# IMPACT OF ABSPP AND CBPP3

January 27th 2015 / ECB

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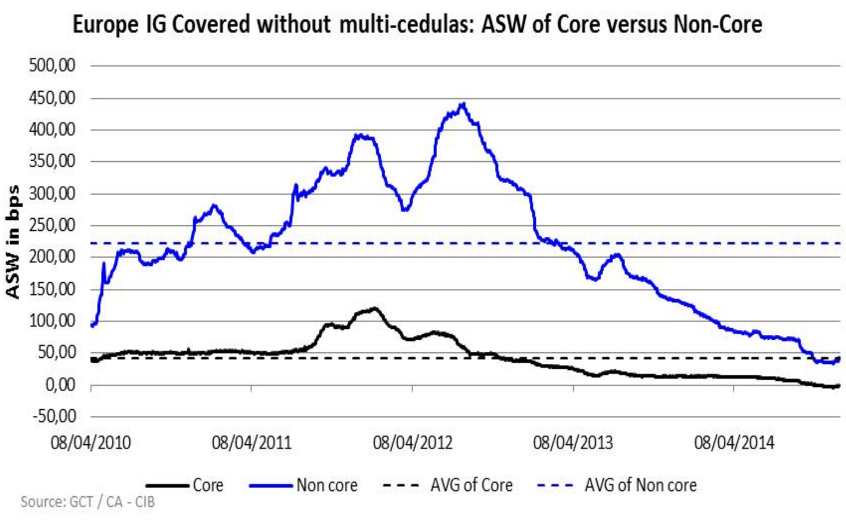
CONFIDENTIALITY LEVEL

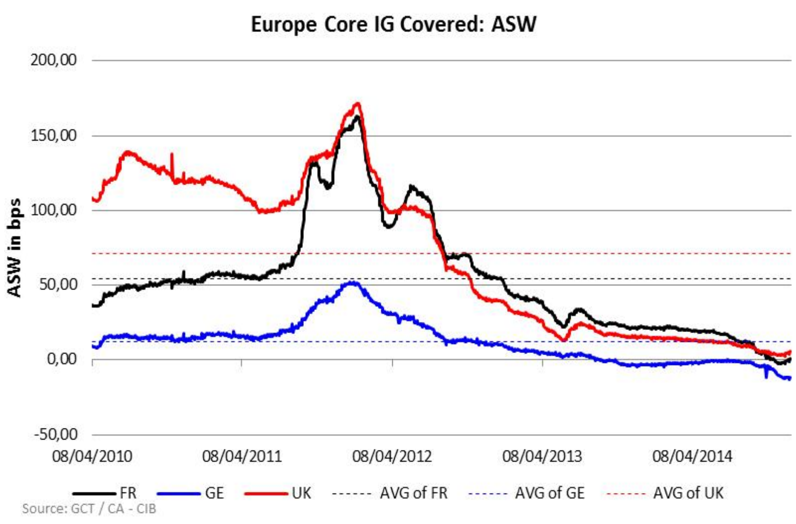
# Impact on market valuations

## Covered bonds

- Dramatic spread tightening for covered bonds issued by MFIs from Core Europe, well below their medium term average

- Substantial spread tightening for covered bonds issued by MFIs from Peripheral countries, the worst rated instruments rallying the harder



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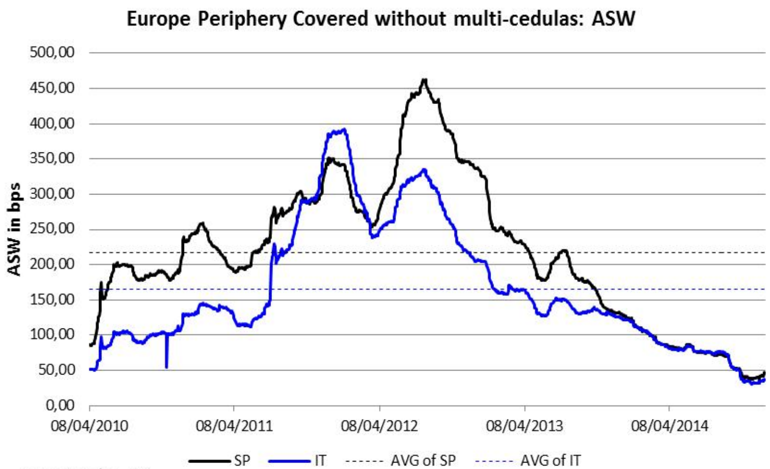
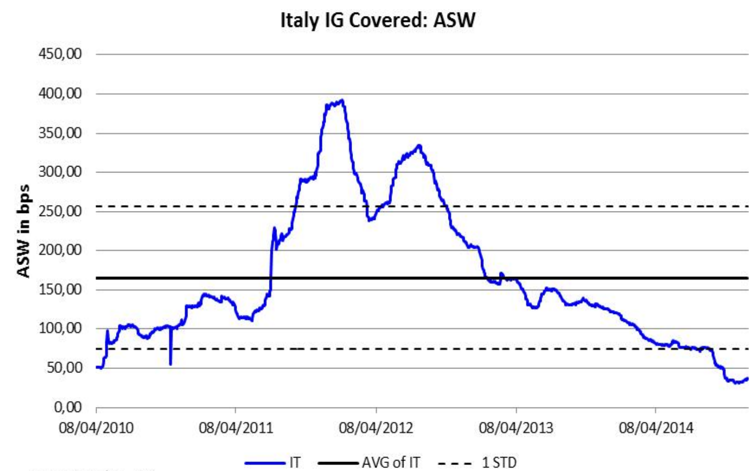
# Impact on market valuations

## Covered bonds




Source: GCT / CA - CIB

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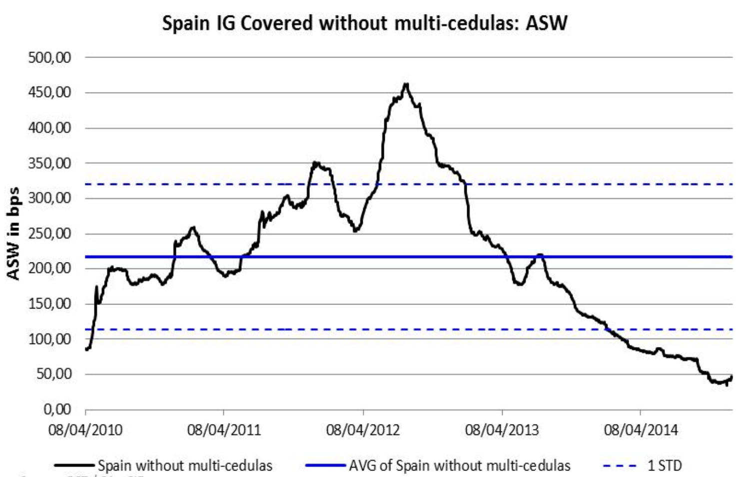


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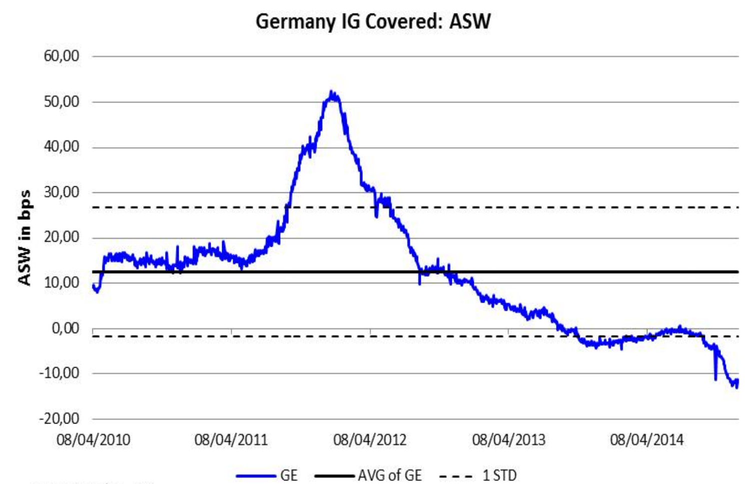


Source: GCT / CA - CIB



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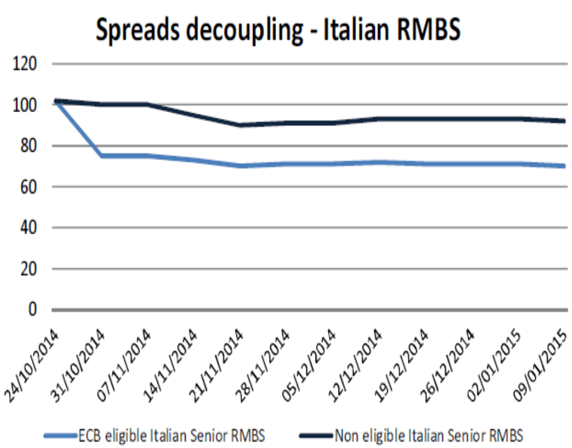
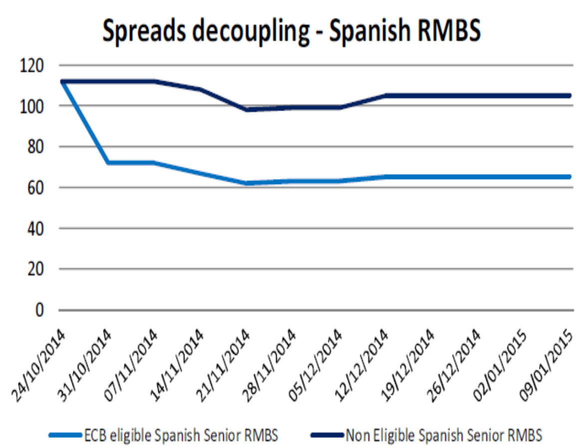
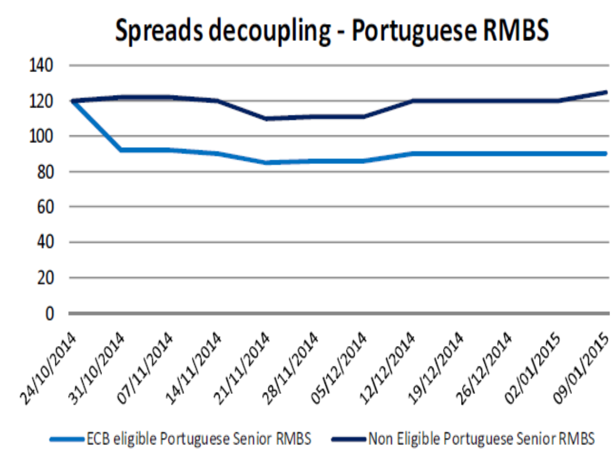
# Impact on market valuations

## Asset-Backed Securities

- European securitisation markets have experienced a significant spreads decoupling between eligible and non eligible ABS (strongly evidence on peripheral markets), post ECB announcement.
- Most of the end-of year rally was driven by ECB purchases and opportunistic buyers, albeit volumes traded on secondary markets were relatively low.



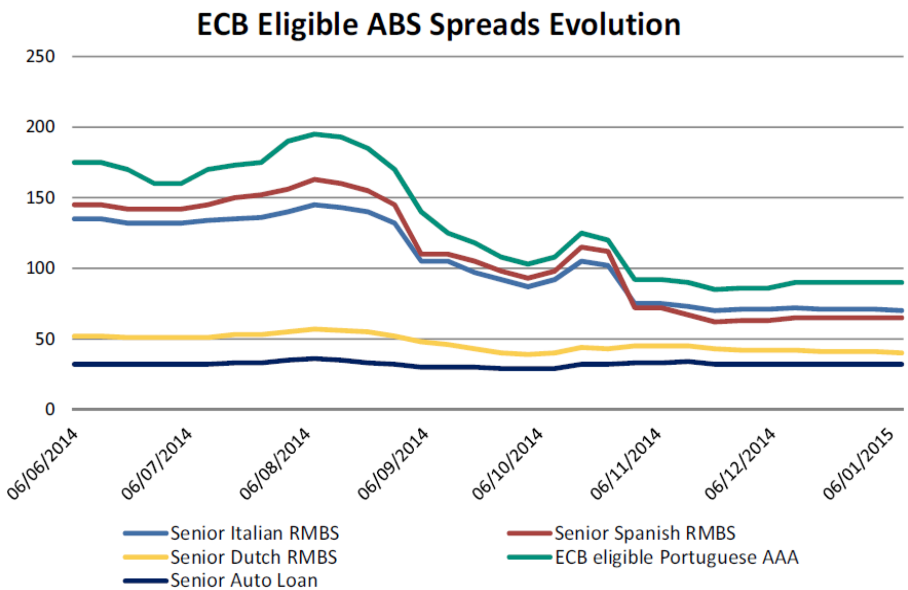



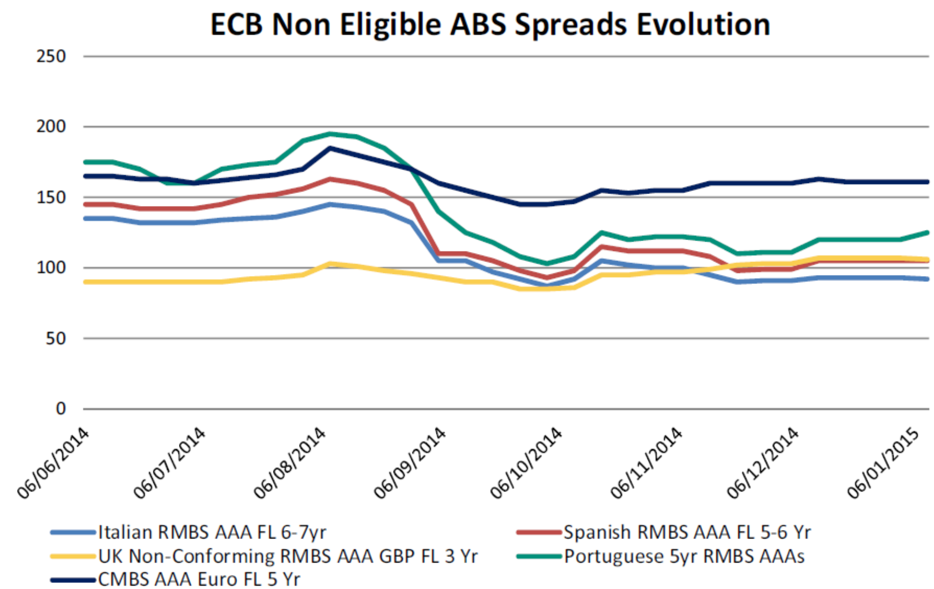




*Source: J.P. Morgan, January 2015*

# Impact on market valuations

## Asset-Backed Securities




*Source: J.P. Morgan, January 2015*



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# Impact on primary and secondary markets

## Covered bonds

- ECB an active participant :
  - → ~35%. From early 2015 deals : LBBW was 35%, CFF was 43%, BBVA was 21%
- What is the supply expected this year ?
  - → net negative issuance of ~€55b in 2014, same level expected for 2015
- What about pricing, tighter?
  - → In November, new issues did not come with any new issue premium, books were subscribed but market felt heavy and secondary performance was poor.
  - → Now the NIPs are 3-5bps , the primary in relative terms is cheapening.
- What about liquidity ?
  - → In the widening of covered in November / December, bid-offers became very wide (dealers were bidding back 4-5bps from screen bids and still being hit).
  - → Since the beginning of the 2015, normalisation again, 2bp bid/offer spread
- How do players position ?
  - → Initially, tightening in secondary market was led by ECB with a one way market
  - → Now, there is more of a two way market with buyers and sellers

# Impact on primary and secondary markets

## Asset-Backed Securities

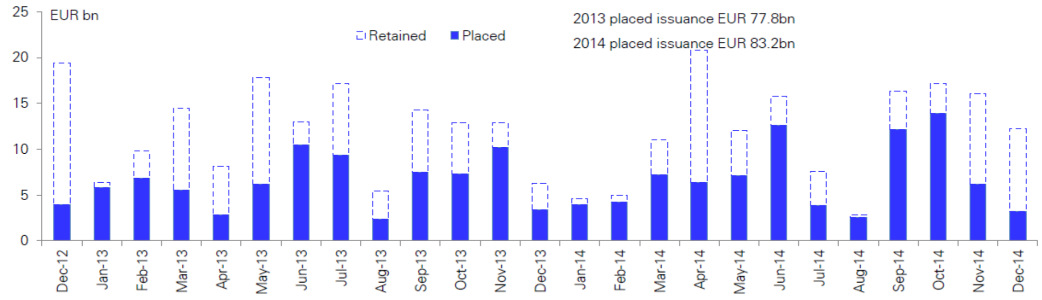
- The primary European ABS market closed in November 2014 and is about to restart, with two Auto ABS and one potential UK RMBS announced so far.
- The sharp increase in ECB ABS purchases to €1.79 bn within two weeks before Christmas was positively welcomed in the market.
- In the secondary market, activity had a slow start with the BWIC volumes being the lowest of the past three years. Non ECB eligible ABS, especially UK transactions, seem to attract rising interest from investors.
- 2015 European securitisation issuance expectations range between €100 bn and €150 bn

# Primary and secondary markets volumes

## Asset-Backed Securities

- In 2014, European ABS primary market volume reached €131bn, out of which €80 bn were publicly distributed.

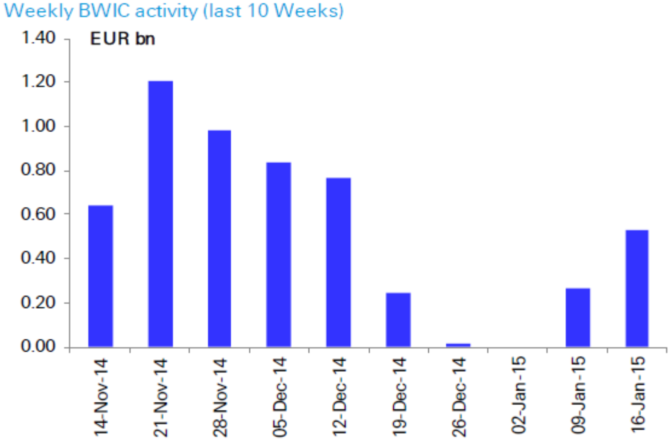
Retained vs. placed issuance




Source: Bloomberg Finance LP., SFW, Deutsche Bank

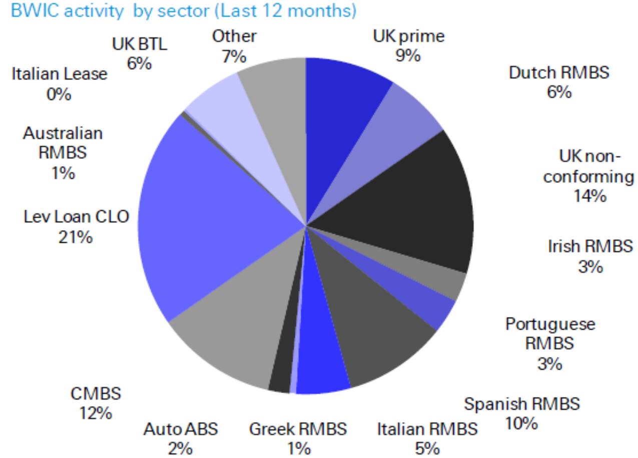
- In 2014, around €20bn of European ABS were traded on the secondary market.

Weekly BWIC activity (last 10 Weeks)




Source: Deutsche Bank, Bloomberg Finance LP

BWIC activity by sector (Last 12 months)




Source: Deutsche Bank, Bloomberg Finance LP

# Return on Capital for European Insurers

## Asset-Backed Securities

- European Insurers could take advantage of the spread pick up offered by Type I non eligible ECB ABS tranches to maximise the Return on Capital

| | SII Type? | ECB Eligible? | WAL | Spreads* | Return / Capital ** |
|---|---|---|---|---|---|
| Senior Auto Loan (AAA) | Type I | Yes | 2 | 32 | 9.29% |
| Senior Dutch Prime RMBS (AAA) | Type I | Yes | 5 | 40 | 4.48% |
| Senior UK Prime RMBS (AAA) | Type I | No | 5 | 49 | 5.33% |
| Senior Italian Prime RMBS (AA) | Type I | Yes | 5 | 70 | 5.13% |
| Senior Italian Prime RMBS (AA) | Type I | No | 5 | 92 | 6.60% |
| Senior Spanish Prime RMBS (AA) | Type I | Yes | 5 | 65 | 4.80% |
| Senior Spanish Prime RMBS (AA) | Type I | No | 5 | 105 | 7.47% |
| Senior Portuguese Prime RMBS (A) | Type I | Yes | 6 | 90 | 4.04% |
| Senior Portuguese Prime RMBS (A) | Type I | No | 6 | 125 | 5.50% |
| Senior Spanish SME CLO (A) | Type I | Yes | 2.5 | 85 | 9.20% |
| Senior UK Non Conforming RMBS (AA) | Type II | No | 5 | 105 | 1.67% |
| Senior EUR CLO (AAA) | Type II | No | 6 | 88 | 1.27% |
| Senior CMBS (AA) | Type II | No | 4 | 160 | 3.12% |

* Spreads indicated by J.P. Morgan as of January 2015

** Capital charges are based on last Solvency II release

- Covered bonds from Core countries having little to nil sense, peripheral covered making some more sense but small available pool and lower ratings (Iboxx data and QIS5 charges)

| asset class | size in bn € | rating | duration | | yield 31/12/14 | | ASW | | STEC | spread/STEC |
|---|---|---|---|---|---|---|---|---|---|---|
| IG covered | 555 | AAA | 4,3 | | 0,5% | | 1 | | 3% | 1% |
| IG covered excl. multis | 154 | A3 | 4,0 | | 0,9% | | 46 | | 6% | 8% |

# Investment rationale

## Asset-Backed Securities and Covered Bonds

- Securitisation offers various maturity profiles along with predictable and robust cash flows
- Securitisation offers some spread pick-up over IG corporate credit of equivalent rating although less liquid, while providing some diversification
- Securitisations offers protection against interest rate increase, being floating rate securities. A few LT fixed rate tranches have been specifically designed in 2013 and 2014 for answering to LT investors duration gap issues.
- Securitisation is an investment vehicle that allows insurers to access real economy financing and take exposures to banks core assets

- Covered bonds benifiting from strong and tested legal framework, having demonstrated their resilience during the last financial crisis, giving double recourse to asset pools and bank credit strength
- Covered Bonds used for duration purpose given rating and credit strength pricing versus sovereigns

# Questions for debate

- Eviction risk for traditional large buyers
  - Tight pricing in case of covered bonds, no longer attractive enough?
  - Shrinking available new issues or investable pools in case of covered bonds from negative net issuance for several years now?
  - Covered bonds were used for duration needs in some countries, ABS instruments to be used in replacement?
  - What is left in size and sufficient liquidity and adequate capital charges… government bonds … ?

- Changing issuer behavior
  - Competition and eviction forces between several tools: TLTRO and asset purchases but on same underlying asset pools?
  - Key issue remains: volume i.e. loan growth revival to meet investors needs in size and pricing?
  - Moral hazard and revival of riskier investment proposals?

# Questions for debate on ABSPP

- → What is the (un)intended purpose of the ABSPP programme: eviction of traditional buyers towards riskier parts ?
  - regulatory regime hindering their ability to move down in capital structure and / or rendering such investments unattractive under current rules
  - issuance revival quite uncertain if nobody buying mezzanine pieces

- → What is the other goal of the ABSPP programme: convergence of pricing among countries?
  - more successful on spread convergence of ABS between countries as shown by compression between periphery and core countries: this is a pricing consideration, not an issuance consideration

- → What is the other goal of the ABSPP programme: capital relief versus funding by TLTRO?
  - transparency issues, information on collateral loans, for buyers of subordinated pieces

- → Other issues:
  - loan demand driven by fundamental investment decisions of economic actors, pricing only one element among others like demand & growth outlook
  - arbitrage between multiple sources of funding by banks based on cost / capital: TLTRO, covered, ABS

- → Mezzanine / subordinated pieces:
  - to be included in the ECB program to revive the issuance market
  - not attractive for insurance or bank under current regulatory regime
  - one part of the capital structure that needs to be tackled in order to revive the issuance

- → Senior tranche:
  - ECB seen buying the 'easiest' or best pieces in the senior tranche driving down valuation
  - real eviction risk under volume and / or valuation purposes