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UK Securitization
A real resurgence?

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The banks are back but it might just be the beginning

GlobalCapital welcomed an exclusive group of securitization issuers and investors for a private GC Live briefing in London that discussed how the UK RMBS market is changing now that many high-street banks and building societies have returned.

With cheap central bank funding schemes winding down, high-profile lenders like Lloyds and Nationwide are back in the prime RMBS sector to much acclaim. But there are questions around the extent of their impact and how the ripples will be felt across the market.

Will these prime issuers pave the way for a thriving and robust market? Is the question for treasurers now just which is tighter, RMBS or covered bonds? How has Nationwide's 'stock and drop' innovation to speed up issuance changed things? Or will slow structuring and high legal costs mean securitization remains a mere diversification play?

There are plenty of wider implications. Once the prime RMBS shelves are back the next step could be more bank issuance in sectors like credit card and auto ABS. Issuers could turn to other currencies like dollar denominated RMBS which has been used heavily in the past.

The impact on specialist RMBS is also unclear. That market has struggled with rising interest rates and ever thinning margins. But there are some signs that with rates levelling, if not falling, that clouds are clearing. Lessons have certainly been learned from a treacherous period and there will be opportunities to come.

Lurking in the background is the long-awaited UK securitization regulation. Initially it seems tweaks, rather than sweeping reform is likely, but there is hope for a more nimble approach in future, working with the UK regulators, free of the straightjacket of primary legislation.

Participants

Moderator: **Tom Lemmon**, global securitization editor, *GlobalCapital*

Harry Choulilitsas, director, structured credit syndicate — Europe and UK, Natixis Corporate & Investment Banking

Gordon Kerr, managing director, head of European research, Kroll Bond Rating Agency (KBRA)

Gavin Parker, head of securitization and collateral, group corporate treasury, Lloyds Banking Group

Aza Teeuwen, partner, co-head ABS, TwentyFour Asset Management

***Tom Lemmon, GlobalCapital*: Gordon, where are things in terms of UK securitization issuance?**

Gordon Kerr, KBRA: I'll go back a little bit: 2022, in terms of distributed issuance was about €20bn of UK collateral in the market. In 2023 that jumped up to €36bn sold to investors. If you compare that versus the euro area, where it was €44bn, a considerable chunk of the market is coming from the UK side.

This year so far, and we're almost at the end of the first quarter, we've seen €8bn in issuance and the biggest positive is that only €0.5bn of that has been retained. Usually, it's just a small retained tranche that's part of the transaction as a whole.

The downside is that only €1.6bn of that is coming from the prime space, largely at the start of the year, so it's still largely a non-bank lender market. And there's a €2bn refinancing so, if you take that out, you're still at around €6bn of new-new collateral. And that is at a good pace for this year.

With regards to the financing market and the way that things are progressing, it's likely to be another good year for the UK market, in terms of where things are, where mortgage rates are heading and that ongoing demand from the non-bank lending market.

On the negative side, that it is still not enough for people like Aza. The market overall in terms of total outstanding is about £50bn in investor hands, £69bn in retained hands. And that is shrinking at a rate of about 17% on the investor market side and 11% overall. So, it's a positive environment, positive market, but it's still not enough to sustain the investor market.

***Tom Lemmon, GC*: Harry, you're the syndicate man. How do you see the rest of the year going?**

Harry Choulilitsas, Natixis: Couple of thoughts on the broader markets: even if you deduct the geopolitical risks, which is hard to quantify in your risk-return calculations, I think the macro-economic backdrop still exists. However, we are receiving several signals of economic information that are cutting through the noise.

For example, on the positive side, you have inflation that clearly is moving in the right direction, and we also see healthy financial statements from large corporates and a relatively healthy consumer outlook. On the flipside, we have bank lending activity that has reduced, as interest rates have gone higher. And we have some tailwinds from fiscal spending over the last two to three years, that has been leading towards higher deficits.

So, I would say that a slowdown in the economy is kind of here, but it should be a comparatively mild one versus a hard one. And how that comes down to – on a spread level – and where we see spreads going from here? History is a good example of how we can position ourselves in that market. Once rates fall and we're transitioning to a more monetary easing environment, longer duration and higher quality fixed income paper tends to outperform risky assets and money market issuance.

And this is something that we have already seen happening in the UK RMBS product as well. UK prime RMBS has tightened 5bp-7bp since November, UK BTL RMBS roughly 10bp-15bp from 90s down to mid-70s, low 80s, while UK non-performing were trading at 100bp in November 2023 and right now they're down to 80 to 90 (bps) area.

And if we take also the significant tightening on the mezzanine that we saw in the primary activity during the first months of 2024, all those factors point to [2023] being a very good year, both for investors, due to yields going tighter, driven by the alpha that floaters (of the structured products) offer versus the corporate ones, but also for issuers, that can now raise capital at lower spreads as opposed to last year.

Tom Lemmon, GC: Aza, how do you feel about that as an investor? What more do we want to see?

Aza Teeuwen, TwentyFour: I agree that, in general, 2023 was a fantastic year. We started the year wide after 2022 and tightened so 2023 was an incredible year. 2024 we've started the year on positive footing as well, spreads are tighter across the board and investors are looking for paper and we've had decent supply so far, but we'd like to see more diversification of primary issuance. We've seen a handful of bank prime deals coming to market. At the start of the year, everyone was talking about this massive pipeline coming our way. Clearly you guys [Lloyds] printed on January 3 and we so thought "Let's brace ourselves, we're going to have bucket loads of primary issuers…"

***Tom Lemmon, GC*: Who was it that came on December 28?**

Aza Teeuwen, TwentyFour: In general, yes there's been some BTL issuers, there's been some non-conforming issuance but we're still waiting for a lot of the big guys to come to market. So yes, we'd definitely welcome more supply and more diversified supply as so far it has been somewhat underwhelming.

***Tom Lemmon, GC*: What effect has the LDI crisis had, because RMBS did phenomenally well in that crisis, so has that been helpful?**

Aza Teeuwen, TwentyFour: It was helpful because you got data. LDI was clearly the biggest liquidity

event we've had since the global financial crisis. What is not helpful is that it started incredibly well for pension funds, particularly UK DB schemes. A lot of the DB schemes are seeing their liabilities sell off more than their assets and we've seen quite a few of them going into a buyout; so that money is not necessarily all coming back into the UK market. If I think about the typical LDI client, they've been buying UK RMBS, CLOs and also a bit of European ABS. That's the typical allocation.

So it is difficult. We talk to a lot of them and they're still rebuilding liquidity, haven't necessarily sold off the less liquid, or illiquid, assets that they have. Lending is generally down. They're all happy with what it's done for them; the asset class has turned out to be liquid, not just UK RMBS but CLOs and Dutch Prime RMBS, it has delivered the liquidity that they needed. And you talk a lot about pension fund consultants, they are actually pitching ABS as a solution. It doesn't necessarily mean that that is translating into a lot of flows yet.

***Tom Lemmon, GC*: Gavin, how long do you think it's going to be before the prime RMBS market is fully up to speed?**

Gavin Parker, Lloyds: I suppose it depends on your definition of 'up to speed'. If we look at Lloyds and what we did last year, we did £1.75bn. For me, that would be probably a reasonably good year in terms of our funding requirements.

And Harry mentioned it earlier, as we start to see improvements in inflation, as we start to see interest rates decrease, as we start to see a pickup in the mortgage market, leading to a pickup in funding requirements, TFSME rolling off in 2025… that will generate a higher funding requirement. And that's what we will start to see. I don't think it will be a wall of issuance but that's when we will start to see more issuance.

Gordon Kerr, KBRA: As you say, I hope we see that.

Aza Teeuwen, TwentyFour: That's not to say the UK is alone either, you are seeing it in Europe as well. A lot of the banks who have been relying on cheap, easy funding, we've seen some of those that we've really not seen for 10 years slowly coming with non-deal roadshows.

***Tom Lemmon, GC*: The market seems to have got into this place where it's starting to properly challenge covered bonds. What needs to happen for that to be sustainable?**

Harry Choulilitsas, Natixis: Prevailing market conditions and the broader macro credit cycle are definitely pushing towards more issuance. And there are a couple of things that support this. The first, is the termination of the Bank of England TFSME programme. The second is probably a declining trend in UK deposits. The third one is a bit of concentration that investors might have on covered bonds and the fourth one is issuers themselves, as they might have some constraints around issuing more (covered bonds).

So, based on those four things, the need for more primary RMBS is here.

And RMBS are becoming very competitive pricewise. We saw very successful issuance with Lloyds last year, where the covered bonds were wider probably 3bp-5bp versus the primary RMBS.

However, I do not expect under the current status quo to see a meaningful challenging environment for RMBS to take on covered bonds.

For that to happen, we need something systemic. And in my view a systemic theme will potentially come from regulation. And we have a very good opportunity right now as the UK is revising its securitization framework to be able to maybe make it more competitive and level out the playing field between UK RMBS versus covered bonds.

***Tom Lemmon, GC*: Is speed a big part of that? Speed of execution when you bring these deals to market?**

Gavin Parker, Lloyds: It's about diversification again. For a large bank like Lloyds, with the wholesale funding requirement we have, diversified products are very important. When it comes to covereds, a smaller institution probably needs to weigh up the collateral efficiency in covereds versus RMBS given the higher collateral requirements you need in covereds. So I agree, 3bp-5bp, depending on the institution, is probably absorbable.

***Tom Lemmon, GC*: I guess I was leading you to the very hot topic, which is the stock and drop announced by Nationwide. What are your thoughts on that?**

Gavin Parker, Lloyds: From my perspective, I'm an interested bystander. Anything that can reduce the speed to announcement needs to be thought about, needs to be looked at, needs to be evaluated. And Nationwide's idea, is something that we need to think about.

The stock element of it, I don't have any issues with; it's the drop element I'm really fascinated to

see how that progresses. Simply how investors look at that process, how they think about it in terms of transparency, how they warm to it. Because that's really what's going to drive whether it's taken up. I'm not going to say we're never going to do it because usually when I say that, six months later I'm doing it.

It's not something that is on our pad at the moment, but we will be very interested to see how it progresses.

Aza Teeuwen, TwentyFour: It all comes down to transparency and knowing what the bank wants to do with it. You talk about speed of execution, on our side we talk about certainty of execution. We see a deal that is essentially fully retained, we have no idea when it's going to come to market, who is going to buy it, if it will all be placed with one investor. We're not going to spend a full day underwriting it. And if they say they want to do a repeat transaction, we've all seen with securitization regulation and the amount of work we have to do on every single transaction, we need certainty of execution. If we see the stock, and all of that is placed with one single investor, you've essentially wasted a day.

So, I don't think it necessarily speeds the process up. Maybe it does for certain investors, for us it doesn't. I think we could see more of it and we're also a bystander and we'll see what happens and what the execution is like. We're also not necessarily going to line traders' pockets, but if it's broadly syndicated and run like a normal primary process and bonds price at par then I can see the merits, let's see what happens.

***Tom Lemmon, GC*: I'm interested to hear what the return of high street banks like Lloyds into the market has done outside of RMBS. Will we see more things like prime autos, credit cards and things like that?**

Harry Choulilitsas, Natixis: First of all, the return of the high street banks in the market was hailed by the industry and the investor base, as they can formulate spreads through what is the UK RMBS curve.

For example, without these assets, we were talking around what is the right spread for UK credit cards? Right now, you have the tightest point, (which is UK RMBS), which is the UK high street banks at 50bp. And then, that gave tremendous price transparency on how we can build (the curve) from here; for the UK buy-to-let, UK non-performing, autos, credit cards etc.

But to answer your question, with respect to how their entry into the (RMBS) market will affect the rest of their (banks) activities, I think it's a combination of the funding needs that they (high street banks) will have.

For example, if they're not able to raise funds from BoE due to the fact that we are under a stricter monetary policy regime, then we should expect to see more funding needs in the foreseeable future, and I do expect high street banks to explore new ways to refinance their collateral or other prime loans by securitization.

So, the answer is yes. Do I see this happening right now? Not really.

I see prime RMBS (deals) coming for the foreseeable future, but the pipeline for (high street) credit cards and auto ABS is really muted for Q2. Before, let's say the summer, we will see elevated supply coming through the (traditional) UK pipeline.

***Tom Lemmon, GC*: Gordon, I know you get a lot of those conversations before they happen, how do you see that?**

Gordon Kerr, KBRA: We are obviously — a little bit less active in the prime space given the issuance we see in the market. But I agree with Harry. The return of the prime RMBS market is important for the UK market overall. So having the big guys giving conviction to the securitization market, saying "We're here", returning after all the central bank funding they've received over the past 10 years, helps to support the market and help it benchmark against covereds. So, I do think that's a supportive sign for the market.

The market itself has also shifted, so investors like Aza who would have historically been active prime investors. Nowadays they are dealing with a lot more non-conforming collateral as it is a high proportion of circulated issuance and is more sophisticated and varied collateral. So, to be able to quickly benchmark that type of pool against higher quality collateral in the market is helpful.

In terms of the pipeline, as the market shows, there was a strong start in January, but then we had a slight pause in February and we are now building a pipeline and getting ready for the run in to Global ABS.

***Tom Lemmon, GC*: We talk about the UK a lot now post-Brexit and we talk about regulation and divergence, but — how many of you were at Las Vegas a couple of weeks ago?**
I've been for three years and I've seen an increasing number of UK-based faces. When we've done interviews in the last year or so, the importance of the dollar market seems to be an increasing

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question. Obviously, it's nice to tap into that but I wonder if it is proving successful? What more do you need it to do for it to be successful?

Gavin Parker, Lloyds: I was there. It was a very good conference. What was interesting was that we were getting questions not only about funding but about risk transfer transactions as well, so a much broader scope in terms of the questions we were getting asked and the products we were getting asked about. And a lot of those questions were coming from investors who had previously invested in our funding transactions.

We did make it clear to investors that the purpose of us being in Vegas was to keep the communication channels open, keep the conversations, keep the relationships going.

There is no current intention to enter the dollar market this year but we see it as a deep market that we've executed into on a number of occasions in the past and we would like to do in the future. It comes down to the need for diversification and the wholesale funding requirements.

In terms of what else we can do, the fact that we had so many UK issuers out there showed US investors that there is still a market here. There is broad interest in the US in UK issuance. And we need to keep those conversations going.

Tom Lemmon, GC: Any questions?

***Question*: Gavin, to your point right there, accessing US capital and US investors has been an important tradition in the UK RMBS market. Do you see that appetite continuing more, especially in a falling interest rate environment?**

Gavin Parker, Lloyds: Certainly, we don't get any sense that the appetite isn't there. The question probably is in terms of volume. And because we've been absent from the US market for a while, it is a question of what volume looks like, what's the capacity? The programme is set up to do 144A so we will continue to do 144A. Pricing at the moment, UK compared to US, just isn't attractive from the UK investors' perspective. So, as I say, it's something that we will continue to look at but not this year.

Tom Lemmon, GC: Thank you all for your time. GC

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