The European Securitisation market in 2020

Navigating uncharted territories
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Introduction

Following up on the report published in 2019, “The European Securitisation market... A year of challenges and opportunities”, HSBC Issuer Services shares the 2020 report highlighting the evolutions in the market in the first half of the year.
“2020 so far has been marked by unprecedented challenges and uncertainty. This translated in a significant slowdown in the European securitisation market, which was starting to show signs of a recovery. However, while the market has been challenged by the disruption generated by COVID-19, it is in an irrevocably stronger position than it was in 2008.

In this report, we outline some of the themes impacting the European Securitisation market in 2020 and the effect of COVID-19. We look at some of the government schemes introduced in Europe in response to the pandemic and their impact on the market, such as the U.K.’s COVID Corporate Financing Facility (CCFF). We also analyse the performance of the top asset classes across markets, namely RMBS and ABS.

While the industry in undergoing these seismic changes, our Issuer Services business has had to adapt and technology was a key enabler, by allowing us to continuously connect with and support our clients. We also upgraded our range of digital tools by launching a new mobile-friendly securitisation Investor Reporting Portal to allow our clients to access their data on the go.”

Karen Lomax
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HSBC Investor Reporting Portal
In June 2020, Issuer Services launched a new Securitisation mobile-friendly Investor Reporting Portal which will allow European debt issuers and investors to access data on their securities and portfolio holdings in real-time and over mobile devices. The mobile-friendly portal will help provide a better experience to clients at a time where access to data has become strategic and this further strengthens HSBC ISV’s Securitisation offering.

Visit the Investor Reporting Portal
Part 1

Which themes have shaped the European securitisation market?

At the start of 2020, the European securitisation market was proving to be in a healthier shape than the beginning of the previous year. The ‘Simple, Transparent and Standardised’ (STS) regulation and the interest rate reform were both more established than they were a year earlier. This led to an increase in investor demand for new transactions in Q1 this year. However, the outbreak of COVID-19 and the lockdown measures taken in response, have changed the landscape of the global economy. Europe has been hit particularly hard by the pandemic: France, Italy, Spain and the UK, all of whom are key participants in European Securitisation, are amongst the top 6 countries with the highest death rate caused by COVID-19 globally.

The economic challenges brought by the crisis are significant and the path to recovery remains uncertain, which draws inevitable comparisons to the 2008 financial crisis. However, key differences are making this crisis unique.

Firstly, countries across Europe have taken unprecedented monetary and fiscal measures in response to COVID-19. Unlike twelve years ago, policy response has been swift and decisive. After the 2008 financial crisis, it took seven years for the ECB to implement its Quantitative Easing (QE) program which eventually started in Q4 2014. In contrast, by March 2020, the ECB had already announced a EUR 750bn programme in response to the market impact of COVID-19.

Secondly, in 2008, the economic downturn started with disruption to the US real estate market which eventually spread to the rest of the global economy after a certain period of time. With the COVID-19 pandemic, lockdown measures have been imposed across the globe to various degrees, having a more immediate impact on the entire economy, with a decline in consumer spending and a rise in unemployment.

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Payment Holidays - A potential concern for UK RMBS originators

In March, UK Chancellor Rishi Sunak announced that banks are to provide mortgage payment holidays for up to three months to customers experiencing financial difficulty in light of the COVID-19 outbreak¹. The scheme is applicable to both owner-occupied mortgages, where homeowners are experiencing financial hardships, and buy to let mortgages (BTL), where tenants are struggling to pay their rent. The Financial Conduct Authority (FCA) guidance requires mortgage lenders to be flexible on how they collect interest covered by payment holidays and states that they cannot start repossession proceedings during the payment holiday period. Further guidance was given in June for customers still facing difficulties in paying their mortgage at the end of the three-month period where the payment holiday could be extended for a further three months.

The payment holiday scheme is designed to provide customers with temporary financial relief. However once the payment holiday period is over, the accrued unpaid interest will be capitalised on the outstanding mortgage balance, leading to a higher interest amount payable, but made more manageable in a lower interest rate environment.

How will the payment holidays affect UK RMBS performance?

The primary consideration is the interest shortfall resulting from the 3-month payment holiday period. To understand its magnitude, a key criteria is the percentage of customers within a transaction’s portfolio to whom payment holidays are granted.

¹ Source: https://www.ft.com/content/038b09ca66875111ea800d-da70cffe4d3

Figure 1 shows nine RMBS transactions currently reporting their payment holiday percentages. At the lower end of the scale, Yorkshire Building Society’s prime RMBS Brass No.5 plc shows payment holidays have so far been given to 10.2% of its outstanding loan balance. In contrast, on Charter Court’s BTL transaction PMF 2019-1B plc, 23.64% of its outstanding balance are affected by payment holidays.

Figure 1: % of outstanding balance granted payment holiday

<table>
<thead>
<tr>
<th>Transaction</th>
<th>% of balance granted Payment Holiday (LHS)</th>
<th>% of which 3-month holiday (RHS)</th>
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<tr>
<td>2MF 2018-1</td>
<td>30</td>
<td>60</td>
</tr>
<tr>
<td>RMAC 2018-1</td>
<td>25</td>
<td>50</td>
</tr>
<tr>
<td>CANBY1</td>
<td>20</td>
<td>40</td>
</tr>
<tr>
<td>TWIN 2019-1</td>
<td>15</td>
<td>30</td>
</tr>
<tr>
<td>RMAC 2018-2</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>CIEL 2019-1</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td>CCMF 2018-1</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>CWR 2</td>
<td>1</td>
<td>2</td>
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Source: Investor reports (May and June 2020), Bloomberg, JPM research
Another key metric is the percentage of customers taking up the full 3-month payment holiday (as opposed to 1 or 2-month), which represents at least 75% of customers utilising the scheme across all nine transactions. But at the current payment holiday levels being reported across the deals, most UK RMBS deals have sufficient liquidity support (such as cash reserves) to mitigate interest shortfall over a 3-month period.

The payment holiday levels could, however become more severe over time. Analysts at S&P have suggested that consumer assets such as RMBS are more insulated from immediate payment disruption risk. This trend can be explained by the fact that borrowers may have sufficient savings, reduced discretionary spending and benefited from government support such as unemployment benefits to support mortgage payments in the near term. Yet, as household savings reduce, more borrowers may request payment holidays further down the line.

In addition, servicers may be facing operational challenges in approving payment holiday requests, many of whom are working from home as a result of the lockdown. The option allowing borrowers to extend their payment holiday period for a further 3 months means that the continued and potentially higher interest shortfall may have a material impact on RMBS transactions in time.

The other potential impact from the scheme is lower CPR (Constant Prepayment Rate). This will likely materialise due to lower amortisations from the payment holiday period and could increase the risk of extension. Non-Conforming (NCF) RMBS in particular is susceptible for two reasons. Firstly, NCF borrowers are considered subprime and adhere to different lending standards than that of a high street bank thus making them more likely candidates for the payment holiday scheme.

By June, NCF transactions were reporting payment holidays at approximately 20.7% of its outstanding balance compared with Buy to Let (BTL) and Prime transactions at respectively 10.4% and 11.9%. Secondly NCF originators are typically specialist lenders who have less access to cheaper funding such as TFSME to support repurchasing the affected collateral.

**UK Government Schemes in response to COVID-19: what’s the market impact?**

On March 11, the Bank of England (BoE) announced three measures in an attempt to encourage banks to put money back into the economy. Firstly, interest rates were cut from 0.75% to 0.25%, which was further cut to 0.1%, the lowest in its 325-year history. Secondly, BoE also cut the countercyclical capital buffer requirement from 1% to 0% so the buffer can be used to support the economy.

Figure 2: UK policy response to COVID-19

<table>
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<td>• GBP 90bn of measures to support households and small businesses</td>
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<td>• Government subsidies for workers who have lost their jobs due to the virus and the self-employed, and cash grants of up to GBP 25k for eligible businesses</td>
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<td>• GBP 330bn made available for government loan guarantee and credit scheme</td>
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<td>• Cut interest rates to 0.1%</td>
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<td>• Restarted asset purchase programme</td>
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<td>• Launched Term Funding Scheme for SMEs (TFSME)</td>
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<tr>
<td>• Cut the countercyclical capital buffer from 1% to 0%</td>
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<tr>
<td>• GBP 200bn of purchases to be made “as soon as operationally possible”</td>
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<tr>
<td>• Launched a COVID Corporate Financing Facility (CCFF) to purchase commercial paper</td>
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Source: Bank of England, Bloomberg, JPM Asset Management (May 2020)

Thirdly, and more significantly for the securitisation market, the BoE announced the Term Funding Scheme for SMEs (TFSME), which offers funding at close to benchmark rate. The scheme provides participants with a cost-effective source of funding to support additional lending to the real economy. The scheme also provides additional incentives for banks lending to small and medium businesses (SMEs) who typically face financial hardships during economic downturns.

The scheme is offered to eligible banks and building societies but is not available to specialist lenders. Senior RMBS and ABS notes can be used as eligible collateral for the scheme. This could encourage more retained securitisations in the market as originators can securitise and retain senior ABS or RMBS notes as its eligible collateral.

3. Source: https://www.ft.com/content/4e60c08e-6380-11ea-b3f3-fe4680eae6b5
4. Source: https://www.bankofengland.co.uk/markets/eligible-collateral
The TFMSE is a reintroduction of a scheme that was initially launched in September 2016, the terms of both schemes are broadly similar. As with the 2016 Term Funding Scheme (TFS), eligible bank and building societies can drawdown from the programme on a daily basis with the term of each transaction at four years from the date of the drawdown. The drawdown period is set at twelve months (from 27 April 2020 to 30 April 2021).

The original TFS scheme was particularly popular, net borrowings totalled 127bn over the 18-month drawdown period. As a result, UK RMBS issuance saw a significant decrease during that period, due to lenders who vastly opted for the scheme over the relatively expensive RMBS senior AAA notes. Nationwide, a prolific RMBS issuer, were one of the largest users of the original scheme but did not issue a single RMBS during that 18-month window.

With maturities coming up from the original TFS over the next three years, Banks and Building societies will likely refinance TFS redemptions using the TSFSM scheme rather than issuing ABS. Furthermore, given the current volatility in the wider market, ABS issuers could be deterred from accessing the capital markets for some time. Both of these factors will likely supress UK ABS issuance levels in 2020.

**European ABS boosted by ECB announcements**

On 18 March, the European Central Bank unveiled plans for its new Pandemic Emergency Purchase Programme (PEPP). The ECB committed to purchase an extra EUR 750bn of net asset purchases under the programme, which was later expanded by a further EUR 600bn. The programme will be conducted until June 2021 and could be extended until the COVID-19 crisis phase is deemed to be over. As stated in their announcement, the primary motivation behind the PEPP is “to counter serious risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the outbreak” of COVID-19.

A week prior to the PEPP announcement, the ECB had already announced plans for a EUR 120bn of extra asset purchases within its existing Asset Purchase Programme (APP), and is on track to buy a record EUR 1.4tn of assets this year across all its QE programmes.

As with APP, Euro ABS will be eligible under PEPP after meeting certain criteria. The ECB’s APP has provided a significant boost to Euro ABS since its inception in 2014. As at end of May, net cumulative ABS investment within APP stands at GBP 30.9bn (book value at amortised cost) which represents approximately 30% of the outstanding distributed Euro ABS eligible for the scheme. Since the start of the pandemic, ECB investment in ABS has been mostly focussed in the secondary market at significant levels, up to around EUR 2.50bn net investment in March. This was the highest level of investment within a month since the APP scheme was first introduced.

Since April however, both the APP and PEPP schemes have focussed heavily in the public and corporate sector. Given that current market volatility has stifled primary issuance levels in European ABS, the ECB will likely invest in Government and Corporate bonds until the primary market picks up.


**Market trends**

**Early Optimism stifled by COVID-19 related market volatility**

Our previous market report published in October 19 highlighted some of the reasons behind stifling primary issuance levels in Q1 2019. The STS regulation was still in its infancy with several key items still being approved, while no third party verification agents were officially authorised. The first STS compliant transaction, VCL 28 was eventually launched in March 2019, which opened the floodgates for the market to pick up significantly. By the end of 2019, circa 50.6% of the distributed European market was STS compliant. By June 2020, the YTD figure has risen to 59.3%.
Furthermore, interest rate reform was under review in the UK. With LIBOR being discontinued by year end 2021, we saw the UK securitisation market gradually adopting SONIA as its replacement reference rate during 2019.

With both the STS regulation and the interest rate reform more established, 2020 started with optimism. Figure 4 shows during Q1 2020, the European market saw EUR 16.2bn of publicly distributed ABS compared to EUR 10.0bn in Q1 2019. However, since the onset of the pandemic and the related widespread market volatility, public issuances have essentially come to a standstill. By the end of June 2020, that figure had only risen EUR 20.6bn which is the lowest YTD figure since 2009 – with eleven public deals priced in the market in Q2 so far.

A closer look at the RMBS and Auto ABS markets

The primary market has heavily issued in two asset classes – RMBS and Auto ABS. The RMBS market was particularly prolific in Q1 taking 68% of distributed issuance, up from 49% over the course of 2019. 52% of the distributed RMBS was backed by prime mortgages. This is largely owed to seasoned originators such as Credit Agricole, Obvion and Skipton Building all distributing sizeable chunks of prime RMBS.

Investor demand was relatively strong in early 2020. January saw the launch of Charter Court’s latest GBP 376m BTL transaction, Precise Mortgage Funding 2020-1B plc – this was Charter Court’s first securitisation since its merger with One Savings Bank. In contrast to the relative market fatigue observed towards year end 2019, coverage ratios were promising at 5.1x/10x/11.2x/8.2x/6x on the A1/B/C/D/E notes driving spreads at the tighter end of guidance across the board.

January also saw two Master Trust UK RMBS transactions come to market. Clydesdale Bank’s Lanark Master Issuer plc 2020-1 and Nationwide’s Silverstone Master Issuer plc Series 2020-1 which were both met with positive market reception, their notes oversubscribed and again pricing at the tighter end of guidance. This further emphasised the strong investor appetite for UK securitisations in early 2020. At GBP 1bn, the class A note in Silverstone Master Issuer plc Series 2020-1 was the largest UK Prime tranche to be placed with investors since 2012.

Source: Concept ABS, JPM research - 26/06/2020

While the UK has taken 46% YTD market share within the European Securitisation market, on the continent, Dutch RMBS is leading the ABS pipeline. Three rare non-prime Dutch RMBS transactions came to market in Q1 – two BTL and one Non-Conforming. This included Dominvest BV’s Domi 2020-1 BV which was a follow up to their 2019 debut BTL securitisation.

The Auto ABS asset class has also benefited from healthy issuance levels 2020, taking 33% market share (versus 27% in 2019). In Q1 alone, eight public transactions came to market including deals from BMW and Volkswagen. Vauxhall Finance completed their first transaction with HSBC Issuer Services when they issued ECarat 11 plc. The STS compliant, SONIA-linked Auto ABS was the eleventh transaction from its E-Carat plc programme. Launched in late February when the onset of COVID-19 was beginning to take effect on the wider market, it obtained modest coverage ratios particularly in the senior tranches – 1.1x in Class A – compared with levels seen earlier in the year.

While COVID-19 related volatility did not have a restrictive impact on the primary market until early April, the impact was more evident in the secondary market throughout March. According to data by JPM Research, March had the highest monthly BWIC (Bid Wanted in Competition) volume since 2016 driven by sell off pressures and volatility in risk markets. Also notable is only 71% of the EUR 2.1bn offered in March was traded versus a 3-year monthly average of 91% indicating marketwide risk aversion.

![Pie chart showing YTD Distributed ABS by collateral type]

Source: Concept ABS, JPM Research – 26/06/2020

![Pie chart showing YTD Distributed ABS by jurisdiction]

Source: JPM research (26/06/2020)
Future outlook

The spread of COVID-19 has sharply slowed the European economy. The crisis could cause a sudden increase in delinquencies for collateral pools backing European ABS and RMBS, which could be severe in some sub-sectors. This could occur both as a result of some borrowers’ inability to pay their instalments in full -- given interruptions to many business activities and employment -- or government-mandated forbearance measures adopted by lenders. However, most ABS and RMBS transactions contain structural features that cover short- and medium-term liquidity stress. In addition, many transactions allow principal receipts to pay interest, which would benefit senior notes at the expense of junior notes, during a more prolonged disruption.

In the longer term however, the possible effects on European ABS and RMBS ratings are not yet clear, given the potential downside risks in the macroeconomic outlook. Based on S&P Global Ratings as of May 2020 global economic forecasts, it is expected the bulk of negative rating actions will affect speculative-grade securities.

ABS transactions tend to have much lower weighted-average maturities than RMBS transactions, resulting in a relatively fast built-up of credit enhancement, further protecting strongly performing legacy transactions.

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HSBC’s approach to operational risk management

Amongst key operational concerns raised by clients at the start of the pandemic, the potential disruption of operational procedures to transfer funds from collection accounts to securitisation issuers ranked high. The process itself could require the implementation of new solutions to ensure an operational ability to make timely payments on securitisation liabilities. Another important operational risk highlighted by clients was related to staff performing administrative functions for the transaction parties, such as paying agents and trustees, who would also need to be able to continue their activities and access data remotely.

“This large-scale remote working experience, forced upon us, has confirmed our ability as a bank to adjust rapidly to challenging market conditions. Our Issuer Services business is heavily reliant on the robustness of our operations. Leveraging our existing technology infrastructure, we have been able to efficiently put in place a safe remote working environment for our teams, while ensuring continuity of service for our clients. For instance, e-signing capability allows us to continue to sign transaction documentation from home. Another example is the use of Zoom which has allowed us to continue to engage with clients on a regular basis, to identify stress situations as early as possible, and provide support as required. Despite experiencing a higher volume of activity due to COVID-19, our operations framework has proved to be resilient and adapted to continue to support our clients.”

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Read the article: COVID-19: Testing operational resiliency within an Issuer Services business.
Helping clients to prepare for the world ahead

In the face of unprecedented market conditions and heightened uncertainty, delivering relevant market insights and data to help issuers make informed decisions has been inherent to HSBC’s proactive approach to further support clients, beyond their transaction needs.

Using data analytics and exploring customers’ trends helps HSBC shape a global picture of where and how economies and businesses can start to restore, adapt or evolve their models. HSBC Global Research’s ‘COVID-19 weekly podcast series’ is complemented by a host of thought leadership covering macro-trends that will continue or accelerate post COVID-19, such as digitisation, data and technology, sustainability. Other topics include supply chain, cash and liquidity management, working capital, risk management, trade, digital, sector trends.

Sustainable Finance – The future post COVID-19

While still under the strain of the COVID-19 pandemic, industries around the world are also anticipating the post-crisis economic recovery through the prism of ‘building back better’ – creating a stronger, more resilient and more sustainable future. The financial sector will have an important role to play in this recovery.

Green issuance and investment is on a firm upward trajectory, propelled by the 2015 Paris Climate Agreement, and the impetus it created to finance $1 trillion a year in investments for renewable energy and other initiatives to limit global warming.

The development of a consistent and simple definition of green securitisation is crucial to the expansion of the green securitisation market.

According to market forecasts, sustainable Asset-Backed securities (ABS) issuance could reach $380bn per year by 2035. The Sustainable Finance Study Group proposed sustainable securitisation as one of the three priority areas for scaling up sustainable finance.

Related articles:

- COVID-19: How have clients’ requirements evolved?
- European securitisation: could the market rebound amidst COVID-19?
- Press release: HSBC launches new mobile-friendly investor reporting portal

To find out more about HSBC Issuer Services, please visit our website: www.gbm.hsbc.com/issuer-services or follow #HSBCCoscrow on LinkedIn.

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