SECURITISATION, RISK TRANSFER, RATINGS[1]

By Kirsty Harshaw

The panel discussed current problems facing the loan market and how securitisation can provide a solution.

The panel opened the session by highlighting that we are still seeing a huge number of loan financings and few securitisations, however, this might not be sustainable anymore, or the best option, for the following reasons:

1. the debt quantum - the value of capital call facilities is somewhere around $700B and $900B and NAV facilities are valued around $100B – that's a huge debt quantum for the loan markets to absorb;

2. the regulatory landscape is changing – new reforms mean that funds and banks will have to report and itemise a lot more. Investors are also asking for more transparency and scrutiny - they too want to know how valuations are done; and

3. the role of Basel IV – the Basel Committee is looking at tightening up the models that banks are using to calculate their capital requirements and address concerns that the current models are too varied and not comparable.

Where does securitisation come into play – can it help?

The panel noted that there are different issues in Europe compared to the US. For US banks, particularly larger banks, from a regulatory view, they are under a standardised approach, and it is a fairly capital-intensive product. Whereas, for European banks it is an IRV (interest rate value) approach, so there is no real risk-weight problem.

Consequently, when it comes to significant risk transfers (SRTs) to address those issues – there are two different markets, (i) US banks are using SRT securitisation to manage risk-weight; and (ii) European banks are using it to create new risk limit.

[1] Panelists included Navdeep Benning (Ashurst LLP); Dr. Eric Denton (Allen & Overy Shearman); Greg Fayvilevich (Fitch Ratings); Fabrice Guesde (Asia Pacific); Andrey Nikolaev (S&P Global Ratings); and James Parsons (PAG).

Either way, what we have seen so far is that SRT securitisation is helping banks to maintain volumes or increase volumes in subscription line lending. The panel observed there were around 12 billion dollars' worth of subscription line portfolios subject to SRT transactions in 2023 and they expect that number will increase this year.

By reducing their debt load and risk (through securitisation), banks can use their capital more efficiently.

Has securitisation made life easier and can it be used throughout the fund's life cycle?

It's undisputed that you need to offer solutions through the funds' life cycle. The panel discussed this in great depth, ultimately highlighting that securitisation should be seen as part of a tool kit. As fundraising becomes more difficult, you need to have leverage and provide investors with liquidity - that's where collateralised fund obligations come into play.

What role do ratings play in securitisations?

The panel considered this across three levels noting that ratings are used on underlying instruments at the first level, by banks and sometimes insurance companies at the next level to grow appetite and on the third level to consider the broader purpose of ratings (i.e., to increase transparency).

It is no longer a small market, and as you syndicate much more increased transparency provided by the ratings becomes so critical across the board.

Who pays for the rating?

This is one of the heavily debated questions, but the panel noted it comes down to the situation at hand. If one bank needs a rating (e.g. for regulatory purposes), then they should pay for it - if it's needed for pricing and distribution, then it is a different story. There are cases where it may be needed on both sides, and you can (of course) split it – therefore it is quite bespoke and dealt with on a case-by-case basis.

Concluding thoughts

Whilst these are continually evolving areas, a couple of points that are clear is that it is all heavily affected by regulations and whilst the market is maturing and SRTs are becoming a robust product there is still little uptake. **So, what could banks do better?** (i) standardise what information is needed and provide standard term deliverables; (ii) provide a consistent approach with NAV financing; and (iii) regarding fundraising process, consider bridge facilities to warehoused private funds. Watch this space.