



# IMPACT OF ABSPP AND CBPP3

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January 27th 2015 / ECB

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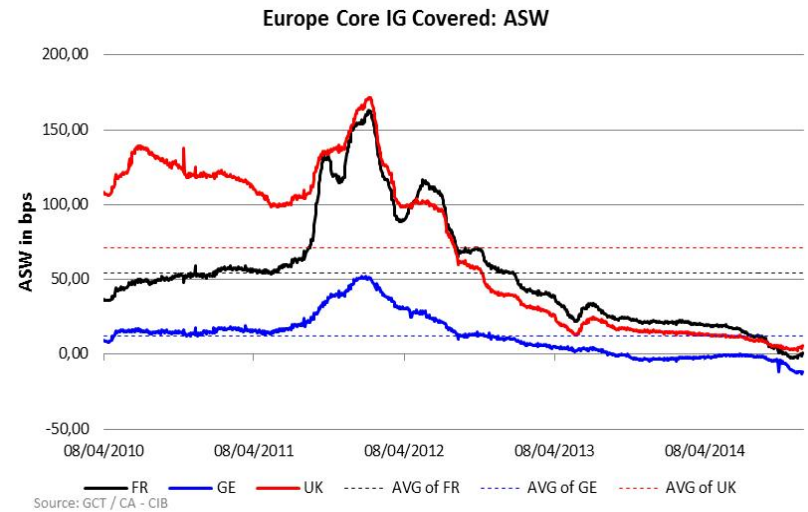
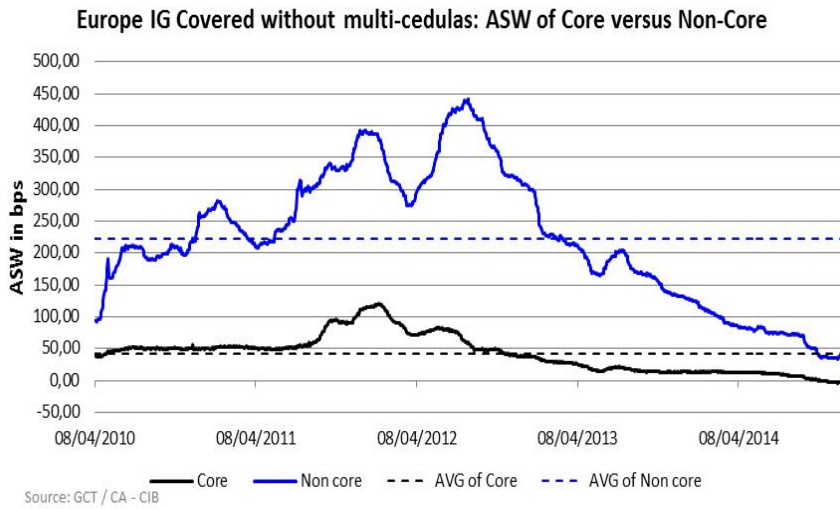
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# Impact on market valuations

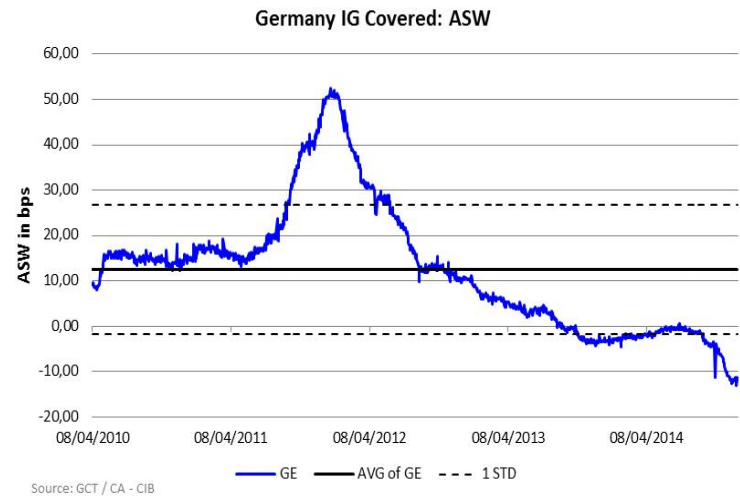
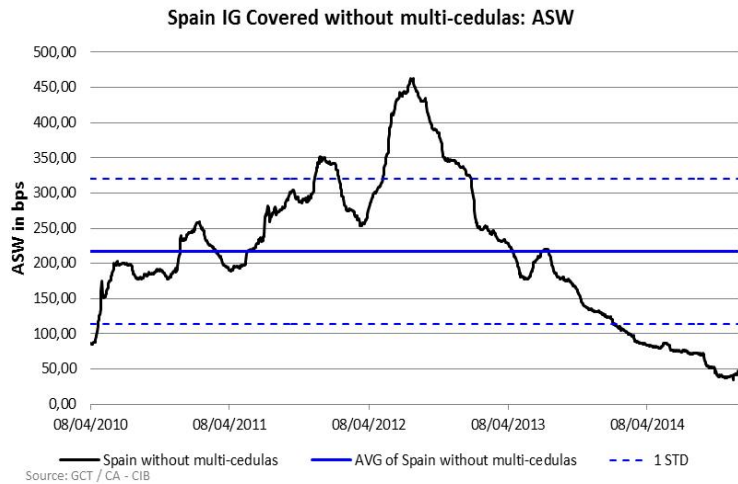
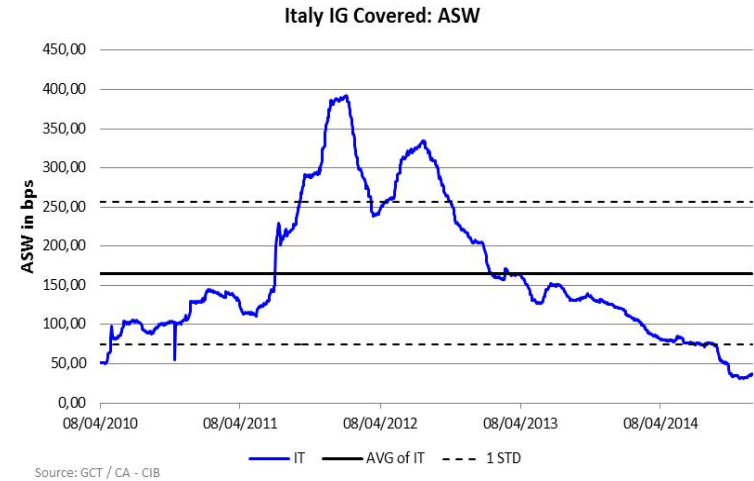
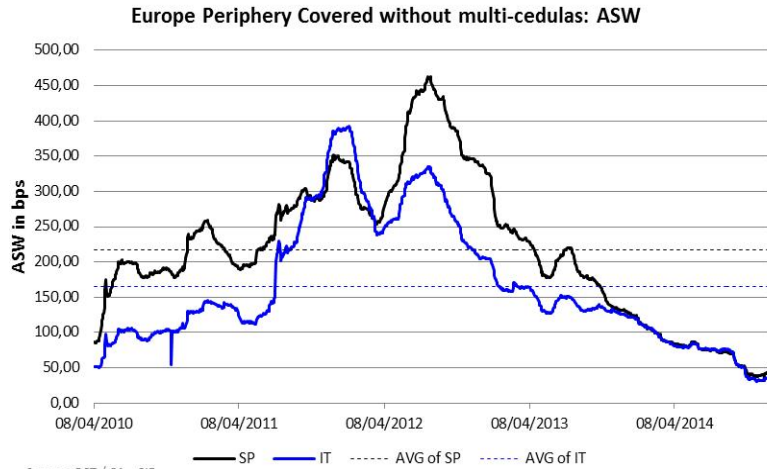
## Covered bonds

- ➔ 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



# Impact on market valuations

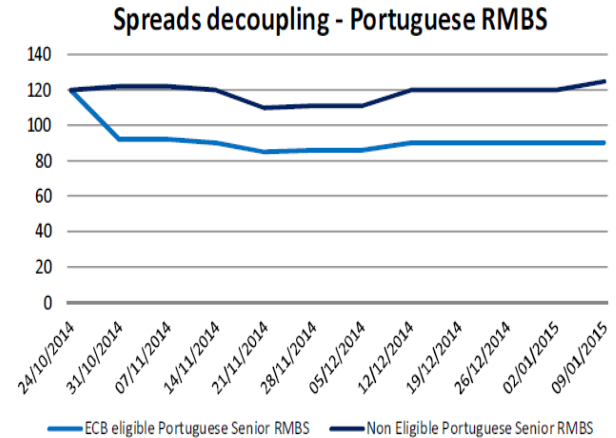
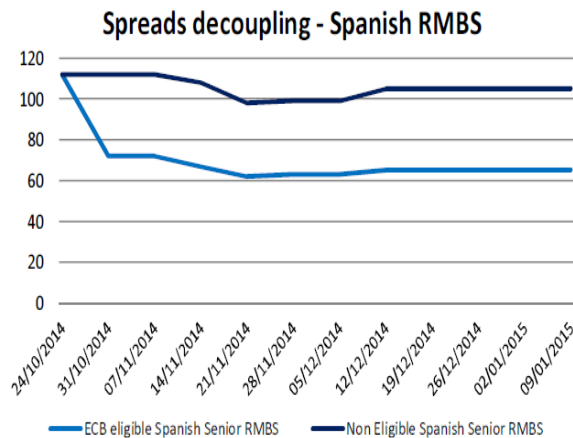
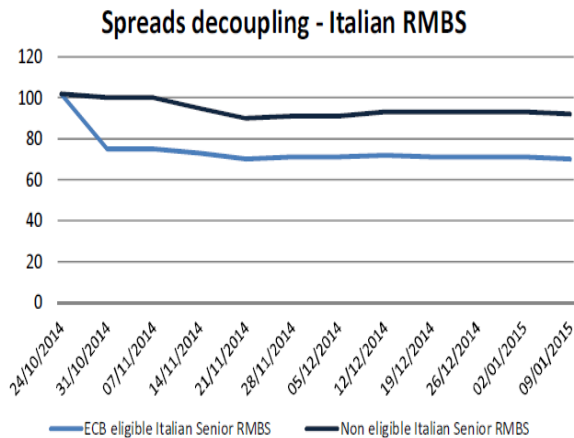
## Covered bonds



# 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.



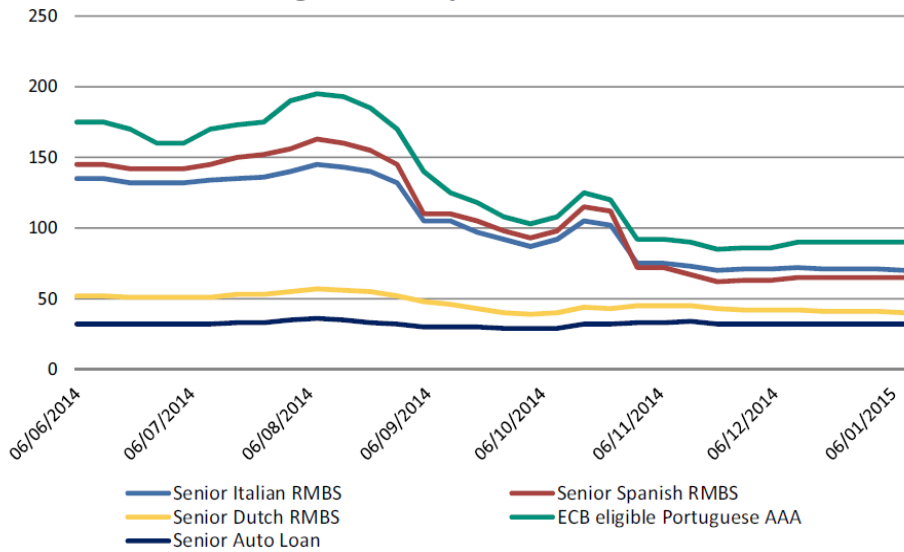
Source: J.P. Morgan, January 2015



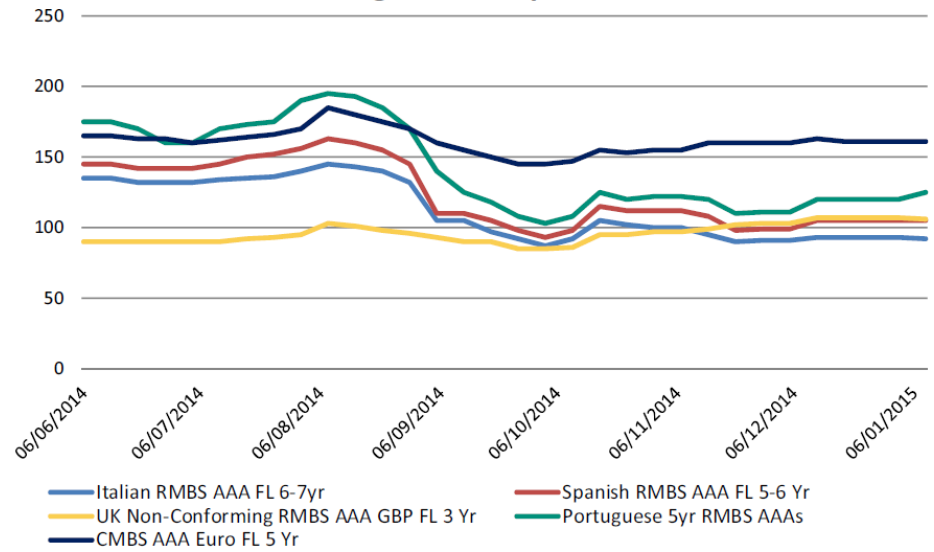
# Impact on market valuations

## Asset-Backed Securities

### ECB Eligible ABS Spreads Evolution



### ECB Non Eligible ABS Spreads Evolution



Source: J.P. Morgan, January 2015



# Impact on primary and secondary markets

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## 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

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## Asset-Backed Securities

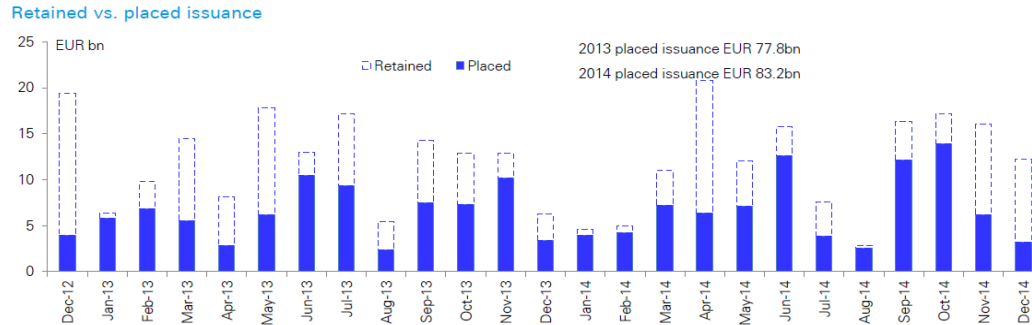
- ➔ The primary European ABS market closed in November 2014 and is about to restart, with two Auto ABS and one potential UK RMBS announced so far.
- ➔ The sharp increase in ECB ABS purchases to €1.79 bn within two weeks before Christmas was positively welcomed in the market.
- ➔ In the secondary market, 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

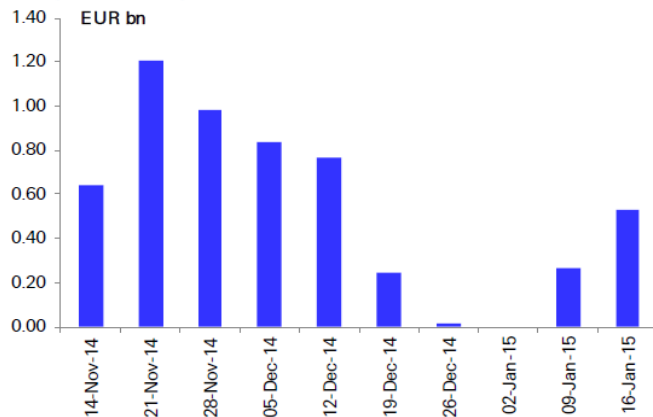
➔ In 2014, European ABS primary market volume reached €131bn, out of which €80 bn were publicly distributed.



Source: Bloomberg Finance LP, SPW, Deutsche Bank

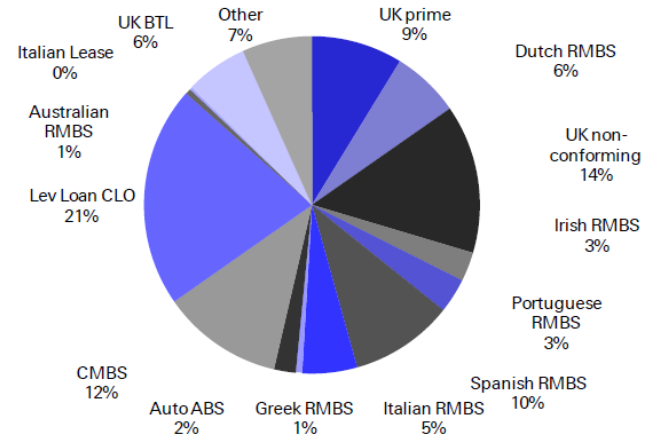
➔ In 2014, around €20bn of European ABS were traded on the secondary market.

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

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## 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
- ➔ Securitisation 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 benefiting 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

## ➔ 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

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- 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