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# **UK Securitization**

## UK ABS ripe for new asset classes

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Several new sectors have emerged to breathe new life into the UK securitization market since 2023. At its latest GC Live briefing in London in March, *GlobalCapital* convened a panel of specialists from leading investors, an issuer and a rating agency to discuss the vital ingredients required to successfully introduce new sectors to the market. They looked at investor appetite for product innovation and variety in collateral, what prospective buyers want to see from unfamiliar issuers and products, and how a less restrictive regulatory approach could facilitate the further growth of the market.

**GlobalCapital:** This is a very timely topic considering new asset classes have emerged in UK securitization in the last couple of years. For instance, small business credit cards in 2023 and data centres in 2024, but also LiveMore securitized retirement interest-only (RIO) mortgages for the first time last year. Simon, what was the journey like to bring a new asset class to the market?

**Simon Webb, LiveMore Capital:** For us, it's very much about early engagement and that's really across the piece. We're a first-time issuer as well as a relatively new asset class — a new asset within a well-known asset class if you like. Even when we were first launching the business and our product, we

engaged some of the rating agencies to understand how they would look at the product and help them understand the product as well.

Then we built the portfolio up to £150 million and we ended up doing a deal of just over £200 million last year on the Exmoor programme. It was very important again to engage early with the rating agencies to help them understand how the product is underwritten, how it's been performing, how it behaves and is expected to behave.

And then as we got closer to the transaction itself, it was very much about early interaction with investors. We did a non-deal roadshow and a deal roadshow; we would have had nearly 100 investor meetings either in person or over Zoom or Teams, as is more common these days.

That really helps investors to understand the product and again the business — how we look at these assets, how we underwrite and ultimately get comfortable with the risk that we were taking.

It's a very thorough process but [it's important] to make sure that investors and rating agencies understand the business, how we approach it and the product.

**GlobalCapital:** So maybe it's a good time to bring in Kali on this point. Rating agencies, as Simon says, have a very important role to play in the process; what are you looking at in that early stage?

**Kali Sirugudi, KBRA:** You're looking at a new lender in the market with possibly a new product as well, which was true in the case

## Discussion participants



Moderator:  
**George Smith**, senior securitization reporter, *GlobalCapital*

**Janet Oram**, head of asset backed securities, USS Investment Management

**Kali Sirugudi**, managing director, RMBS, KBRA

**Simon Webb**, managing director — finance and capital markets, LiveMore Capital

**Peter Wong**, portfolio manager, Nationwide Building Society

of Exmoor because you had not just the RIO mortgages, a new product, but also LiveMore as a new entity with a short history of origination. What rating agencies look for is at least a meaningful number of years of historical performance data.

You get over the challenge of limited performance history by looking at the origination criteria for the product and comparing it with that of established lenders. That gives you a sense of the similarities and meaningful differences which could drive the expected performance of origination by a new lender.

Then there is also the complexity of the product. In the case of RIO mortgages, you're looking at assessing the expected default while a borrower is actually making regular interest payments, while being employed and when retired. And then there is the complexity of what is the timing of a mortality event, which then leads to determining the liquidation value of the property at that point in time. That means combining both the forward mortgages methodology along with that for equity release to assess the expected loss for RIO mortgages.

So that's pretty complex. I agree with Simon that the lead time to rating agencies and other market participants is critical. It's essential for us to be able to process and model the complexity of a product.

And on the servicing side, it could be the case that a new lender outsources the servicing. In the last decade I have seen new lenders enter the market but outsource the servicing to an established servicer. That's a good mitigant to begin with. The new lender and the team build that servicing expertise over a period of time.

Rating agencies also look to assess the financial strength of the entity or seller providing the representations and warranties; a relatively new lender may or may not have the ability to purchase back the loans in breach. One of the key mitigants there could be that the entire mortgage book or originations are re-underwritten; that gives you a sense of comfort or reassurance that a breach of warranties can be limited and reliance on the seller to purchase-back loans in breach is mitigated.

**GlobalCapital:** Pete, what are you looking for at the stage

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*Peter Wong, Nationwide Building Society*



where a new issuer may be engaging with investors for the first time?

**Peter Wong, Nationwide Building Society:** Some of the key things that we look at: We like to see track records of collateral and we like to have physical due diligence with the issuer as well. We have in the past gone through the due diligence process and decided to step back from the transaction just because we felt the issuer was not up to speed or leaning very heavily on the banks.

On top of that, we also look at whether there has been issuance in the past — some [firms] have decided to do a retained issuance before coming with their inaugural public issuance. That can be useful for us because we can then see that the reporting, the infrastructure and the plumbing is in place. We all know how onerous the reporting can be for an ABS.

**GlobalCapital:** Do you think there's a premium to pay for first-time issuers?

**Janet Oram, USS Investment Management:** Not demonstrably by the deals that have gone recently. I think the points that Simon and Pete have made are really important though, because there have been quite a few new issuers and new products that have come recently and they decided not to do — or maybe they just didn't want to talk to me — non-deal road shows.

When you are in a busy market and you've got a 45-minute Teams meeting to understand what the business is, what the product is, who the customers are, how it works, how it's going to be underwritten, what the data is, how the servicing is, and then you've got probably four days to read the documents, it's actually really hard to make

a sensible investment decision when you've got a business you don't know, with no track record and products that are possibly completely untested.

The early engagement, for me at least, is really important and, like Pete, where it's a new set of processes, we quite like to do on-sites as well. If someone has literally gone "bang," we're doing a deal and we're going to price it on Monday, great, but there is no time for me to go and do that kind of thing.

At the moment there is so much money in the ABS market that it's very difficult to discern any premium for doing anything, or any lack of premium. I think in other markets, yes, there is a premium associated, but you can overcome that by getting more investors in the book. To do that, you need to find the ones that are going to take a bit longer and engage with them earlier.

**GlobalCapital:** Thank you. To move on to the next section of the discussion, we've got quite a lot of mortgage expertise on the panel, so we thought we'd take a bit more of an in-depth look at that market. Kali, do you want to set the scene for what's been going on in the mortgage market?

**Sirugudi, KBRA:** The reported lending volumes by the FCA at the end of the third quarter last year clearly indicate modest growth — 1.3% year-on-year. You're not looking at volumes anywhere near their historical peak.

Buy-to-let sector lending volumes have actually fallen, compared to 2022, over 50% and that's dramatic. Of course, that's driven by higher interest rates and falling yields which mean that landlords don't find it attractive to borrow.

Then you have a small portion of the market which is later-life mortgages and I'm focusing on that because the topic here is to look at any new products which are expected to be introduced or have already been introduced into the market. Later-life mortgages is a tiny portion of the lending market in the UK and that's fallen by about 60%, and only because of the way an equity release mortgage works. Higher interest rates mean that it's not great for the lender or the borrower because LTVs are tighter and it might not be attractive for a borrower to borrow at those low LTVs.

One other aspect [of the market] which I've noticed is the above-90% LTV originations. [There's been a] 6% increase in that lending, the highest since 2008. So that's driven by borrowers looking for a higher lending amount, because of where the house prices are.

Hopefully buy-to-let volumes continue to at least remain stable in the current year, given where interest rates are.

**GlobalCapital:** There has been a bit of a pick-up in interest in the later-life sector obviously. As well as your deal, Simon, there was a deal towards the end of last year, involving Aviva assets, of equity release mortgages. What are you seeing in terms of innovation in that sector and do you think it's going to result in more securitization deals?

**Webb, LiveMore:** There's lots of innovation in the later-life sector. It is a growing sector and we expect it to continue to grow with the aging population.

To Kali's point around house prices and the ability of the younger generations to actually get on to the

housing ladder, [they can] use the bank of Mum and Dad to facilitate that as well.

So we've seen the RIO product, which itself was innovation five or six years ago, we've seen the equity release deal that you touched on in December last year, we know that there are a few other equity release deals that were done a couple of years ago. So you're starting to see some activity back in that market, which is great.

We're developing our platform really to cater for all the different mortgage products that could be available to a later-life customer, whether that be a current-pay mortgage through to an equity release product. This is where you are seeing the later-life market go in terms of making borrowers aware of all the different options that are available to them and the increasing range of those options.

In terms of innovation and where we see it going in the future, it is hybrid products as well. So as an older borrower's circumstances change as they age, the concept of moving from perhaps a current-pay product into an equity release product over time at a certain point in time or at their election is certainly some innovation that we see happening.

It's not the easiest but ultimately, we see the market heading in that direction. There have been some attempts to do it to date, but they haven't been overly successful. Part of the challenge is knowledge and education with UK brokers — as well as with consumers and their understanding and knowing that they do have options available to them and exactly what those options are.

**GlobalCapital:** Thank you. Obviously, all this comes against an already thriving specialist

securitization mortgage market. Pete, you spotted some innovation last week from a particular bank. What did you make of that? This was a buy-to-let covered bond from Paragon.

**Wong, Nationwide:** Yes. That was an interesting product; we've not seen a public buy-to-let covered bond come to market in the UK, but there was one fully retained buy-to-let covered bond from a building society.

I can see exactly why Paragon went down that route. Before they got their banking licence, Paragon Bank was a stalwart of the buy-to-let RMBS market. Since then, they've gone down the retail deposit route to fund their business.

As a bank treasury, buying a covered bond is a lot easier and has less regulatory haircuts — 7% on a covered bond versus 25% for an RMBS, and I'm talking about prime RMBS here because a buy-to-let RMBS isn't LCR eligible.

When you factor in the economics, all things being equal, I need about 10bp to 12bp more to buy a prime RMBS and we are not even considering the difference in collateral.

The other thing to think about as well is the execution risk. We've talked about Article 5 due diligence in ABS for a very long time and how much more DD is needed for ABS for an investor. If you're thinking from an issuer's point of view, you can come to the covered market with an established programme and issue £500m on the same day. That takes out a lot of execution risk for the issuer. With an RMBS, you probably need at least three days.

When you factor in those things, you can see why Paragon has gone down the covered route.

**GlobalCapital:** Janet, how do you distinguish between all these different types of products? What are you looking at from your perspective when you see these new or existing mortgage products being innovated upon?

**Oram, USS:** I don't think it's any different comparing different mortgage products to anything else. Does the product make sense for the customer? Does the borrower make sense for the business? Is the sponsor still going to be around when I want my deal called? And actually, how do

*“There's lots of innovation in the later-life sector. It is a growing sector, and we expect it to continue to grow with the aging population”*

*Simon Webb, LiveMore Capital*



the differences in those borrowers and that product versus the standard mortgage assumptions mean that it's going to behave?

Models are generally based on a standard prime mortgage market going back however many years, and then to a lesser extent a buy-to-let mortgage market going back however many years. Maybe I'm just more conservative, but I worry sometimes that my expectations for how some of these pools are going to perform don't sit nicely within some of the structures.

The equity release deal that was done at the end of last year is a really good example of how different structures need to be sometimes in order to suit the product. That was very carefully thought out because the underlying mortgages don't pay interest. So there's a huge great reserve to pay interest on the senior notes, the juniors don't have interest.

That's not a normal public securitization but it worked really well because it was targeted at a particular set of investors. The insurance community are really keen for those senior notes because they sit in a matching adjustment bucket and they can be structured as such.

What you're going to get with some of this innovation is actually that I won't see all those deals because I'm not the target investor. They're going into insurance money, which doesn't need to be a broadly syndicated securitization. Some of the innovation in the products might end up sitting with slightly different pockets in the market. You're not going to get standard public securitizations of equity release products because I'm not sure that the structures that are right for the product are a normal ABS that necessarily works for your "standard" ABS investors.

**GlobalCapital:** Thank you. Pete, do you want to add anything else in terms of how products compare?

**Wong, Nationwide:** One thing I would point out is that as a bank treasury the asset types you can buy for HQLA [high quality liquid assets] purposes are very limited.

We've seen a lot of collateral leave the market. We've talked about the Paragon buy-to-let covered bond already. On top of that, there's the shrinking credit card segment. That market is very, very quiet right now,

*"We looked at the Enpal deal and understood that product as an unsecured loan, not necessarily secured on the underlying property"*

**Kali Sirugudi, KBRA**



we've just got NewDay. We've not seen Penarth [from Lloyds], Gracechurch [from Barclays], and also Delamare [from Tesco Bank, now owned by Barclays] is out of the market as well.

On top of that [Barclays has taken over] Kensington Mortgages, while Charter Court and OneSavings Banks have merged. A lot of collateral has just disappeared. I think it's so important that we continue to be constructive in getting new asset classes in. The ABS market is ripe for it.

There's certainly a regulatory angle at play here, to factor in as well. The FCA came out just last week and outlined flexibility in its rules on how banks look at stress tests now that rates are likely trending down. That will have an impact on some specialist lenders and the demand for their products.

In the past the equity release mortgage market was shrouded with regulatory and headline risk. A lot of lenders shied away from it but it's nice to see these types of products being ramped up again.

**Webb, LiveMore:** I'll just touch on [Janet's] comments around pockets of funding for particular products. That's very much how we see our business.

We're very much looking at different funding programmes for the different products that we have. The equity release side, which is very much targeted at insurers or pension funds, versus the securitization programme, which is more targeted for our standard product or the RIO product as well. I very much concur with those comments.

**Sirugudi, KBRA:** Just to add, in the past 12 months to 18 months, we've looked at mortgage portfolios where the borrowers for buy-to-let loans are

expatriates or foreign borrowers. That introduces quite a different dimension to the risks of a buy-to-let loan.

The other which I mentioned was that we looked at a portfolio of UK HELOCs (home-equity line of credit), akin to the HELOCs in the US. That's a second lien credit. That's an interesting development in terms of new products in the UK.

**GlobalCapital:** In case anyone is not familiar, could you give just a quick description of what HELOC is?

**Sirugudi, KBRA:** This is a line of credit provided to a borrower — usually a second lien loan. The borrower is given a certain limit which can be drawn down and paid back along the lines of a credit card. Of course, it's not a credit card but a line of credit with a lender.

**GlobalCapital:** We'll move on from mortgages to maybe some more of the unusual assets that have made their way into securitizations lately. To come back to you Kali on solar ABS and the prospects for a UK deal, is it possible that someone could follow what Enpal did in Germany?

**Sirugudi, KBRA:** We looked at the Enpal deal and understood that product as an unsecured loan, not necessarily secured on the underlying property. What is prevalent in the UK, and a trend which we observe, is that the High Street lenders, and the building societies particularly, look to provide a further advance. For example, the Nationwide Building Society provides you with an additional mortgage called a green mortgage. It bears no interest rate and has a two year to five

year maturity. It is secured on the underlying property.

In the UK, that is a prevalent way to fund retrofitting or new renewable energy generation to reduce the carbon footprint of your property. I can see some lenders on the non-bank side who are keen to look at this space and to provide those funding options to borrowers.

I think Enpal is a leader in terms of what they've done in Europe and Germany. We're hoping that there can be something like that lending product in the UK in the near future.

**GlobalCapital:** *The other asset class which has attracted a lot of excitement is data centres. There was a first UK deal from Vantage last year. Janet, do you have any thoughts on how these two asset classes are developing?*

**Oram, USS:** One comment just to add to what Kali was saying, if you've got a prime High Street lender and you're taking out a further advance, that's reasonably straightforward to do. On the specialist side, if you've securitized the first mortgage, the chances are that it's going to limit your ability to do further advances for retrofitting or heat pumps and all the rest of it. I think there's a question mark, structurally, around how those lenders then do the further advances or help support the retrofitting that really does need to happen. I don't know if there's some product innovation to come there.

On the data centres, I lose count of the number of conversations that have been going on recently about them. We did look at the Vantage deal; it didn't help us because it was fixed rate, which doesn't really tick boxes for us. More broadly though, I'm not sure I'm going to get

hugely comfortable with a large land value on any of that, which probably goes a little way away from a CMBS structure.

The logic of discounting the lease payments where you've got a high-quality lessee in place for many years makes a lot of sense. I guess the thing from my perspective is it's all well and good if the rating agencies have seen the lease contract and the rating agencies know who the tenant is, but as an investor, if I'm being asked to invest in essentially a cash flow that's a discounted lease, I'd quite like to know who the tenant is and what the lease terms are because that's the basis for my underwriting.

I think there's probably a balance to be struck in terms of transparency about the kind of information that we're going to need for that to really become easier to invest in.

**GlobalCapital:** *Our US colleague Nick has been covering this. The debate in the US definitely seems to be heating up around the topic of disclosing who the lessees are. Maybe we should move on to hopefully an optimistic note. Do you think this increasing innovation and increasing diversity makes UK securitization more attractive for investors?*

**Wong, Nationwide:** I think the ABS market is [great for it]. The market is filled with sophisticated investors who are willing to do the hard yards, do the cash flow modelling, the securitization technology allows tranching, allowing various investors to partake, the rating agencies are happy to do the due diligence and the ABS market doesn't need large transactions to come to market. So it's actually a great place for new assets to come in.

As I mentioned earlier, from a bank treasury perspective, the main hindrance has been the imbalance in regulatory treatment, especially in the EU and UK when compared to the US. You've got very different perceptions between covered bonds and ABS.

Also, some of the regs that we are constrained by are very prescriptive. When you're so prescriptive it hinders our participation, for LCR purposes, in the more niche asset classes. So perhaps the regs need to be re-looked at and focused more on the economic risk rather than the asset type itself.

**Oram, USS:** Focusing on the need to sort out the regs, having new asset classes being funded by the securitization market and new issuers coming into the securitization market means that it's very clearly relevant and worthwhile supporting from a regulatory perspective. So I think actually yes, it does help. And quite frankly, it's always nice to look at something different!

**Wong, Nationwide:** As a bank, we're quite limited with the asset classes that we have. We don't have much [paper backed by] cards, we don't have many autos, so you end up buying lots of resi. And when you look at banking books, it's predominantly resi, which doesn't really help with diversification.

**GlobalCapital:** *Yes, indeed. Would anyone in the audience like to ask the panel a question?*

**Audience member:** If the market is busy, how difficult is it to get investors interested in these more esoteric products?

**Webb, LiveMore:** [From the perspective of] not being an investor but selling to investors, it goes back to that time piece. [You need to] give investors the time to understand the originator, understand the product, understand the structure and invite them in, be transparent, invite them to understand your processes. I think the more you can do that, the more chance you have of investors showing interest in your transaction.

**GlobalCapital:** Thank you very much to everyone for great points and a great discussion. GC



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*Janet Oram, USS Investment Management*



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