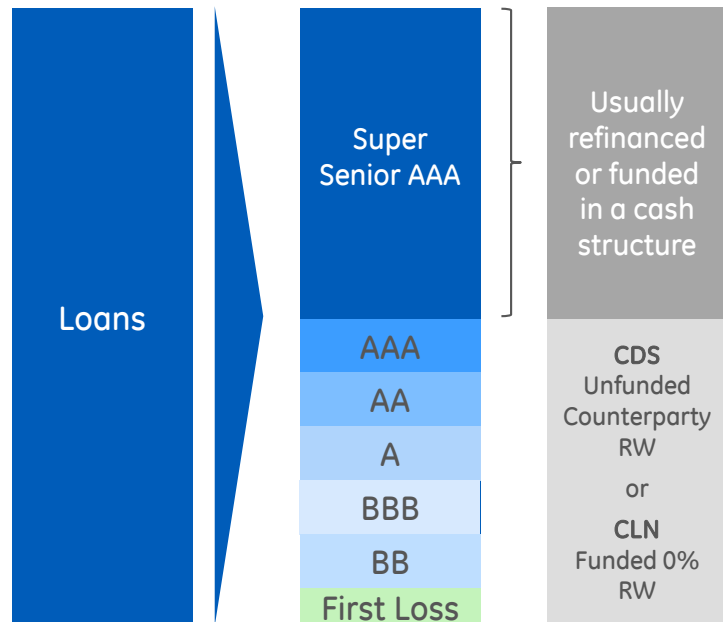


# Risk Transfer - Synthetic Securitisation

## Features

- Created when a bank only wants to obtain capital relief and/or risk mitigation
- The bank purchase credit protection from bank counterparties and/or other (non capital markets funded) market counterparties
- Obligations may or may not be funded (CDS vs CLN)
- Payments/Losses allocated in the same manner as other structures

## Structure

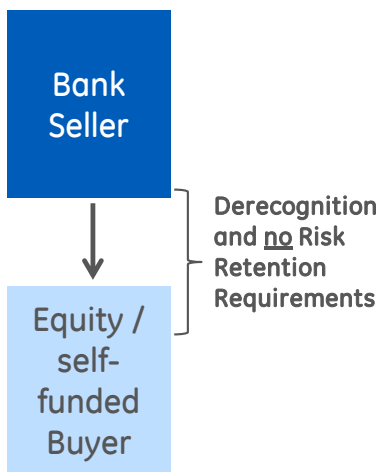


Source: Lloyds Bank

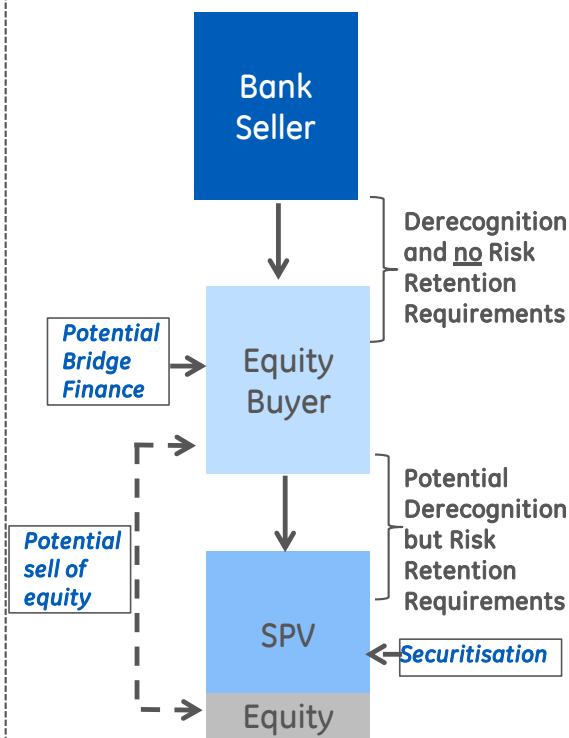


# Portfolio Deleveraging (3 options)

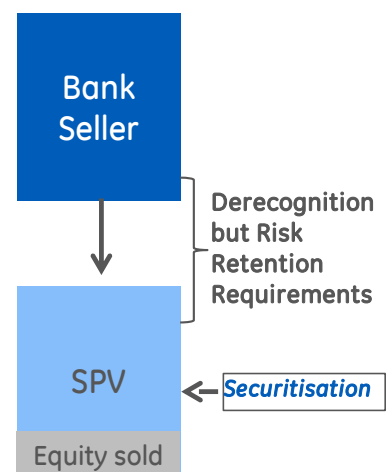
## Whole loan sale without leverage



## Whole loan sale with subsequent leverage/securitisation



## Full stack securitisation



Source: Lloyds Bank

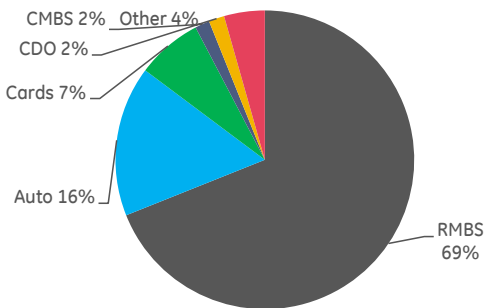


---

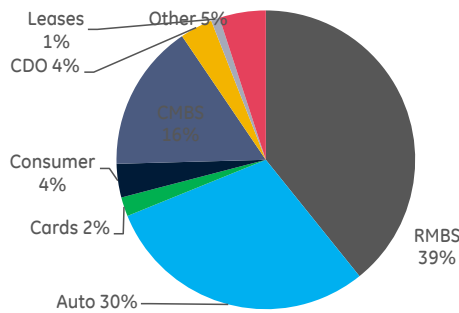
## POST CRISIS TRENDS IN EUROPE

# Market Evolution by Asset Class and Geography

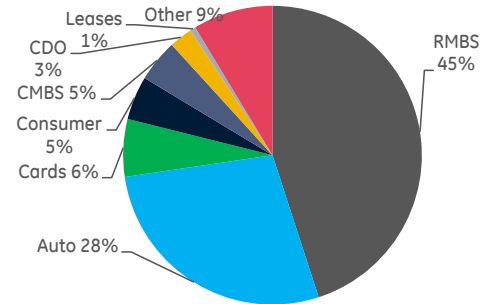
2011 - by asset class



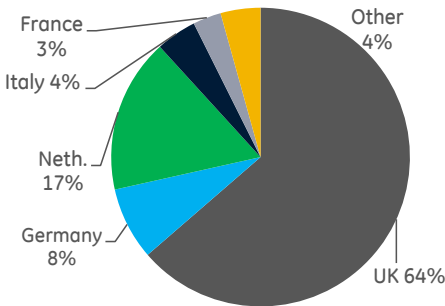
2013 - by asset class



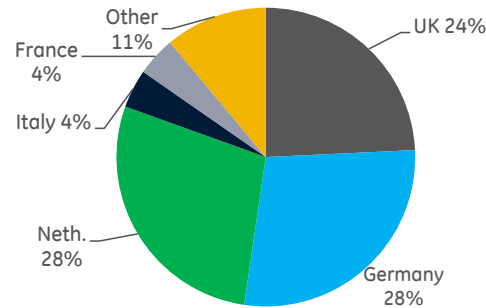
2014 YTD - by asset class



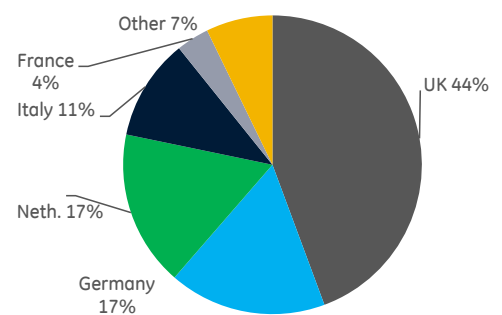
2011 - by geography



2013 - by geography



2014 YTD - by geography

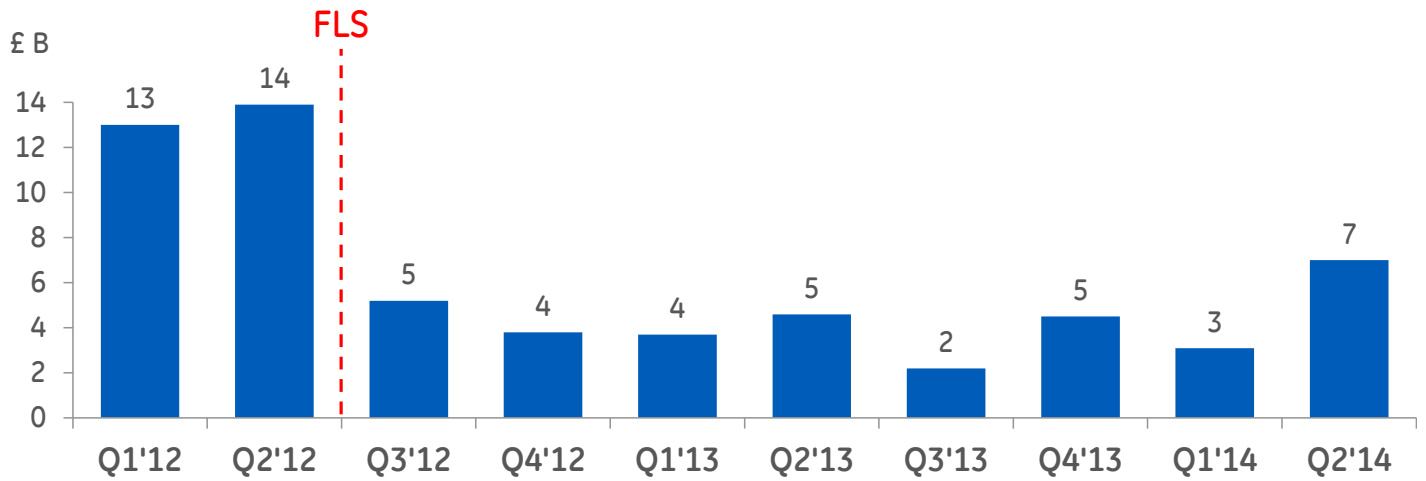


Source: J.P. Morgan International ABS & CB Research



# The Impact of Central Bank Liquidity in the UK

UK Market issuance Q1'12 to Q2'14

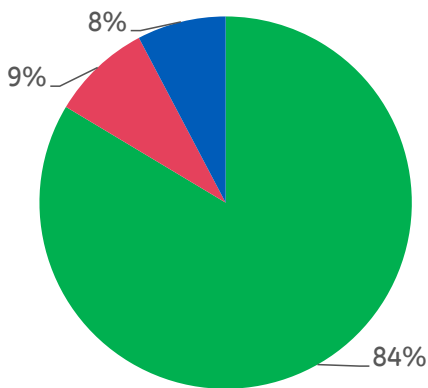


Source: Lloyds Bank

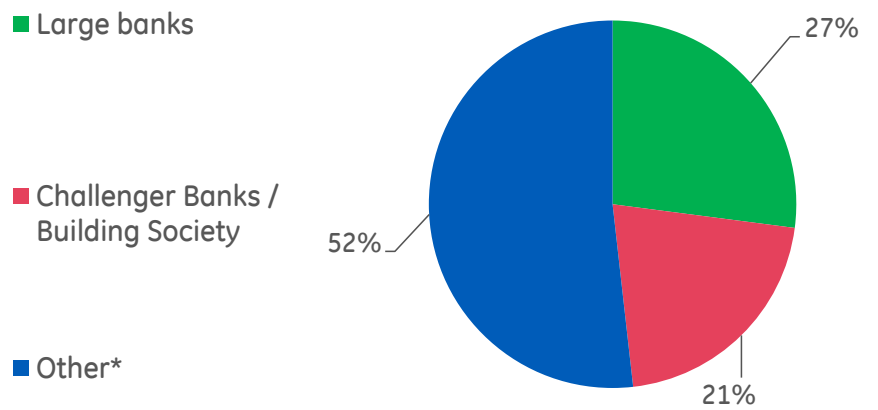


# UK Securitisation Market by Issuer Type

2011 issuance by issuer type



2014 YTD issuance by issuer type



Source: Lloyds Bank. \* Includes Corporate, Automotive, Non-Bank FI, PE

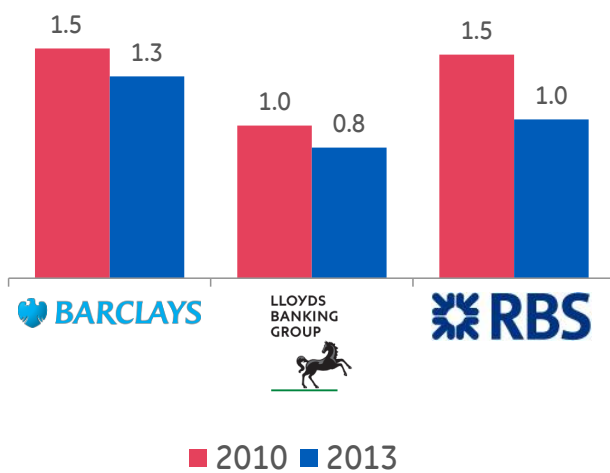
---

WHATS HOLDING THE MARKET BACK IN EUROPE?

## Decreasing Wholesale Funding Needs (UK examples)

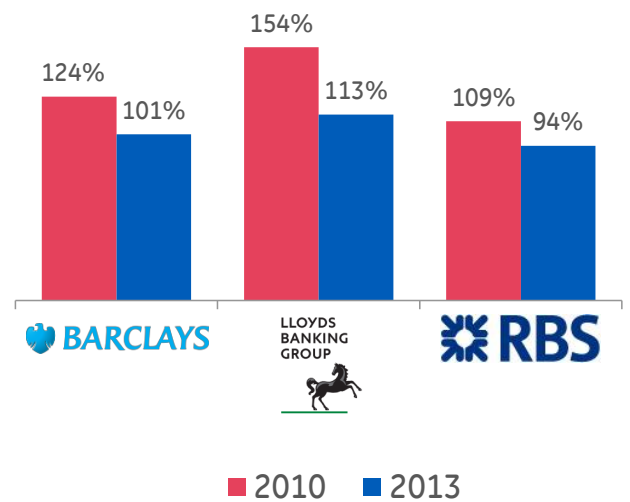
### Total Balance Sheet Assets (£ Trillions)

#### Deleveraging



### Loan to Deposit Ratio \*

#### Increased Focus on Deposits



Source: Annual Reports. \* Loan to customers / Customer accounts

## Central Bank Liquidity Facilities in Europe

---

### Bank of England



- Special Liquidity Scheme
- Funding for Lending Scheme

2008-2012

2012 (active)

### European Central Bank



- Long term refinancing operation 1
- Long term refinancing operation 2
- Targeted long term refinancing operation
- ABS Purchase Program

2011

2012

TBD\*

TBD\*\*



Source: GE Analysis. \* Announced in June'14; \*\* Announced in Sep'14

GE Capital

## Lack of Deep Investor Base (1)

---

- **Relative Value Regulatory “Punishment”**
  - Solvency II
  - Basel Risk Weighting Proposal
  - Liquidity Coverage Ratio
  - Definition of “Securitisation”

## Lack of Deep Investor Base (2)

---

- Perceived Continued Taint of the Product

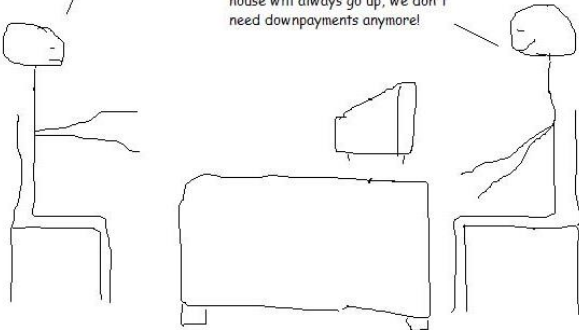
### *The first stage ...*

#### Ace Mortgage Brokers

"We Make Your Dreams Come True"

Gee, I'd like to buy a house but I haven't saved any money for a downpayment and I don't think I can afford the monthly payments. Can you help me?

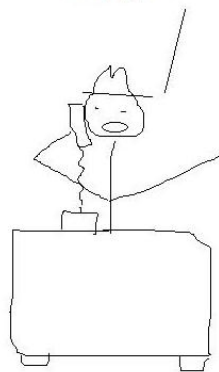
Sure! Since the value of your house will always go up, we don't need downpayments anymore!



### *... the last stage*

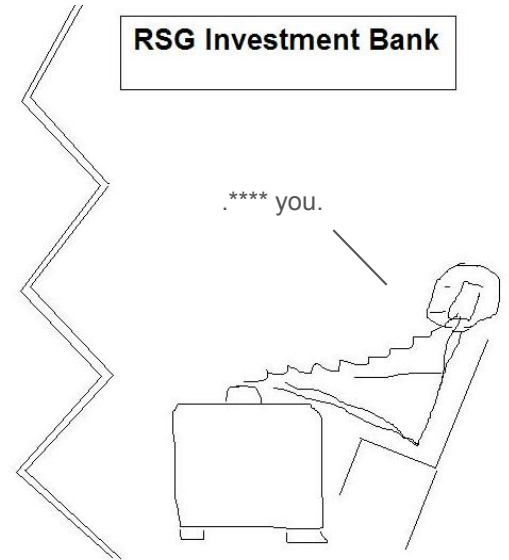
#### Norwegian Village Pension Fund

Hey man, what the hell is up? We're not receiving our monthly payments!



#### RSG Investment Bank

.\*\*\*\* you.



## ABS Less Competitive Wholesale Funding Source for Large UK Issuers

---

Typical 5 year sterling headline pricing (bps)

November 2011

---

L + 270

Senior Unsecured

L + 150

RMBS

L + 120

Covered Bond

Today

---

L + 70

L + 45

L + 30

---

Lloyds and GE Capital approximation of expected primary issuance levels based on observed primary issuance and secondary spreads (Sep-14)

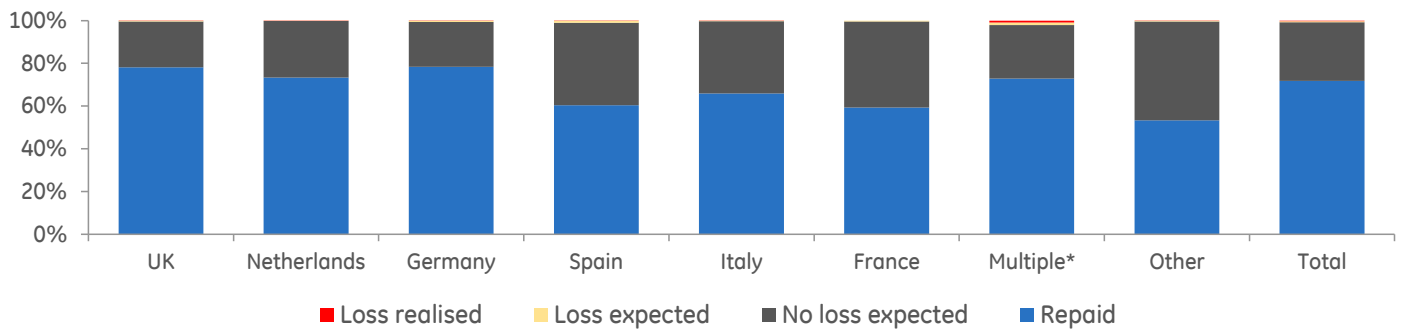
1. UK spreads for A+ rated entity
2. Spreads are for 5 year term (or nearest available) and all quoted over GBP LIBOR
3. Spreads are illustrative only

---

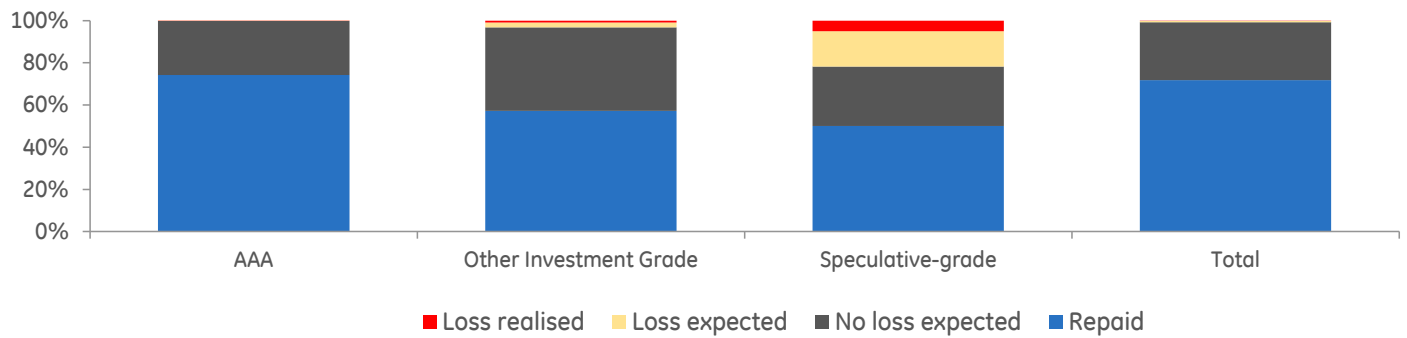
## REGULATORY REVERSAL?

# Strong Credit Performance of European Securitisation Product

## Securitisation Losses by Jurisdiction



## Securitisation Losses by Rating Category



Source: FitchRatings Report: "Global Structured Finance Losses: 2000-2013 Issuance". Data refers to Fitch-rated Structured Finance tranches (ABS, CMBS, RMBS, Structured Credits)

## Political Rethink ...

---

2007-2009

Today

- All securitisation products tainted because of US Subprime RMBS and its export overseas
- **C. Lagarde (IMF):** "Securitisation must lose the excesses of youth" (2007)
- **C. McCreevy (EU Commissioner):** "The needless opacity and shamefully lax standards of a hyper-active securitization industry has caused so much damage to the global banking system" (2009)

- **M. Draghi (ECB):** "Securitisation has a very bad name, but because of what was being securitised, and there isn't necessarily only bad securitisation"
- **Central Bank Official:** "Correcting the regulatory over-reaction to securitisation is a top priority of this Central Bank"
- **M. Barnier (EC):** "There is the low-quality securitisation. We have seen that it has cost a lot of money, subprime and other examples. But there is also good securitisation. We want to encourage good securitisation. We are not going to invite a new subprime disaster"

# The Regulatory Pendulum Swinging Back in Favour of ABS

## 2011\*

- Regulators driving issuers and investors to covered bonds
- While the investor costs associated with new capital requirements are obvious, the costs of contingent liquidity for issuers, especially when combined with more stringent rating agency triggers, are more subtle but as problematic
- These regulations will impact the cost of consumer and corporate credit and potentially stifle economic recovery
- Regulators may need to rethink the trade-offs and potentially adjust some of the more punitive and conflicting rules

## 2014

- **Regulatory and Political Reversal**
  - **Solvency II:** reduced capital requirement for ABS but still penal especially vs. raw assets
  - **Basel Risk Weighting Proposal:**
    - Increases in RW for ABS but less than originally proposed
    - US/European differences
  - **Liquidity Coverage Ratio:**
    - AA or better recourse RMBS eligible but US says no ABS
    - Europe contemplating going it alone
    - Strong European lobbying efforts
- **ECB ABS Purchase Program**
  - Applied to Eurozone assets only
  - Simple and transparent products (like PCS)
  - Primary and secondary purchases
  - Size and timing TBD



\* "The Secured Funding Markets – Where Do We Go From Here?" Annual ALMA Conference, Robert Plehn, Jan-2012

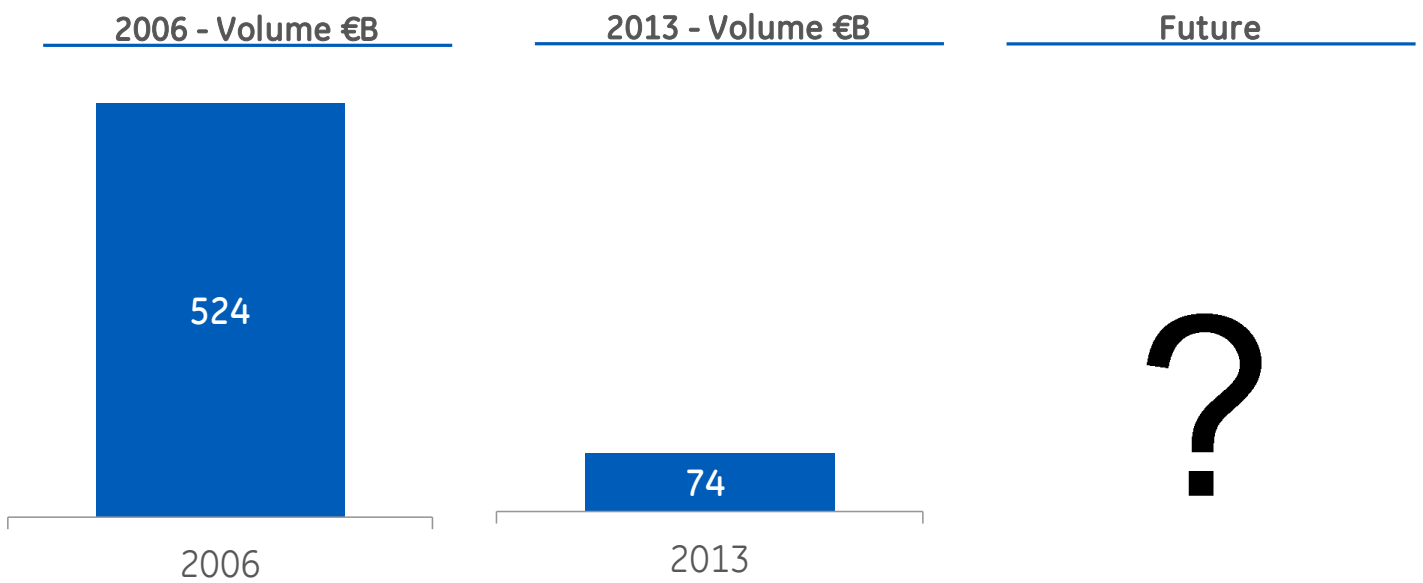
GE Capital

---

## OUTLOOK FOR THE FUTURE IN EUROPE

## What is the Ideal Size of the Market?

---

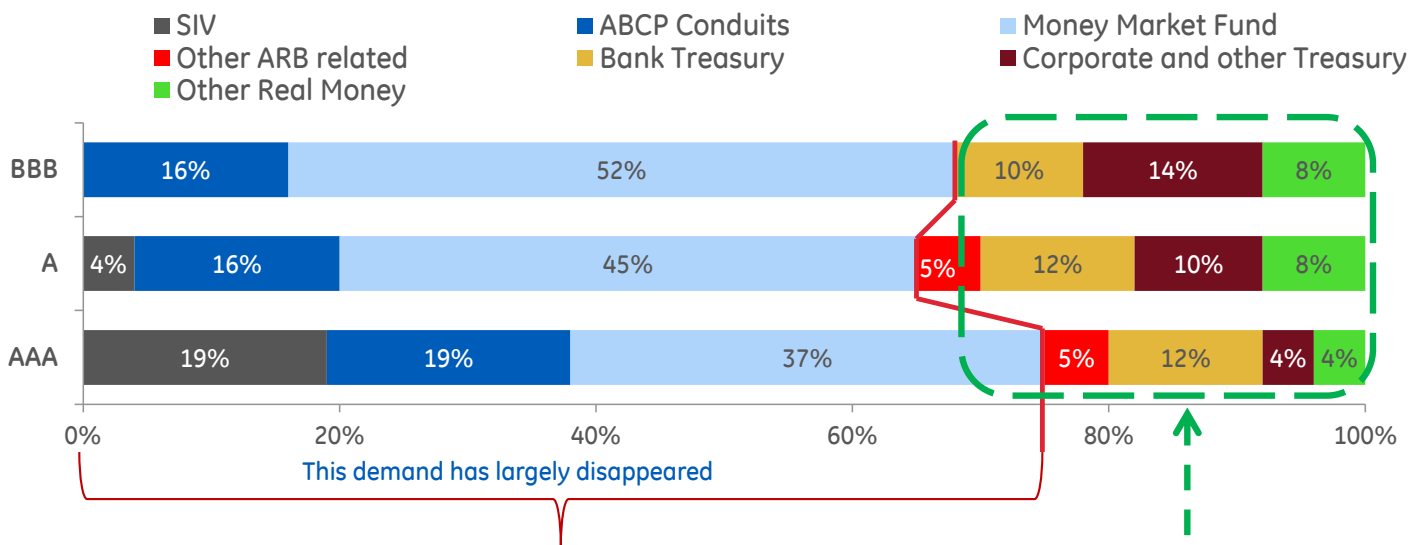


---

Source: J.P. Morgan International ABS & CB Research

# Investor Make-up

## Investor Type in European Primary Market Demand – Aug 2007



- The securitisation product needs to re-build the depth of its investor base in order to come back to pre-crisis volumes

Source: International Financing Review, DB Global Markets Research; www.ifre.com

## ECB ABS Purchase Program – Help, Hindrance or Irrelevant

---

September 4th – long awaited ABS purchase programme finally announced but with little detail

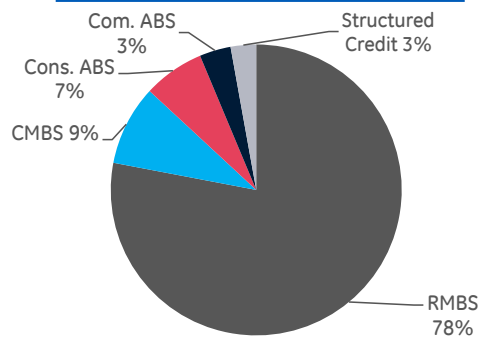
- Blackrock appointed as advisor
- Key focus is to stimulate SME lending but more asset classes will be eligible
- Will buy senior and “guaranteed mezz”
- Potential price tightening for certain asset classes and sympathetic price tightening for others
- Unclear that programme addresses the problems (i.e. liquidity vs. capital for banks)
- While a positive signal and a quick reaction in spreads, without regulatory changes it has no long term impact
- Potential to chase away existing investor base if leads to material price tightening with no corresponding regulatory change and/or reduces already reduced supply

---

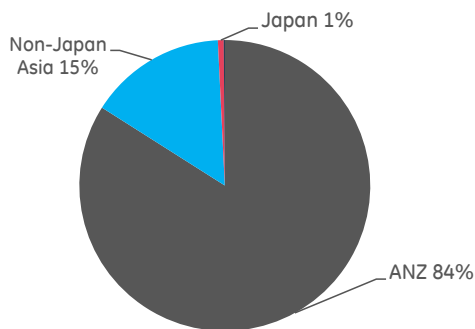
## THOUGHTS ON AUSTRALIASIA

# Asian Securitisation Market by Asset Class and Geography

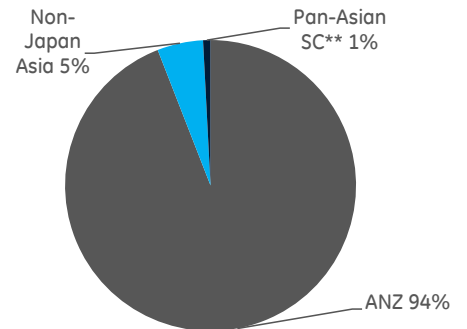
Issuance by asset class\*



2011 - by geography



2013 - by geography



Source: FitchRatings Report: "Global Structured Finance Losses: 2000-2013 Issuance". Data refers to Fitch-rated Structured Finance tranches.

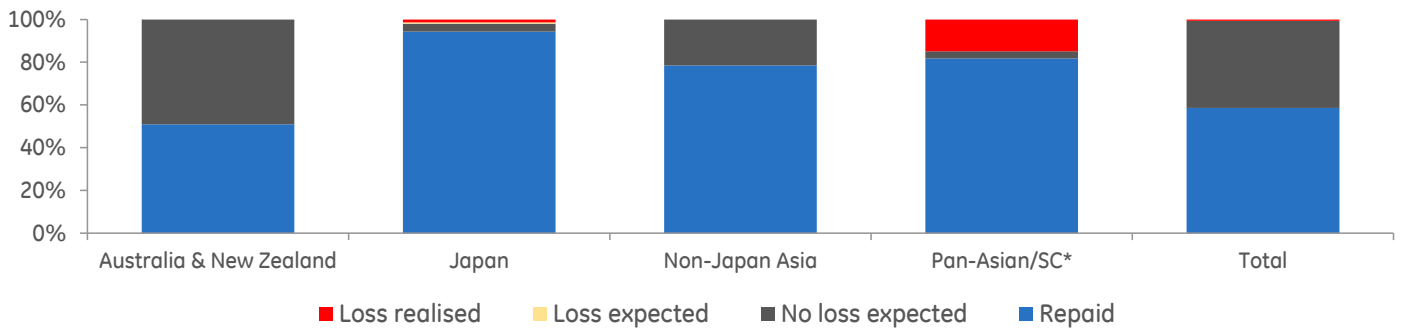
\* Split by Asset Class refers to the original balance derived from tranches issued between 2000-2013. \*\* IG Corporate CDOs and SF CDOs



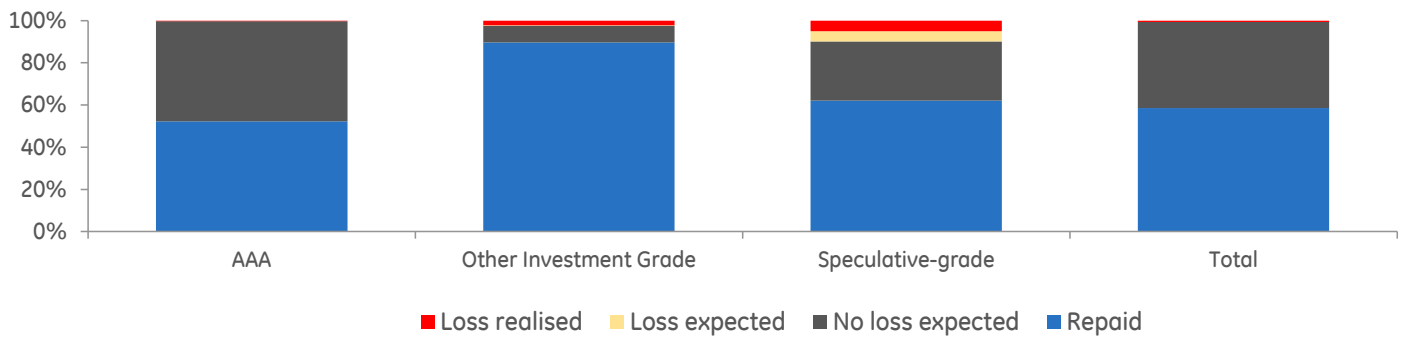
GE Capital

# Strong Credit Performance of Securitisation Product in APAC

## Securitisation Losses by Jurisdiction



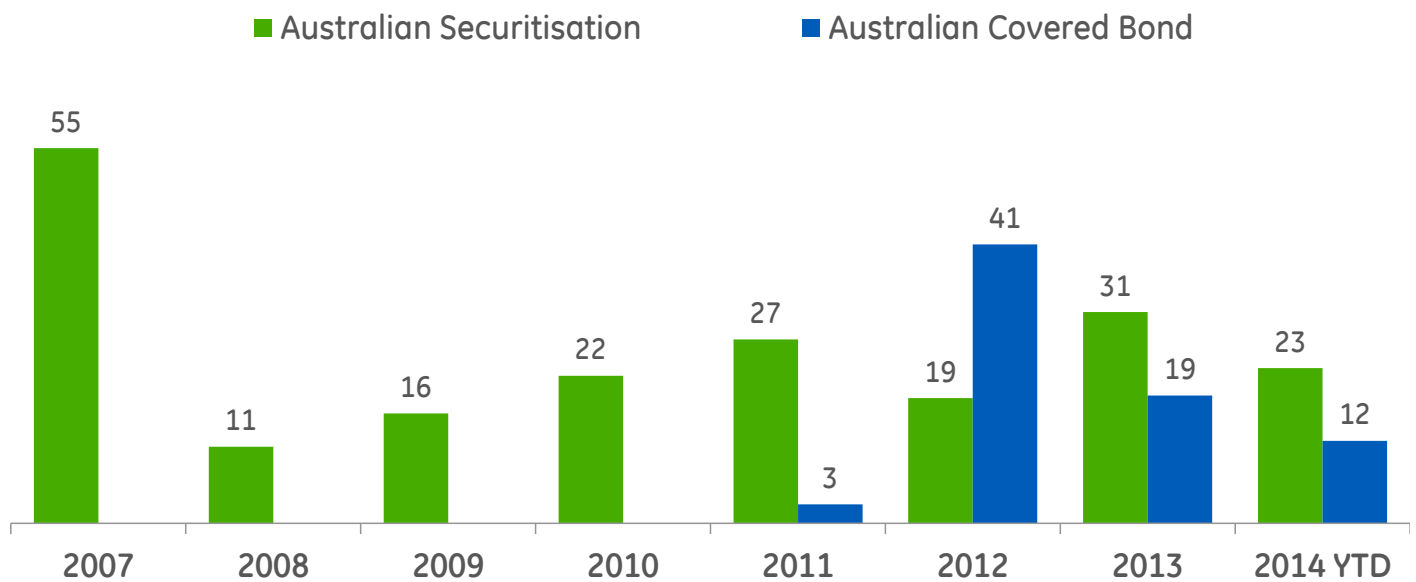
## Securitisation Losses by Rating Category



Source: FitchRatings Report: "Global Structured Finance Losses: 2000-2013 Issuance". The data refers to Fitch-rated Structured Finance tranches (ABS, CMBS, RMBS, Structured Credit). \* IG Corporate CDOs and SF CDOs

## Australian Securitisation Market Volumes (AUD Billions)

---

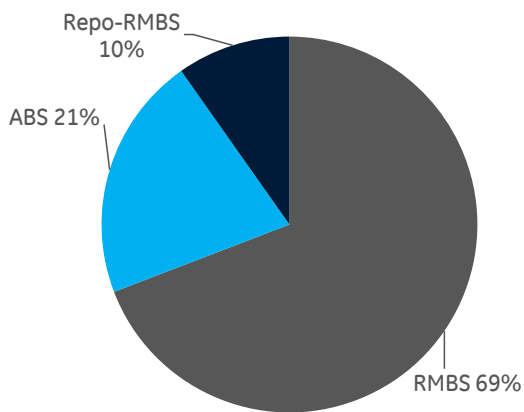


Source: Macquarie Bank

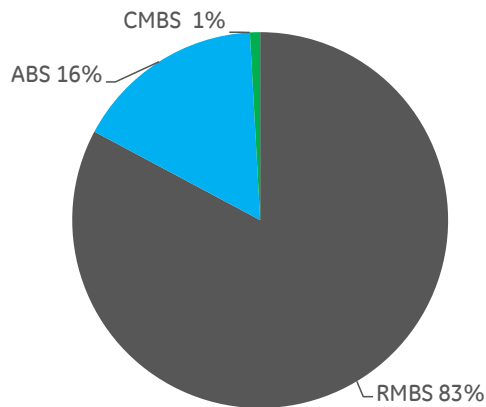
# Australian Securitisation Market by Asset Class

---

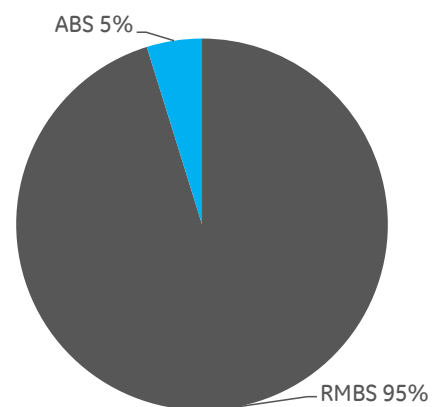
2011 - by asset class



2013 - by asset class



2014 YTD\* - by asset class

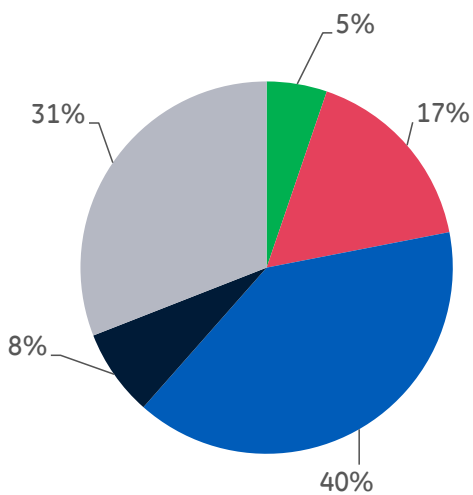


Source: BofA Merrill Lynch Global Research estimates. \* YTD refers to May 2014

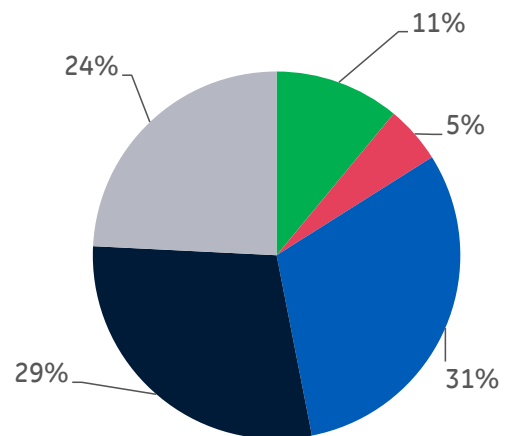
# Australian Securitisation Market by Issuer Type

2011 issuance by issuer type

2014 YTD\* issuance by issuer type



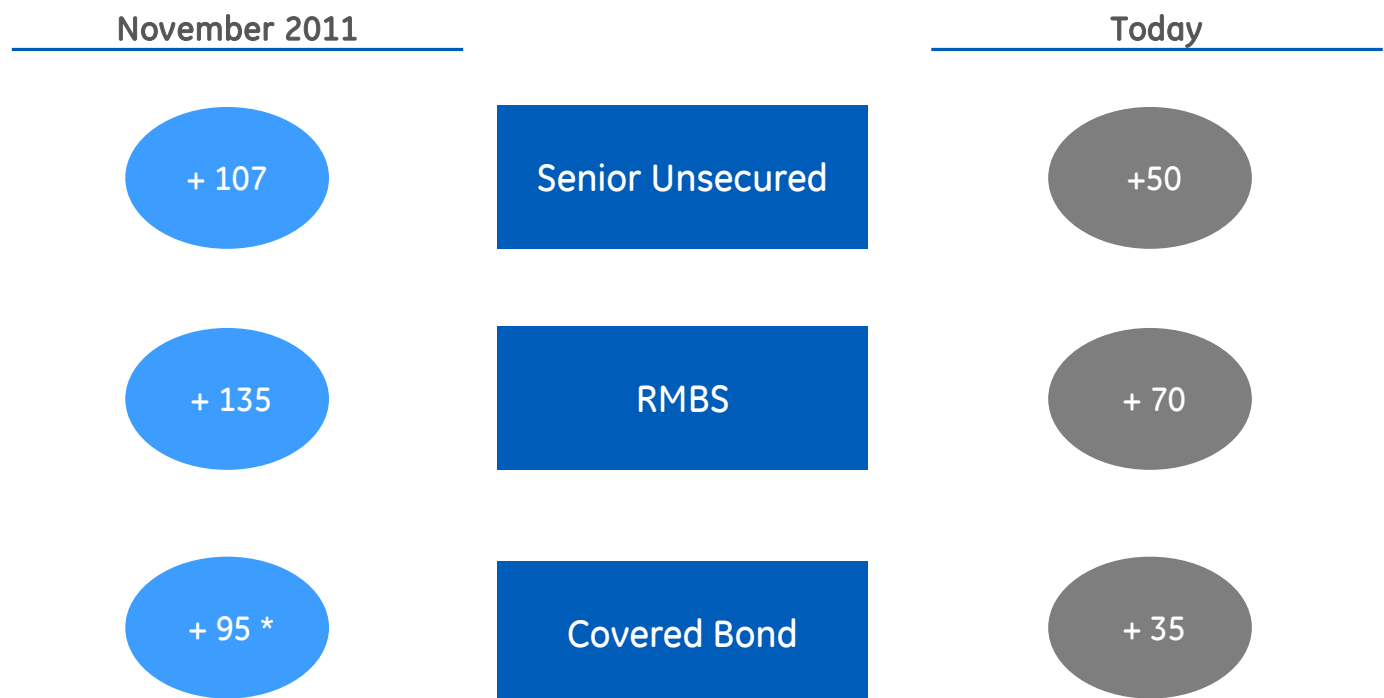
- Non-Bank FI
- Regional bank
- Big 4 Banks
- Non-bank originator
- Bank-other



Source: BofA Merrill Lynch Global Research estimates. \* YTD refers to May 2014

## Relative Funding Value for Australian Issuers

Typical 3 year AUD headline pricing (bps)



Source: Bloomberg and RMBS new issues. \* Covered bond spread as of March 2012

- Spreads based on 'Big 4'
- Spreads are for 3 year term (or nearest available) and all quoted over AUD\$ BBSW
- Spreads are illustrative only

## Stable Wholesale Funding Needs

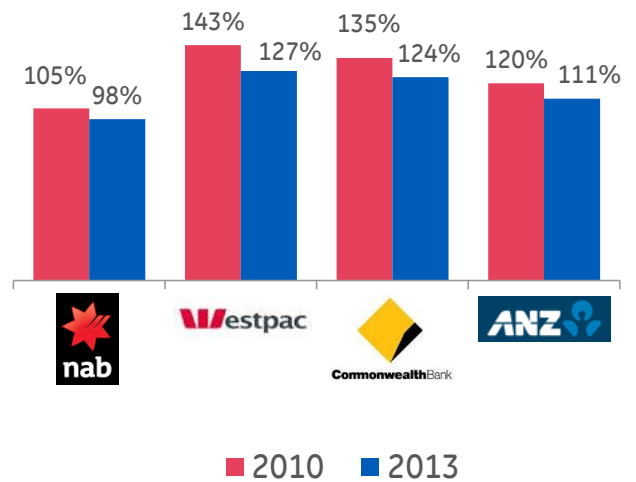
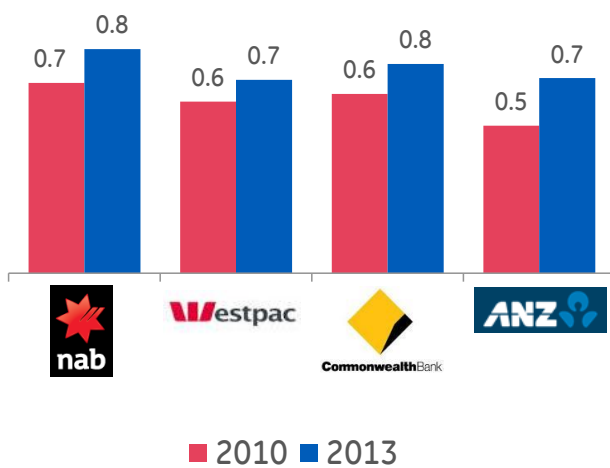
### Total Balance Sheet Assets (AUD Tr)

*Growing Balance Sheets ...*

*But*

### Loan to Deposit Ratio

*... Increased Focus on Deposits*



Source: Bloomberg data, Fiscal-Year End

## Thoughts on the Asian Securitisation Markets

---

- **Stable market but at a low level of volume**
- **If politicians / regulators want the market to expand then they need to:**
  - Be clear on objectives
  - Implement policies backing these objectives
  - Remove uncertainty for investors
- **Part of the reason for a marginal market may be:**
  - Lack of certainty by politicians and regulators whether they want the market to flourish (financial crisis hangover)
  - Less of a funding need due to significant availability of cheap bank funding
  - Lack of a mature market (data, legal certainty, etc.) in which to develop risk transfer and deleveraging trades
  - Lack of a deep and diversified investor base

## Disclaimer

---

*This presentation is for information purposes only and is not intended as an offer, solicitation, or recommendation for the purchase or sale of a financial instrument or to effect a transaction. The information contained within this presentation has been obtained from and is based upon sources believed to be reliable. Whilst all reasonable care has been taken to determine the accuracy and completeness of the information, General Electric Capital Corporation and any of its affiliates (collectively "GECC") do not guarantee the accuracy or completeness of the information, make no express or implied representations and do not accept responsibility for any loss arising from reliance on it. All opinions, projections and estimates constitute the judgment of the authors as of the date of the presentation and are subject to change without notice. Market rates, valuations and availability of financial instruments also are subject to change without notice. Nothing contained within the materials constitutes financial, legal, tax, accounting or other advice, nor should any investment or any other decisions be made solely based on this presentation. You should obtain advice from qualified experts before making any decision.*

*This presentation is produced separately from any other activity of GECC and was completed without access to non-public information that may have been received by other units of GECC. This presentation may not be reproduced or redistributed in any form without prior written permission from GECC. The use of this presentation in connection with the writing, marketing or promotion of any financial instruments, services or products is prohibited. This presentation is being recorded, and will be accessible online after this session*

*© 2014 General Electric Company. All rights reserved. Neither this publication nor any part of it may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of General Electric Company.*

*GE Capital EMEA Services Limited. Registered Address: The Ark, 201 Talgarth Road, London W6 8BJ, United Kingdom. Registered in England and Wales No. 00244759*