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Study | Securitisation in Europe

Asset-backed finance research
Future of securitisation in Europe

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List of abbreviations

ABCP	Asset-Backed Commercial Paper
ABS	Asset-Backed Security
AMLF	Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
ASF	American Securitisation Forum
BaFin	Bundesamt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)
BdB	Bundesverband Deutscher Banken (Federal Association of German Banks)
CDO	Collateralised Debt Obligation
ESF	European Securitisation Forum
EU	European Union
ECB	European Central Bank
MBS	Mortgage-Backed Security
SIV	Structured Investment Vehicle
SPV	Single-Purpose Vehicle
TALF	Term Asset-Backed Securities Loan Facility
TSI	True Sale International

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1 Executive summary

The refinancing and placing of risks in the market by securitising receivables has come under heavy criticism in the wake of the financial crisis. Securitisation transactions have even been held partly responsible for the emergence of the crisis. Nevertheless, the resurrection of the securitisation markets is at the centre of current discussions in order to avert a possible credit crunch and hence to stop the economic recovery from being strangled.

Against this background, the BearingPoint 'Future of securitisation in Europe' study throws light on a possible reorganisation as well as future opportunities of the European securitisation market. Participants from financial institutions, service providers, industry and associations have given their assessments about the further development of the market, what hurdles exist and how they can be overcome.

The key individual results of the study are:

- A possible credit crunch can only be averted with a functioning securitisation market.
- A resurrection of the securitisation market for the important ABS and MBS segments is only likely from 2011. For the ABCP segment, the investors are expected to return in 2010. There is no confidence in a return of the CDO segment.
- The focus of future securitisation deals will be on receivables from the real economy, particularly leasing receivables, trade receivables and consumer loans, but no longer on the repackaging of securitisation tranches.
- Securitisation will remain economically attractive, yet at much higher risk costs.
- The overriding motive for future securitisation deals will be asset-backed refinancing and not the placement of risks in the market.
- An essential prerequisite for a functioning securitisation market is the supervision of the rating agencies.
- In order to resurrect the securitisation market, transparency, standards and less complex transaction structures are required.
- For securitisation deals, a seal of quality is required that defines minimum requirements for the structure of transactions and their external reporting, in order to create a new segment for high-quality, transparent and easy-to-understand securitisation deals.

According to the view of the study's participants, the interest of investors in the important ABS and MBS securitisation segments will not return until 2011, meaning that the 2010 securitisation market cannot yet provide the desired relief for the banks. In order to avert a possible credit crunch, measures such as continued liquidity injections from the state or the central banks will therefore be necessary to support the market.

2 Starting position and objective of the study

2.1 The role of securitisation in the financial crisis

The real-estate bubble in the USA created by the low-interest policy during 2003 and 2004 went hand in hand with the breakthrough of a special capital market product, the mortgage-backed security (MBS), which is an interest-bearing security backed by a portfolio of mortgage loans. With the help of the MBS, players in the financial markets were able to take mortgage loans off balance, free the tied regulatory capital and reuse it to service the high demand for mortgage loans. Using this so-called leverage effect, up until 2007 it was possible for these players to further optimise their return on equity.

The possibility of using this form of securitisation to sell the cash flows as well as the risk from mortgage loan portfolios encouraged the switch from buy-and-hold to originate-to-distribute strategies at the mortgage lenders. This switch, however, promoted the desired credit expansion at the cost of stringent credit checks on the debtors. This led to a boom in second-class ('Old-A') and third-class ('sub-prime') mortgage loans, which, bundled and structured, were securitised into large MBS tranches, evaluated by rating agencies as first class and sold to investors. Subordinated MBS tranches with a worse rating were, if necessary, rebundled, structured and securitised again through collateralised debt obligations (CDO).

Off-balance-sheet structured investment vehicles (SIV) and conduits invested in these securitisation products and refinanced themselves using short-term commercial papers. They thus took over the term transformation for institutional investors interested in the real-estate market. Against the backdrop of low interest rates, investors on their part had a strong interest in the higher-interest-yielding securitisation products that at the same time came with a good rating.

With the rise in the US Federal Reserve interest rates in 2005 and 2006, however, an increasing number of borrowers with low credit rating got into payment difficulties, as many mortgage loans in the US market have variable interest rates. This resulted in enforced house sales and the end of the rise in real-estate prices that had persisted over 20 years.

The fall in the US housing market in 2007 ('sub-prime crisis') was followed by a loss in confidence in the SIVs and conduits that were invested in the real-estate market through MBS transactions. By the middle of 2007, institutional investors were no longer willing to buy the commercial papers issued by these vehicles for refinancing purposes. In order to safeguard their refinancing, however, the credit lines provided by the sponsor banks were resorted to. The banks, which had taken their much-leveraged credit risks off the balance sheet, were now called on to provide billions at short notice to support their off-balance vehicles, thereby falling headlong into their own liquidity crisis.

The sub-prime crisis spread and led, on the one hand, to a securitisation crisis due to the investors' loss of confidence in all forms of asset-backed products, and on the other, to a general liquidity crisis caused by the loss of confidence between banks. There followed the collapse of Northern Rock, the crises at IKB and Sachsen LB, the collapse of Bear Stearns and the federal takeover of the American mortgage finance companies Fannie Mae and Freddie Mac.

The climax, however, was marked by the surprising insolvency of Lehmann Brothers in autumn 2008. Due to the massive uncertainty regarding the stability of the banks, the interbank market almost became paralysed. Only by means of huge and concerted government interventions in the form of liquidity injections, interest-rate cuts and the provision of fresh equity was it possible to prevent a collapse in the entire global financial system.

Even if the effects of the financial crisis on the real economy still persist, at least a basis for the financial markets of the world's largest economies has been found in the meantime. The securitisation sector has undergone a profound break and is under fire for being at least jointly responsible for parts of the financial crisis.

Nevertheless, the need for a new quality of securitisation is becoming stronger in the context of overcoming the effects of the crisis in the real economy. The reason for this is the credit crunch that is feared for the industry due to the deleveraging process of the banks' equity. In addition, the capital market must reassume its systemic risk-transfer function in order to release the central banks in the medium term from their role of 'lender of last resort'.

2.2 Aims of the study

Against the backdrop of undesirable developments and the possible reorganisation and resurrection of the securitisation market, the BearingPoint 'Future of securitisation in Europe' study looks for answers to the following questions:

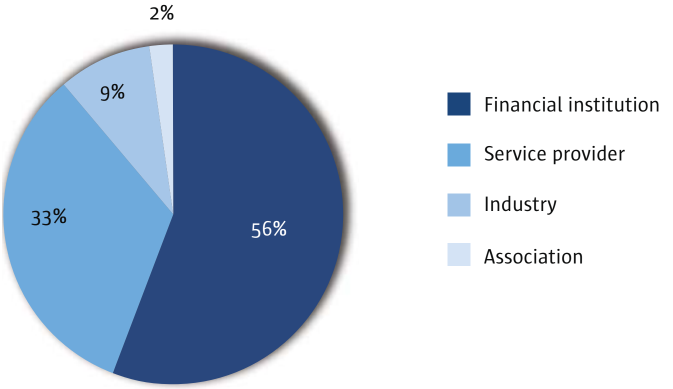
- How does the demand and involvement of the market players change with regard to the different types of securitisation (asset classes)?
- What aims are sought by means of securitisation?
- What is currently hindering the securitisation market?
- How has the attitude towards the rating agencies and their ratings changed?
- Which measures could be used to resurrect the securitisation market?
- Does a seal of quality for securitisation deals make sense, and how should such a seal of quality be arranged?
- How do the market participants adapt to the altered conditions from an organisational and technical point of view?

3 Participants and methodology of the study

In autumn 2009 BearingPoint asked market participants for their assessments of the European securitisation market. The survey was carried out between mid October and mid November by online questionnaire, fax and email.

Altogether, 55 market participants from financial institutions in the private, cooperative and public sector, from service providers in the securitisation field (corporate service providers, consultants, lawyers, rating agencies, auditors, credit insurers) and from industrial companies and associations took part in the study.

Figure 1:
Industry affiliation of the organisations involved in the study



Questions were put to market participants who are active in the securitisation market as arrangers, investors, originators and service providers. Multiple entries were possible in this case, as some financial institutions are responsible for both structuring securitisation deals for third parties as arrangers, as well as securitising receivables from their own balance sheet as originators or investing in securitisation deals from other arrangers. Furthermore, some arrangers see themselves as service providers at the same time.

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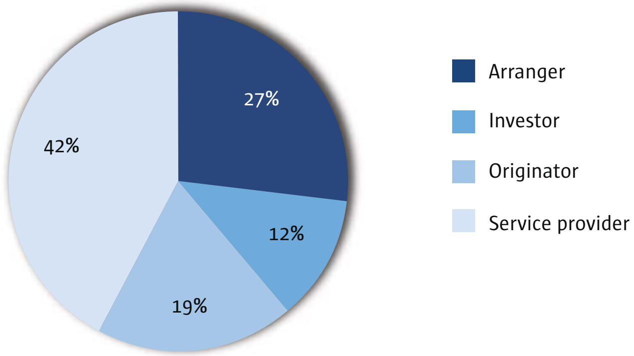
Figure 2:
Roles in which the participants are active in the securitisation market



The survey was predominantly conducted among German-speaking organisations, although five representatives from British institutions also answered the questions.

The study concentrated on looking at the following four segments in the securitisation market:

- Asset-backed commercial papers (ABCP)
- Asset-backed securities (ABS in the narrower sense)
- Mortgage-backed securities (MBS)
- Collateralised debt obligations (CDO)

These are explained below. The participants in the survey are represented at very different levels in these four segments.

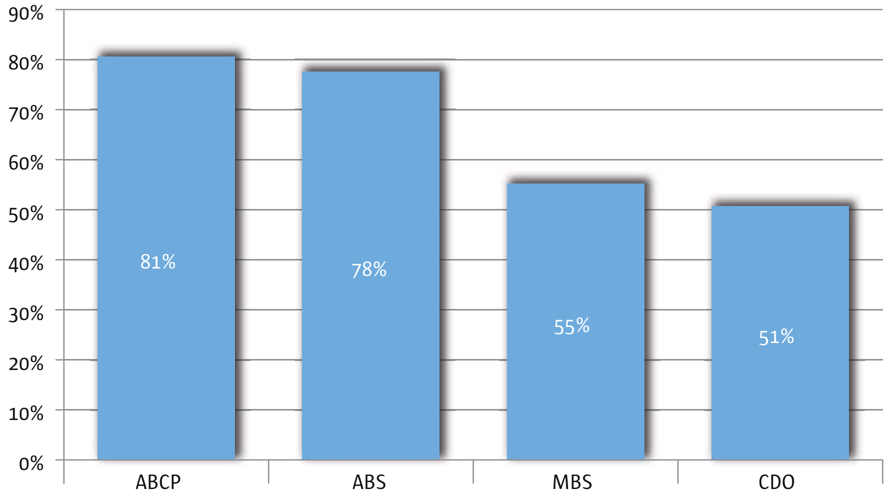
Accordingly, 81% of those questioned are active in the segment of **asset-backed commercial papers**, where, for example, short-term trade receivables are securitised on a revolving basis. Although this segment of securitisation has been forced to register a severe drop in the wake of the financial crisis (halved since 2007), due to its manageable risk for investors (30-day term of the commercial paper), the ABCP market has been spared from completely drying out compared to the other securitisation segments.

Besides the ABCP market, 78% of the participants are involved in **asset-backed securities**. This segment, featuring longer-term securitisation transactions, after coming to an intermediate standstill, was reopened with the VCL11 transaction by Volkswagen Leasing[1] in autumn 2009.

Mortgage-backed securities encompass the securitisation of commercial mortgages (commercial MBS, CMBS) and retail mortgages (retail MBS, RMBS). 55% of those questioned are active in this segment, which is still suffering from the financial crisis, since the RMBS is attributed a central role in the emergence of the sub-prime crisis. In addition, the housing market in Europe – especially the MBS-active countries of Spain and Great Britain – is suffering from a sharp drop in house prices as well as increased late-payment and default rates. This market segment was also reopened in autumn 2009 by the PERMM 2009-1 transaction issued by the Lloyds Banking Group[2].

In the last of the securitisation segments looked at, the **collateralised debt obligations**, 51% of the survey participants have been active here in the last three years. This segment recorded very considerable slumps in the wake of the financial crisis and came under huge criticism due to its partly high complexity and the resulting intransparency for evaluation and rating purposes.

Figure 3:
Securitisation products which the participants have been involved in since 7/2006



1 Volkswagen Car Lease 11 (VCL11), EUR 0.519 billion backed by automotive leasing receivables.
2 Permanent Master Trust Issuer 2009-1 (PERMM 2009-1), GBP 4.05 billion, backed by personal mortgages from the Halifax Bank of Scotland (subsidiary of Lloyds Banking Group).

When illustrating the results of the survey, aggregations of the answers are partly made using scaled averages. Some answers are hereby converted on a scale of +100% to −100%, and afterwards an average is collated across all answers. In this case, for example, the following range of value allocations is used:

- 'Significantly increased' = +100%, 'increased' = +50%, 'stayed the same' = 0%, 'decreased' = −50%, 'significantly decreased' = −100%
- 'Very much applies' = +100%, 'somewhat applies' = +50%, 'does not really apply' = −50%, 'does not apply at all' = −100%
- 'Increased' = +100%, 'stayed the same' = 0%, 'reduced' = −100%

An example should shed light on this method:

A result of the survey, where out of 100 participants, 65 answered 'increased', 23 said 'stayed the same' and 12 said 'reduced', is accordingly represented with a scaled average of 53%.[3]

Where periods are compared, the change in the answers is shown based on the difference between the two scaled averages taken from the answers in the first and second period.

3 Calculation of scaled average: [(65 * 100%) + (23 * 0%) + (12 * (−100%)]/100 participants = 53%.

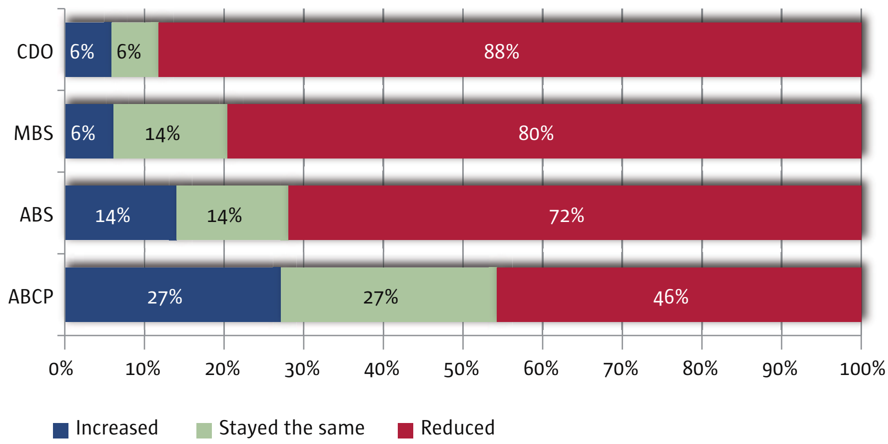
4 Results of the study in detail

4.1 Changes in the demand for securitisation products

The use of securitisation products has considerably fallen in part since the beginning of the financial crisis, whereby the categories of securitisation examined have recorded drops of different severity.

According to the **originators' demands** – in other words, the demands of those who create the receivables being securitised and look for refinancing or to sell its risk – participants have noticed the biggest fall in the CDO segment (88%), followed by MBS (80%) and ABS (72%) since the financial crisis.

Figure 4:
Changes in demand from originators for securitisation products since the financial crisis

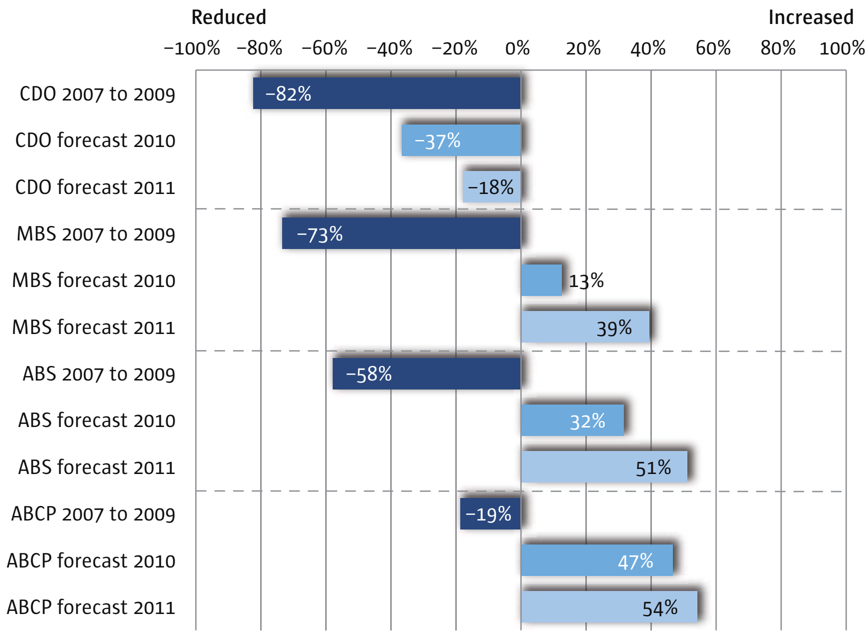


An exception to this lies with the short-term ABCP, where only 46% of those questioned recorded a drop, whereas 27% actually noticed an increase in demand, meaning that, at –19%, the scaled average change in this segment since the financial crisis comes out comparatively even (see Figure 5).

Looking to 2010 and 2011, according to the view of those questioned, there will be a further fall in demand from originators in the CDO segment, whilst the MBS, ABS and ABCP segments will be able to recover.

The relative strength of the ABCP segment is evident again here, as not only the smallest fall in demand was observed in the wake of the financial crisis, but also the quickest and strongest recovery in demand within the segments is forecast.

Figure 5:
Scaled average change in demand from originators for securitisation products

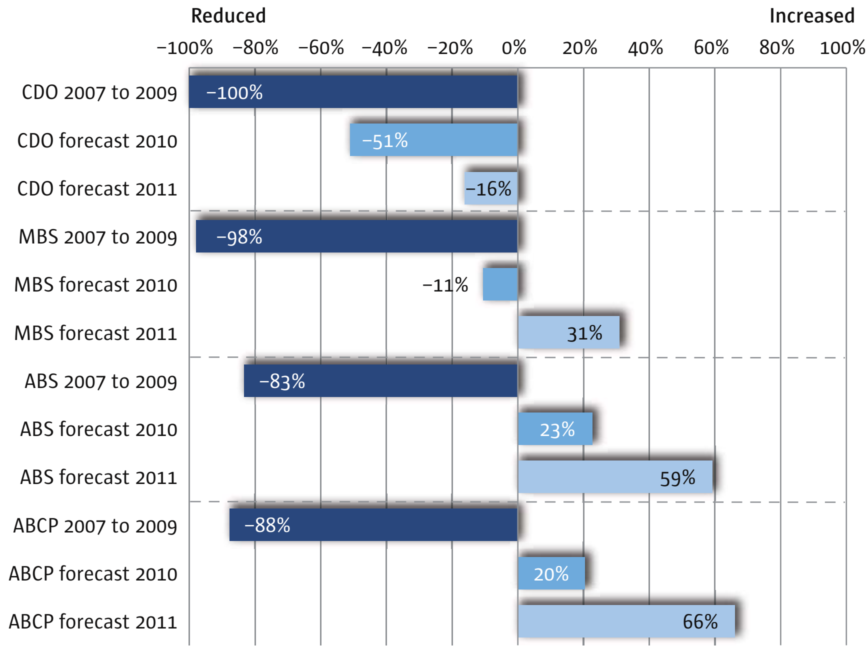


Looking at the assessments of the participants about the demand for securitisation products by **investors** since the start of the financial crisis, however, the almost complete collapse of the securitisation market across all securitisation classes[4] is reflected here. In this case, the ABCP products almost spared by the originators are also registering severe drops in investor demand.

In the medium-term outlook, however, the trend statements about demand by investors and originators lead to the same conclusion, namely that the ABCP, ABS and MBS products will recover, but that the demand for CDO will continue to fall.

4 The validity of the survey about the historic development of the ABS securitisation product (−83%) should be qualified here, because compared to an abstention rate that was otherwise around 5%–15%, in this case 75% of participants made no statement. It was very possible, however, for the participants to give a trend statement for 2010 and 2011 for ABS. In this case, the abstention rate was even slightly below the average.

Figure 6:
Scaled average change in demand from investors for securitisation products



Key message 1:
A resurrection of the securitisation market for the important ABS and MBS segments is only likely from 2011. Investors are expected to be found in 2010 only for ABCP. There is no confidence in a return of the CDO segment.

A survey of the participants about their own involvement with the different securitisation products since 2007 and forecast for 2010 and 2011 shows the same trends (2011: CDO −27%, MBS +21%, ABS +49% and ABCP +61%).

4.2 Securitised asset classes

As part of the survey, the participants were asked to name the types of receivables (asset classes) and securitisation in which they were involved before the financial crisis, and those that they will probably securitise in future transactions.

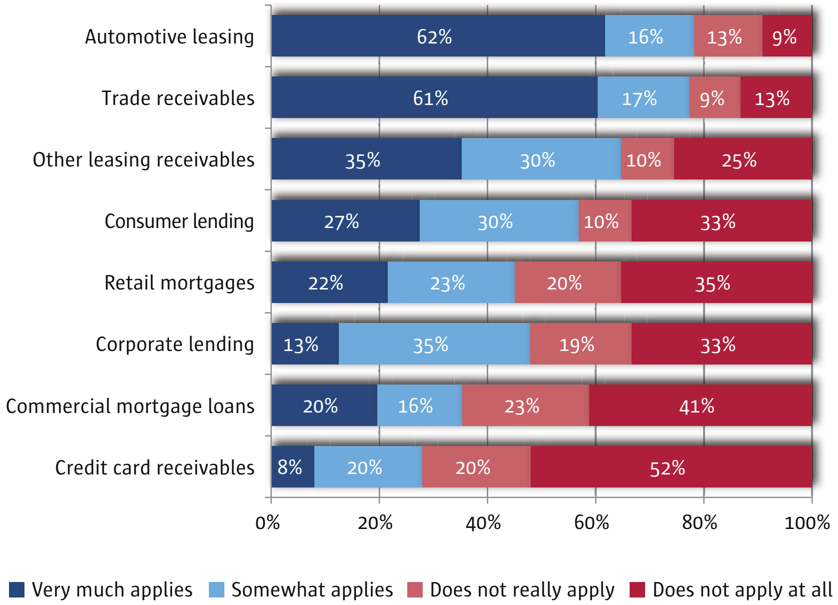
The forecast showed that those questioned will predominantly be active with securitisation deals that are backed by automotive leasing contracts (78%[5]) and trade receivables (78%), but also other leasing contracts (65%) and consumer loans (57%).

Key message 2:
The focus of future securitisation deals will be on receivables from the real economy, particularly leasing receivables, trade receivables and consumer lending.

Credit card securitisation deals, on the other hand, which are more seldom in Europe, hardly play any role, as compared to the USA, where this asset category is more strongly represented. In Europe, debit and charge cards are used more instead of ‘genuine’ credit cards, meaning that no longer-term and securitisable credit comes from these cards.

5 62% of participants answered ‘very much applies’ and 16% answered ‘somewhat applies’, in total 78%.

Figure 7:
Forecast of the asset classes whose securitisation those questioned will be involved with in future

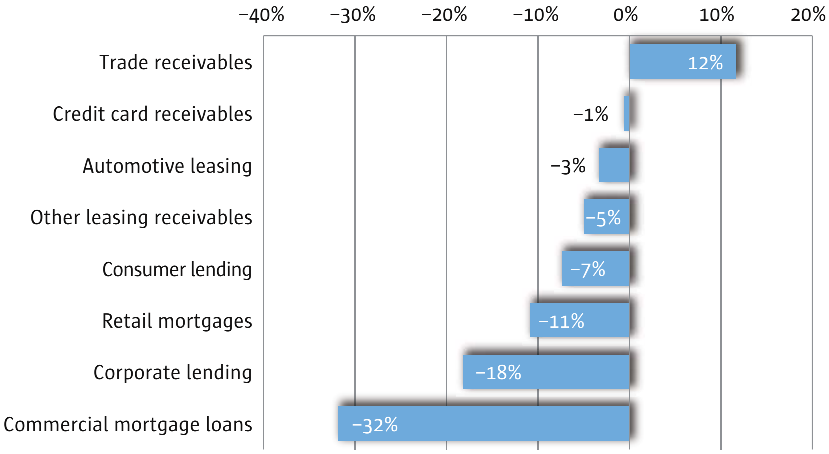


The change in the scaled averages per asset class compared to the figures before the financial crisis (see Figure 8) shows that the securitisation of commercial mortgage loans and corporate bonds will at first slip out of focus.

In the case of commercial mortgage loans, which have registered the biggest fall with –32%, the speculation seems likely that, besides the huge loss in confidence from the crisis in sub-prime mortgage securitisation deals, real-economy factors from the ensuing slump will now also influence this asset class for a long time to come. The prevailing uncertainty regarding further possible economy-related corrections in the real-estate market will probably not lead to a quick recovery in either the CMBS or the RMBS market.

The securitisation of trade receivables with +12% is the only category of receivable to have gained in comparison with the figures before the financial crisis. One possible explanation here is that in 2008 and 2009 the conduits were able, in the face of confined but not completely collapsing refinancing options, to improve the quality of their portfolios and increase their fees. Many conduits thus restructured asset transactions, tightened up purchase agreements, increased credit enhancements, narrowed trigger definitions, renegotiated pricing and deliberately moved away from some sellers of receivables.

Figure 8:
Change in the forecast future involvements per asset class compared to before the financial crisis



4.3 Motivation for securitisation

Originators who take receivables off their balance sheet by means of securitisation try to achieve various aims with this process. As part of the surveys, BearingPoint asked the participants to evaluate selected reasons for securitisation by their importance and to give an assessment for the motives before the financial crisis and for those in the future.

According to those questioned, in future the focus will be on making use of the refinancing option before the transfer of risk or balance control. 91% of the participants see improving the liquidity situation as important. In this case, securitisation is seen (84%) as a way of expanding the refinancing mix and opening up further financing channels for the originator. More difficult access in future to unsecured refinancing by means of the classic bank loan or corporate bonds, for example, is mentioned by 64% of participants as a reason for using securitisation. 62% of those asked regard a transfer of risk, by which the originator places the default risk of its debtors on the market, as a motive.

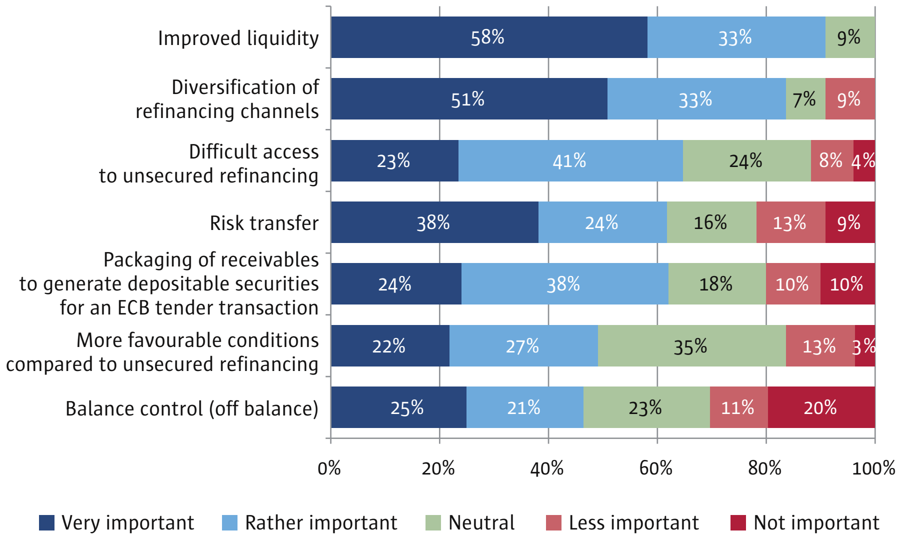
Key message 3:
The overriding motive for future securitisation deals will be asset-backed refinancing and not the placement of risks in the market.

Just over half of the participants also see the use of open-market operations by the European Central Bank (ECB) as one of the reasons to securitise. By 'packaging' receivable portfolios into securitisation transactions, originators can create depositable securities for the tender business and ask for liquidity from the ECB in return for submitting them. Even if the ECB is forever tightening the quality criteria for securitised securities (such as AAA evaluation from two rating agencies) in order to let liquidity injections slowly die away, and is now only providing short-term liquidity, 52% of the participants continue to see a motive for future securitisation deals here.

Besides the general access to secured refinancing, the cheaper refinancing costs from this form of refinancing also play an important role – 49% of participants consider this aspect to be important in the future, too.

According to the participants, balance control using off-balance transactions, with which a company’s return on equity can be increased, or capital backing can be released if it concerns a bank, does not represent a particularly distinct motive for securitisation in future. 46% of those questioned see this aspect as important, whilst 31% consider this motive as unimportant.

Figure 9:
Reasons for securitisation in the future sorted by scaled average

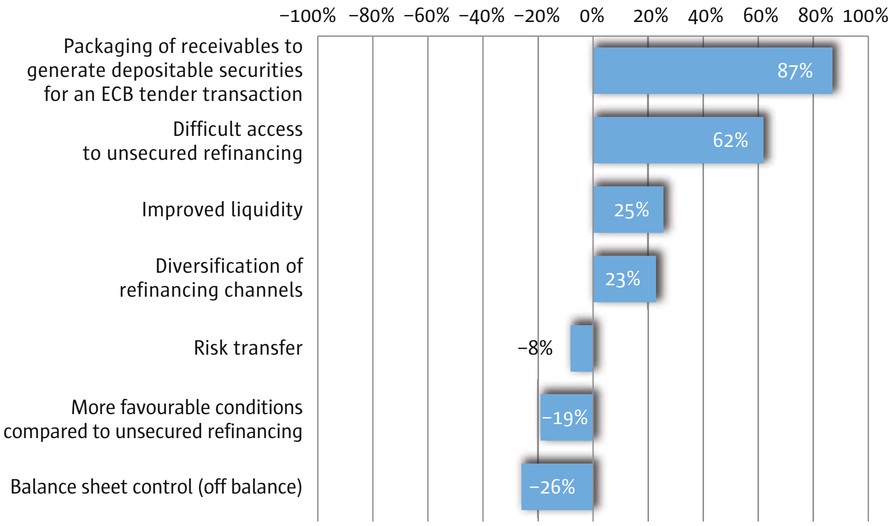


As part of the study, the motives for securitisation were also questioned from the time before the financial crisis, allowing the change in the evaluation to be seen by means of a comparison.

A change in the scaled average evaluation of +87% shows the much wider use of ECB liquidity support, which hardly played a part before the crisis. In 2008 and early 2009, this tool allowed banks that, for example, were able to fall back on bigger mortgage portfolios on their balance sheets to access liquidity to the tune of billions in multiple digits at short notice and thus help the RMBS segment towards a short-term boom outside of the capital market.

Furthermore, the figures show that the refinancing motives predominantly increased in the wake of the financial crisis. What is interesting here is that at the same time the motive ‘access to more favourable refinancing conditions compared to unsecured refinancing’ was pushed into the background. One possible explanation is that the originators accepted the sharp increase in risk premiums in the secured refinancing segment in order to get liquidity no matter what or to diversify their refinancing channels. According to the majority of those questioned, difficult access to unsecured refinancing was namely not a priority reason for securitisation before the crisis.

Figure 10:
Scaled average change in the reasons for securitisation compared to before the financial crisis



4.4 Barriers in the securitisation market

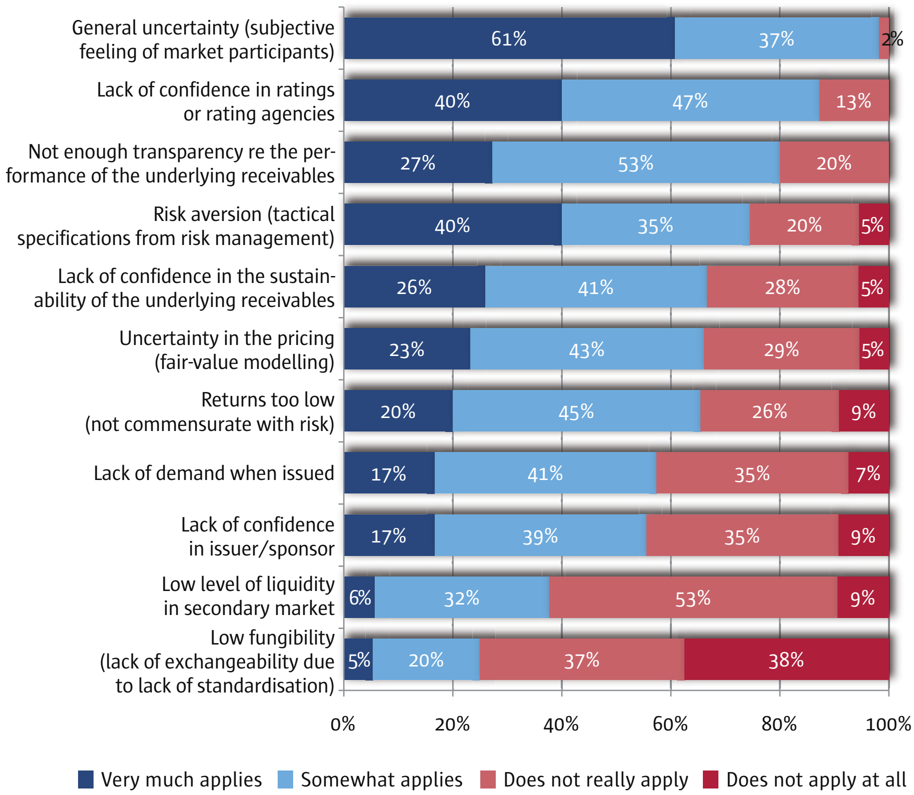
The fact that the securitisation market is in tatters is shown by the current ongoing discussion about the need to resurrect it. As part of the study, BearingPoint asked about the reasons and hence about the problems that currently exist when it comes to placing securitisation transactions.

According to the participants, the lack of liquidity in the secondary market and a low comparability and exchangeability between securitisation transactions are not primary reasons for this.

In fact, 98% of those asked agree that a general uncertainty, and hence the subjective feeling of the market players with respect to securitisation transactions, generally represents the main reason for the slump in the securitisation markets. Judging by what the participants say, all aspects of securitisation are suffering from a lack of confidence: the evaluation of the rating agencies (87%), the performance (80%) and sustainability (67%) of the securitised receivables portfolio, the pricing (66%) and the ratio between risk and return (65%), as well as the issuer and/or the sponsor of the transaction (57%).

An increased aversion to risk is noticeable on the buyer's side. According to 75% of those questioned, the investors' risk management specifications make it more difficult to sell new securitisation deals. This leads, among other things, to a general lack of demand in issues (58%).

Figure 11:
Current barriers in the securitisation market sorted by scaled average



4.5 Rating agencies and their evaluation of securitisation deals

Since the beginning of the financial crisis, rating agencies have come under public criticism: firstly, for having awarded too-good evaluations for securitisation deals, which in part they tested with inadequate models, and secondly, for having corrected these ratings downwards too late in the wake of the crisis. In addition, they were accused of a conflict of interest, as they had an influence in an advisory capacity on the formation of the structured products, which they subsequently evaluated for a fee.

The rating agencies have since reacted and have both adapted their evaluation methods and introduced separate rating categories for securitisation products. They are designed to make it easier to distinguish between ratings of other evaluated financial products or companies.

The mistrust levelled at the ratings pronounced by the rating agencies and the agencies themselves, however, is reflected clearly in the answers given. Hence, 82% of participants reported a lower confidence in the ratings given on securitisation transactions. Confidence in the agencies themselves suffered more severely than that in the ratings. 94% of participants talk of a lower confidence in the rating agencies in general.

Figure 12:
Confidence in the ratings pronounced on securitisation transactions

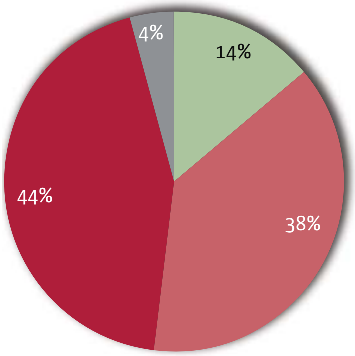
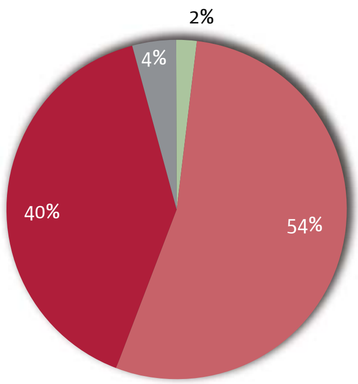


Figure 13:
Confidence in the rating agencies generally



Much higher
Higher
Stayed the same
Lower
Much lower
Don’t know

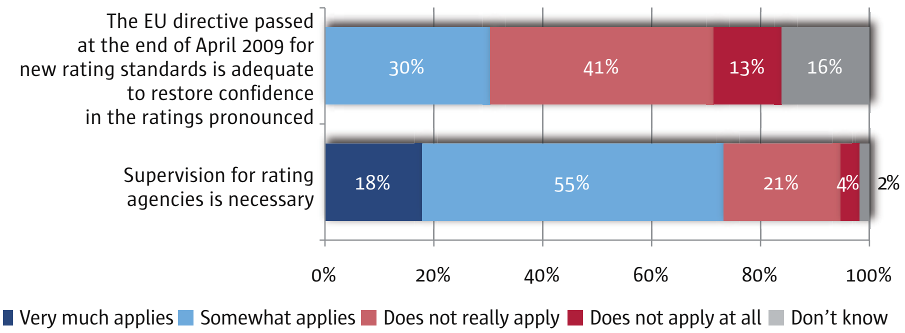
At the end of April 2009, the European Union passed a directive to introduce new rating standards. This directive's regulations include that rating agencies:

- Are no longer allowed to provide consultancy services
- Must publish their models and methods
- Must specially identify the ratings for securitisation products

This EU directive is seen by 54% of participants as not enough to restore confidence in the ratings pronounced. They argue, however, in favour of supervision for the rating agencies. Over 73% of the participants consider such supervision to be necessary.

Key message 4:
An essential prerequisite for a functioning securitisation market is the supervision of the rating agencies.

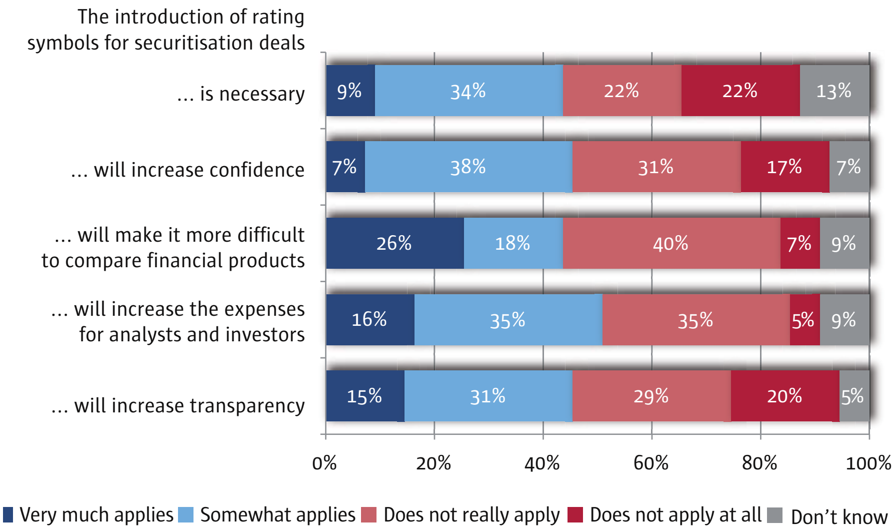
Figure 14:
EU directive for rating standards and supervision for rating agencies



The introduction of new rating symbols for securitisation products called for by the EU directive is received among those questioned with a divided opinion. Judging by the answers given, it apparently does not manage to convince market participants of the meaningfulness of separate rating symbols.

Half of the participants see such an introduction of distinct rating symbols as necessary, whereas the other half see it as unnecessary. No clear tendency can be detected, either, as to whether separate rating symbols will increase confidence or transparency or improve the comparability of financial products. Only when it comes to the question about the extra cost that could be involved due to the new rating symbols does a slight tendency emerge. 51% of those asked believe that the introduction will lead to more expenses on the analysts' side. 40% of those questioned do not share this opinion.

Figure 15:
Distinct rating symbols for securitisation transactions



4.6 Measures to resurrect the securitisation market

Various measures are under discussion to resurrect the collapsed securitisation market. The Federal Association of German Banks (BdB) proposes a 'premium segment', for example, for the securitisation of SME loans. If this measure should not prove adequate, the BdB argues for government guarantees for mezzanine securitisation tranches, among other things.

As part of the study, BearingPoint asked the participants for an evaluation of selected measures to resurrect the securitisation market, divided by ABS/MBS/CDO on the one hand and ABCP on the other.

In this respect, limiting securitisation to receivables from the real economy received the best response with regard to ABS/MBS/CDO. 84% of the participants thus argue for prohibiting a renewed securitisation of securitisation tranches (CDO on ABS, CDO2, CDO3, etc.).

This is followed by measures to standardise the securitisation sector with a simultaneous increase in transparency and comparability. 85% of the participants argue for standardisation in external reporting. Only once the market participants have agreed on a harmonised form of reporting, with clearly defined key data per type of receivable, will a regular, automatic monitoring and evaluation of complex securitisation transactions also be possible for investors and rating agencies. In addition, according to 78% of the participants, the complexity of the structures should be reduced. Accordingly, 69% of

Key message 5:
The focus of future securitisation deals will be on receivables from the real economy, but no longer on the repackaging of securitisation tranches.

Key message 6:
In order to resurrect the securitisation market, transparency, standards and less complex transaction structures are required.

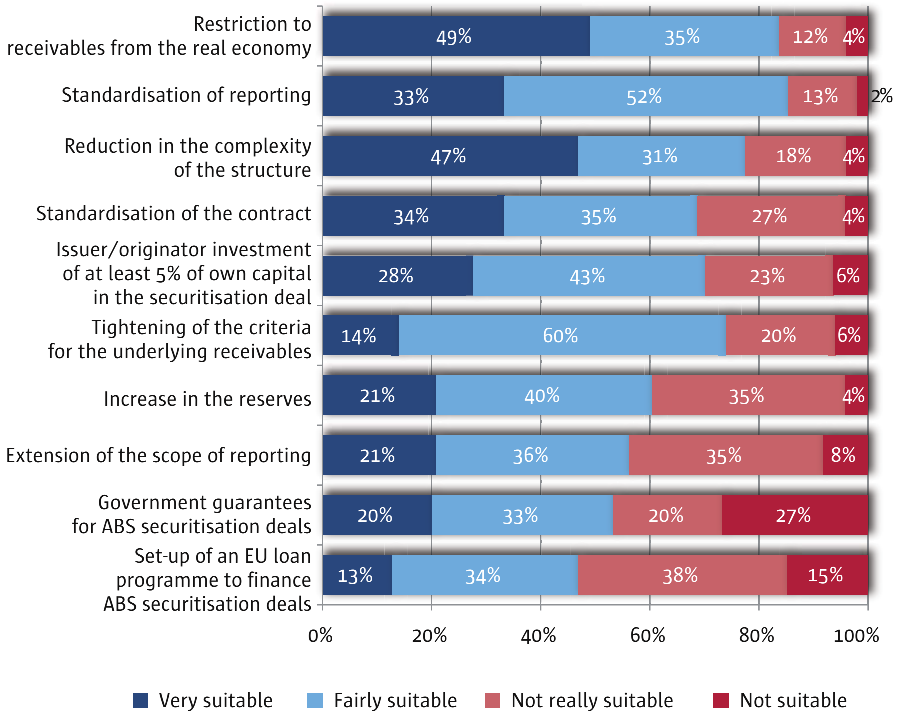
those questioned argue for transaction documentation to be standardised, i.e. the contract for the securitisation deal.

71% of the participants are in favour of the obligation for the originator to retain an investment of at least 5% in the securitisation deal, as is set out in the new Article 122a of the EU Capital Requirements Directive for the banks.

Stronger and better-quality backing for securitisation deals is seen by those questioned as reasonable. Hence, 75% of the participants argue for the selection criteria for the individual receivables in the securitised portfolio to be tightened up. 61% are also in favour of an increase in reserves for the transactions. A narrow majority of 57% is in favour of extending the scope of reporting.

What is interesting and at odds with the ongoing discussion is that government guarantees or a programme of loans to finance ABS securitisation deals – modelled on the TALF[6] programme backed by the American Federal Reserve – do not secure a majority. A European TALF programme is even considered by 53% of participants as unsuitable for resurrecting the securitisation market.

Figure 16:
Measures to resurrect securitisation (ABS/MBS/CDO) sorted by the scaled average



6 Term asset-backed securities loan facility.

The propositions to resurrect the ABCP market are very similar to the statements made above about the ABS/MBS/CDO market, but are less pronounced. Standardisation and the reduction in complexity come to the fore here, too.

Government guarantees, however, are rated by 56% of those questioned as less suitable for resurrecting the ABCP market, coming last among the measures to be assessed.

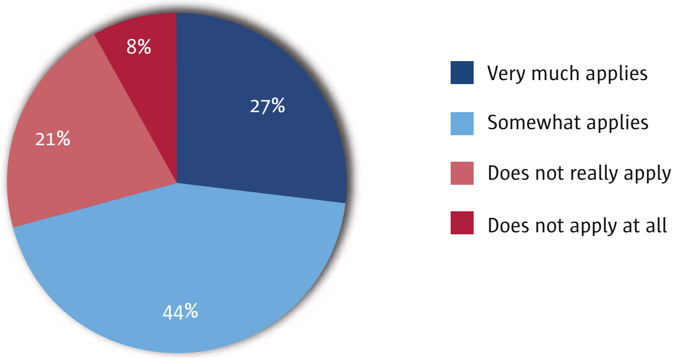
4.7 Implementing a seal of quality

The proposal from the BdB to create a premium segment for securitisation deals naturally poses the question as to whether the market participants generally support a seal of quality to resurrect the securitisation market, and how such a seal of quality should be developed. As part of the study, the participants were also asked which institution should develop and award such a seal of quality.

A large majority (74%) of participants believe that the introduction of a seal of quality for securitisation deals makes sense. The desire already expressed many times by the participants for quality standards and transparency is confirmed here.

Key message 7:
For securitisation deals, a seal of quality is required that defines minimum requirements for the structure of transactions and their external reporting, in order to create a new segment for high-quality, transparent and easy-to-understand securitisation deals.

Figure 17:
Meaningfulness of a seal of quality for securitisation deals



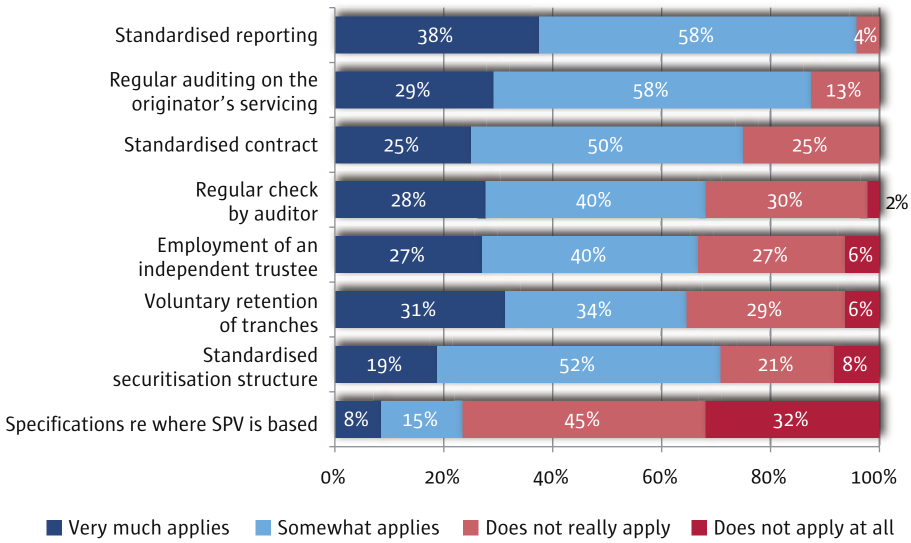
When it comes to implementing such a seal of quality, the criteria proposed by BearingPoint for evaluation gain wide approval. The desire expressed previously for a standardised reporting system comes first here – with 96% approval, this is seen as a central element of a seal of quality, as is a standardised contract (75%). Standardisation of the structures of securitisation deals is favoured by 71% of participants.

Besides the documentation standards, regular auditing efforts are, above all, considered to be important. As a result, 87% of those asked see it as reasonable to regularly check the receivables management provided by the originator as part of the seal of quality. An external check on securitisation transactions by auditors at 68% and the involvement of a trustee at 67% are also seen by the participants as important criteria for a seal of quality.

65% of those questioned are of the opinion that a voluntary retention of parts of the securitisation transaction by the originator should be part of the seal of quality.

Only the question about the location and hence the legislature covering the SPV (single-purpose vehicle) was not seen as important for a seal of quality. Only 23% want to adopt a regulation in the seal of quality regarding where the SPV is based – with a figure of 77%, the majority of those asked reject such a regulation.

Figure 18:
Criteria for a seal of quality sorted by the scaled average



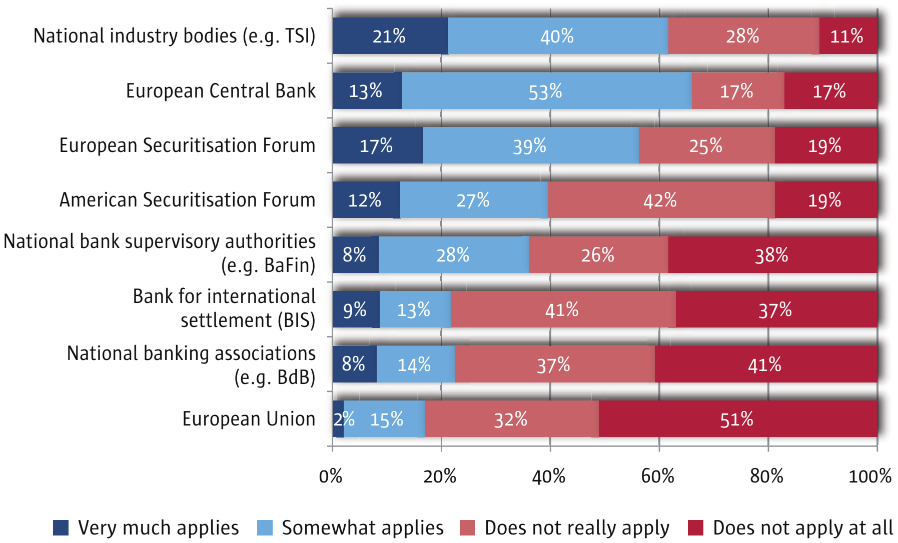
As regards the choice of institution that should develop and establish such a seal for securitisation transactions, a group of three preferred organisations emerges. Judging by the scaled average, first and foremost the participants are in favour of development by national industry bodies, such as True Sale International (TSI) in Germany, which as an initiative by 13 banks is dedicated to developing the German securitisation market.

Not far behind and, unweighted, with even more positive replies (88%), the ECB is nominated. The interesting point here is that the ECB is not at all responsible for developing regulatory and supervisory measures. This task at European level actually lies with the European Union (EU), which with only 17% approval of those questioned, however, surprisingly comes in last place. A possible explanation for this is that the competence shown by the ECB in stabilising the financial markets is now rubbing off on other issues related to overcoming the crisis. The market therefore trusts the ECB with this task, even if this could overstep the actual job of the ECB.

Somewhat further behind, but still with a positive result (56%), the European Securitisation Forum (ESF) follows in third place, which, as a lobby association, similar to TSI, promotes the development of the securitisation market.

All the other organisations put forward for evaluation, such as the American Securitisation Forum, the national bank supervisory authorities (e.g. BaFin in Germany) or national banking associations (e.g. BdB in Germany), are seen as less suitable for developing the required seal of quality for securitisation deals.

Figure 19:
Preferred institutions for the development of a seal of quality, sorted by the scaled average



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4.8 Organisational and technical changes for originators and arrangers

During their term, securitisation transactions must report on the performance of the securitised receivables portfolios on a regular basis, and calculate the cash flows both from these receivables and between the parties involved in the securitisation deal. In the case of securitisation deals that are backed by a large number of small-sized receivables or that have to report more frequently, the use of technical support as part of the reporting and settlement is essential.

Against the background of the collapse of the securitisation market, the participants were asked to evaluate the effects on the organisation and the technical support of the securitisation team by the originators and arrangers.

The participants in the survey reported a slight reduction of the team sizes in the securitisation teams in the wake of the financial crisis, whereby 55% made no changes and 32% reported smaller teams, but 14% of the participants added to their securitisation teams.

The questions about technical support in the securitisation processes were aimed at a limited target group – approx. 50% of participants were not able to give statements about the following topics.

As a reaction to the financial crisis, they see an increased use of centralised data management systems and evaluation functions for:

- Securitisation-specific stress tests (63% of participants)
- Internal rating mechanisms (47%)
- Risk control (44%)
- The central control of their own securitisation commitments (36%)

When it comes to portfolio and transaction monitoring, the solutions based on MS Excel and MS Access continue to dominate (over 60%). Even if applications for reporting and transaction management are already available, 66% of the participants monitor their transactions manually (MS Excel).

The level of automation in the technical support of transaction administration (portfolio monitoring and reporting) is higher with ABCP transactions than with other categories of securitisation. In the case of ABCP transactions, over 60% of the participants reported semi- or fully automatic functions in the administration process, whereas with the other categories of securitisation, only 12% of the participants employ such an automated support system.

4.9 General outlook for the securitisation market

To conclude the survey, the participants were asked to give an outlook for the securitisation market on the basis of trend statements.

95% of the participants are convinced that securitisation deals will still be commercially attractive for the market participants in future. However, industry and financial service providers who want to use securitisation to remove receivables from their own balance sheets must reckon on higher interest costs (risk premiums) and fees in future, as 91% of those questioned agree that securitisation will become more expensive for the originator. The agreed-upon capital requirement retention for the originator is also expected to have an effect on the cost structure.

Key message 8:
Securitisation will remain commercially attractive, yet at much higher risk costs.

Figure 20:
Trend statement about commercial viability

Securitisation will still remain commercially attractive in future

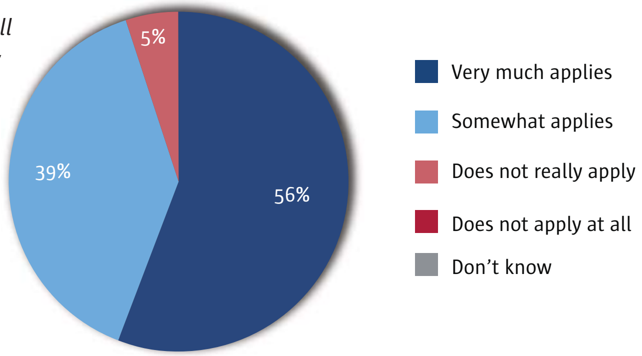
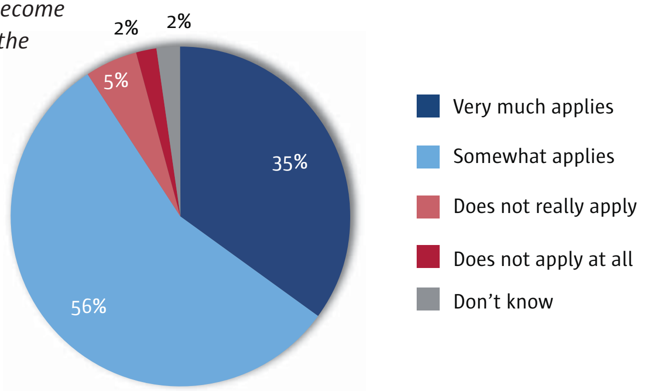


Figure 21:
Trend statement about the costs for originators

Securitisation will become more expensive for the originator in future



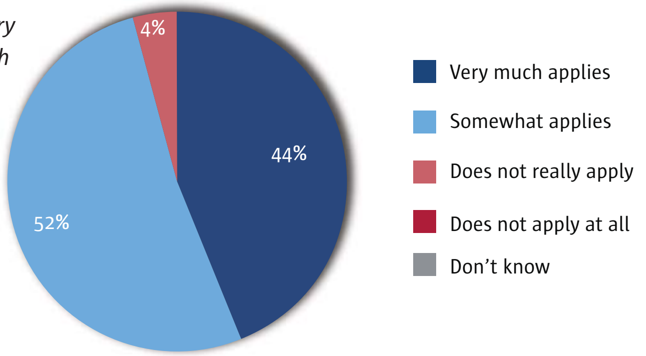
Even if the securitisation industry has been held responsible for parts of the financial crisis, politicians and financial institutions stress with increasing frequency the need to resurrect this securitisation market in order to enable the banks to supply the economy

Key message 9:
According to the participants, a possible credit crunch can only be averted with a functioning securitisation market.

with sufficient credit. Consequently, 96% of the survey participants are convinced that securitisation is necessary to prevent a possible credit crunch. Without leveraging equity capital by selling loans and distributing them across the capital market, it will barely be possible to secure the required credit for the upcoming economic recovery.

Figure 22:
Trend statement about the credit crunch

Securitisation is necessary to prevent a credit crunch

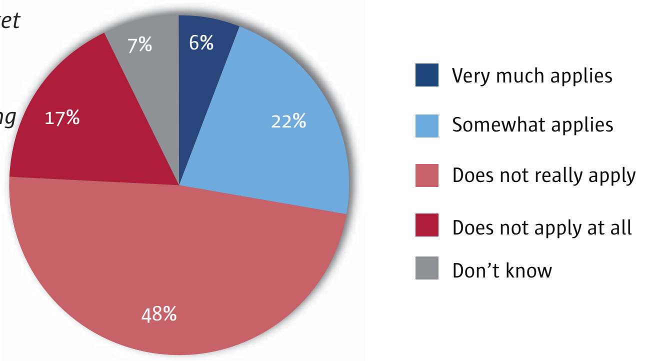


The high volumes from the boom years of securitisation will no doubt only be reached again with difficulty, according to the participants. 65% of those surveyed do not believe that the securitisation market will exceed the highest levels of 2006/2007 in terms of the outstanding volumes. Only 28% have confidence in a complete return of the market.

It should be borne in mind that in 2006/2007, the outstanding volume from issued securitisation deals due to renewed securitisation of securitisation tranches (CDO on ABS, CDO2, CDO3, etc.) was artificially inflated and will now begin to subside again for the time being.

Figure 23:
Trend statement about the market volume

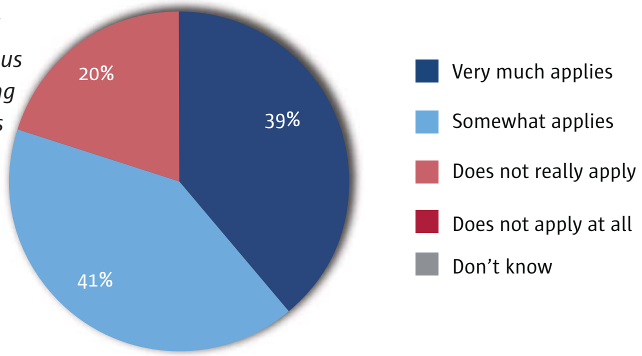
The securitisation market will exceed the highest levels of 2006/2007 in terms of the outstanding volumes



Perhaps a change in dealing with risks from securitisation transactions arises as one of the lessons from the financial crisis with its significant market collapses: hence, over 80% of those asked argue that the financial crisis will lead to a more conscious handling of risks among all participants in the securitisation sector. This is also shown by the increased investments in risk management systems at the banks issuing securitisation transactions (see Chapter 4.8).

Figure 24:
Trend statement about dealing with risks

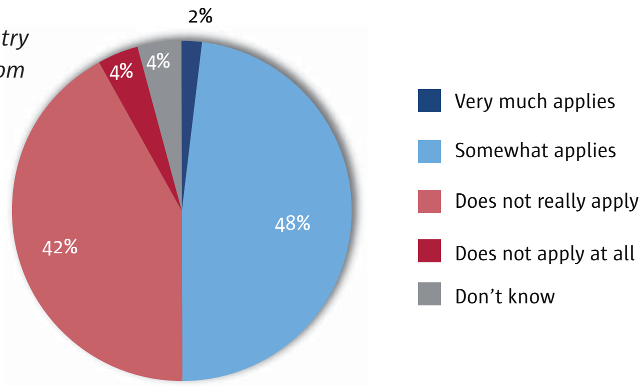
The financial crisis will lead to a more conscious handling of risks among all market participants in the securitisation sector



Finally comes the question as to whether the securitisation industry will emerge from the financial crisis stronger than before. The answers from participants give no clear statement in this case – this applies for 50% of those questioned, whilst 46% of the participants are of the opposite opinion. Once again, the general uncertainty among the market participants regarding the future of the securitisation market is shown here.

Figure 25:
Trend statement about quality development

The securitisation industry will emerge stronger from the financial crisis



5 Conclusion

Securitisation is suffering from a severe collapse in the market in the wake of the financial crisis. The part it played in initiating this crisis and the subsequent huge loss in confidence are causing investors to almost completely withdraw from the securitisation market. A large share of the recently issued ABS was not even placed on the capital market, but only structured, so that it could be used as a deposit guarantee for the various liquidity programmes from the central banks. In order not to further increase the liquidity in the market, however, the central banks – and the ECB as one of the earliest here – are withdrawing from these liquidity injections step by step. ABS is being increasingly limited as collateral for the ECB tender business. 'Genuine' investors, such as insurance companies, pension funds or annuity funds, are not returning to the market at the moment. A true balance between market demand and supply is not expected until 2011.

At the same time, however, discussions on the market are getting louder that securitisation is necessary to allow the banks to supply industry with credit to the required extent. It is feared that without a resurrection of the securitisation market, the desired economic recovery could be strangled. However, as a return of investors on a broad front is not expected until 2011, further measures to support the market will be necessary for 2010, such as continuing with liquidity injections from the government or the central banks.

But in order to enable the banks to place portfolios and their risks through the capital market again and consequently release the tied-up equity capital to award new credit, the confidence of investors in securitisation must be resurrected. The creation of a seal of quality, which defines standards and minimum requirements for reporting and structuring of transactions, is seen as a means to this end. A new segment for high-quality, transparent and easy-to-understand securitisation deals will therefore be established.

However, it is likely that not all segments of securitisation will be able to be brought back to life. Hence, ABCP transactions, backed by receivables from the real economy (e.g. leasing receivables, trade receivables or consumer loans), were able to stay at a low level and should find their way back out of the crisis sooner. ABS and MBS should be able to win back investors from 2011 without ever reaching the market volumes from the 2006/2007 boom period.

There is no confidence in a return of the CDO segment, however. An increased risk awareness is noticeable here, as even the rating agencies reached their limits when it came to evaluating the complex structures with their rating models. The loss of confidence in the rating agencies and the ratings awarded by them is still prevalent.

It is still not certain whether the securitisation market will emerge stronger from the crisis. The outlook from the survey shows, however, that securitisation deals can still be commercially attractive in future, yet at much higher risk costs. In future, the focus will no doubt be on an asset-backed refinancing and less on the placement of risks in the market.

To conclude, BearingPoint derives the following basic recommendations for the market participants from the findings of the study:

- To start working with a professional body (e.g. together with TSI) to drive forward the necessary standardisation and increase in transparency and to preserve independent influence on the creation of standards
- To prepare the data (data size and quality) with regard to the anticipated broadening reporting requirements for securitisation transaction
- To adjust the data supply and reporting applications to enable a higher reporting frequency (weekly/daily)
- To replace manual processes in order to be able to meet the increased reporting requirements and to compensate at least in part for the escalating risk costs

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