HSBC Issuer Services

Repacks revival

An alternative yield opportunity for investors

HSBC

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Naoufel Chatri
Global Head of Fixed Income Structured Investments, Markets & Securities Services

Key takeaways

- Fuelled by the challenging return conditions in fixed income, investors are embracing repacks as an alternative avenue to unlock yield.
- Repacks can give investors access to assets that they may not normally have been able to invest into directly before.
- Repacks can also help institutional investors address a number of operational and regulatory requirements.
- HSBC's Issuer Services solutions are designed to facilitate the ongoing operational and administrative requirements involved in repacks.

After undergoing a significant contraction in the wake of the financial crisis, SPV (special purpose vehicle) repackagings or 'repacks' have enjoyed a strong revival of late. But what exactly are these instruments?

In their most basic format, SPV repacks involve an SPV purchasing an underlying asset, and re-profiling the cash flows by entering into a derivative transaction with a swap counter-party. The combined transaction is financed by the issuance of a note, which is then sold to an investor. Although there are parallels between SPV repacks and securitisations, the former are widely considered to be more cost-effective and less administratively complex for small portfolios.

Fuelled by their operational benefits and degree of flexibility, investor appetite for repacks is gaining momentum.

Supporting investors with return generation

Equity market volatility combined with the prevailing low interest rates are forcing institutional investors to scope out alternative sources of yield. Naoufel Chatri, Global Head of Fixed Income Structured Investments, Markets & Securities Services at HSBC, said repacks are becoming an increasingly popular tool among yield-starved investors.

"The low rates are forcing investors to identify yield enhancement strategies when they are not meeting their targets. In response, many are exploring illiquid credit instruments – such as loan repacks or trade finance repacks," said Chatri.

In both cases, loan repacks and trade finance repacks give investors – such as pension funds and insurers – access to assets which normally would not be easily available to them. This is often because very few investors will have the systems or technology in place to administer standard loan payments. On the borrower side, SPV repacks can facilitate major advantages as well. Many of the underlying assets in repacks are less liquid, meaning it can be more difficult to obtain financing for them. By leveraging SPV repacks, however, the assets can be converted into a note format, giving borrowers easier access to funding.

"SPV deposit-linked notes are also becoming increasingly ubiquitous in the Middle East markets as regional banks look to raise deposits to meet regulatory capital requirements (e.g. loan to deposit ratio and net stable funding ratio [NSFR] obligations under Basel III) or diversify their funding sources," said Chatri.

"As a custodian, HSBC can hold securities as collateral for a diverse range of structures included repacks. Our global reach, credit rating and strong balance sheet allow us to support clients in both traditional markets and emerging markets."

Phil Townsend
Head of Repackagings, Issuer Services

Case study: HSBC & the trade finance market

- HSBC entered into a strategic partnership with AllianzGI, the global asset manager, to develop a solution which would make the trade finance market more easily accessible for institutional investors. Under the arrangement, assets originated by HSBC's Global Trade and Receivables Finance (GTRF) business will be selected by the investor and transferred by HSBC to the SPV via a fully funded risk participation (including an HSBC insolvency ring-fencing mechanism).
- HSBC provided an end-to-end solution, with Markets & Securities Services structuring the notes, originated from the GTRF business, while Issuer Services provided agency services to facilitate the ongoing operational and administrative requirements.

"We have noticed that there is growing appetite for SPV deposit linked notes from investors such as those from HSBC's Wealth and Personal Banking arm," he added. Nonetheless, Chatri adds that educating clients is a key aspect of their conversations on repacks to ensure clients fully understand both the potential benefits and risks associated with SPVs. "We are putting a lot of efforts in continuously educating clients on repacks as alternative sources of yield and the role of SPVs. One aspect that clients may not always initially grasp is that repacks can be processed as bond instruments," he explained.

Enabling operational efficiencies

Repacks can help investors meet a number of other operational and regulatory requirements. Firstly, repack notes are bespoke, which provides investors greater flexibility in terms of their currencies, maturities, coupons and credit.

Consequently, the risk profile can be fully customised according to investors' preferences. Chatri noted that major derivatives users – a number of whom are facing increased cost pressures as a result of EMIR's (European Market Infrastructure Regulation) collateral margining and transaction reporting obligations - are starting to leverage repacks more frequently too.

"Repacks allow for liquidity risk to be externalised. Any derivatives transaction on a repack takes place between the SPV and HSBC. From an investor perspective, repack notes are settled and processed like regular bonds at a Central Securities Depository (CSD), so clients can avoid some of the operational costs associated with holding derivatives. A number of our UK institutional investors clients are now actively exploring the repack market," said Chatri. For banks, repacks can also help optimise capital charges as SPVs are off-balance sheet.

Adapting services to meet client demand

As a leading wholesale bank, HSBC is in an excellent position to capitalise on the increased investor interest in the repack market. While the bank's Markets & Securities Services arm oversees structuring, HSBC Issuer Services manages the ongoing cash flows and asset servicing, for vanilla, bespoke and complex repack transactions. In addition to supporting HSBC led transactions, the latter provides trust and agency services to a significant number of third party arranging banks and has been making meaningful investments into its infrastructure to support steadily increasing transactional volumes.

Note:
1. Global Trade Review (May 21, 2019) HSBC to wrap trade finance assets into notes for investors

Did you know…

Issuer Services as an independent service provider

- HSBC's Issuer Services division provides trustee and agency services to a wide range of clients, including SPIRE (Single Platform Investment Repackaging Entity), a multi-dealer platform that allows for repacks arranged by its dealer members to be issued in a standardised format. According to SPIRE, this gives investors exposure to the returns of a number of underlying collateral assets and customisable payoffs[1].
- The platform also brings enhanced transparency, liquidity and simplicity to the repack market, it continued. "SPIRE has lots of positive momentum and we are delighted to play our part in supporting the platform, which has been a remarkable success story in the market" said Townsend.

Phil Townsend, Director, Head of Repackagings, Issuer Services at HSBC said that in addition to allocating significant resources to streamlining processes and enhancing technology, HSBC's Issuer Services has reorganised its repack sales, transaction management and client services into a single cohesive team unit. The new consolidated approach has played a crucial role in enhancing the customer experience, by allowing its subject matter experts to focus on a small number of clients, whilst maintaining the flexibility to offer a global solution for more complex cross border transactions, explained Townsend.

"The success of our repack business relies on the quality of the service providers we work with. When looking for a service provider to support our transactions, we prioritise those we deem reliable, efficient and whose servicing has proved to be seamless, such as HSBC Issuer Services," commented Chatri.

Market participants also look to HSBC as it is an institution which boasts an extensive geographical footprint and a robust commitment to risk management.

"We operate in a wide range of markets. One of the main strengths of our Issuer Services offering is that we have a large global custody network, which allows us to offer custody services in more than 90 markets, of which HSBC is the direct custodian in 33 of them," said Townsend. As a custodian, HSBC can hold securities as collateral for a diverse range of structures including repacks. "Our global reach, credit rating and strong balance sheet allow us to support clients in traditional markets, across Europe, Asia and the Americas and new emerging markets, such as Egypt and Korea. We have made it a priority to continue to work hard to deliver solutions for our clients across all markets," concluded Townsend.

Note:
1. http://www.spiresa.com/about-spire/

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