



SECURITIZATION PULSE REPORT 2019

In association with:

GlobalCapital
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Foreword

We are delighted to have collaborated with GlobalCapital on our inaugural Securitization Pulse Report. To complete our report, we surveyed more than 150 top issuers, arrangers, investors, and advisors across Europe, the U.S. and Asia to help us understand the key trends and their expectations of the industry. Unsurprisingly, the respondents' view of the U.S. differed significantly to that of Europe.

The global economy is facing a variety of challenges; most people agree we are now in the final stretch of this stage of the credit cycle. Notwithstanding macroeconomic headwinds, the narrative is still quite bullish across specific asset classes in U.S. and Europe.

In Europe, expectations of growth reflect ongoing structural change in European financial services, namely the reduction in banks' balance sheets through ongoing NPL sales and securitisations and the rise of non-bank lenders.

The EU Securitisation Regulation has applied since the beginning of 2019. Our survey respondents said that complexity of compliance was at the top of their list of concerns. It will be interesting to see if this theme continues into 2020.

In the U.S., despite multiple headwinds, there is a general expectation of growth, particularly in RMBS and consumer ABS, albeit, with pockets of risk in assets classes with untested underwriting models. Interestingly, there is strong evidence of a growing appetite for esoteric assets, such as whole business and aircraft ABS.

We hope that you enjoy reading this year's survey and that it provides you with some insights as you develop strategies to navigate the market.

Survey methodology

This research report is based on a market survey conducted by GlobalCapital from April 1 to May 31, 2019. A total of 162 responses were collected across 21 countries and respondents answered a tailored set of 14 market-led questions. Respondents spanned 26 different functions including capital markets, treasury/funding, origination, investor relations and many others. The respondent demographics included five core stakeholder types: issuer/sponsor (29%), service providers, investors, underwriters/arrangers/bookrunners/structurers (52%) and other (19%).

THE STATE OF SECURITIZATION

A Confident Market Despite Credit Cycle Questions

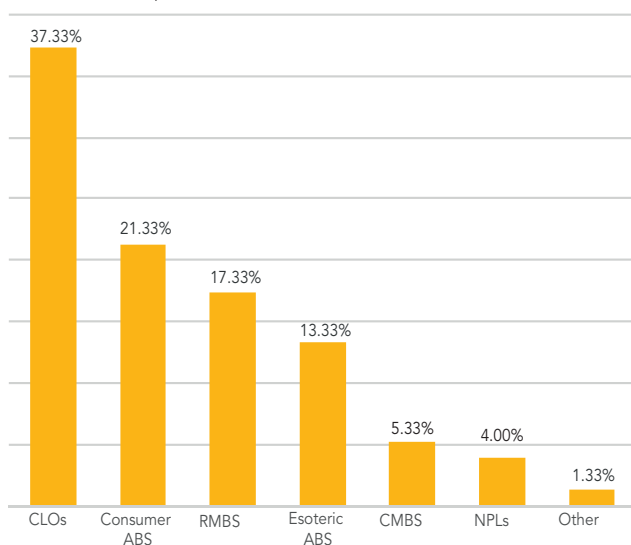
In a tumultuous and unpredictable economy, securitization is an increasingly important source of funding for businesses, consumer lenders, and commercial assets. It funds auto loans, home mortgages, small business loans, student debt, and commercial property, to name only a handful of assets in the structured finance ecosystem.

To better understand this fast-moving market we produced the first annual Securitization Pulse Report. The report analyzes the opinions of more than 150 global market participants on their outlooks across various asset classes and regions.

The results paint a picture of a market on the move and generally upbeat about the direction of most asset classes. Participants from across the industry gave their views on every securitization subsector, from CLOs, to MBS to NPLs, giving their thoughts on where they see pockets of opportunities and risks, liquidity in the markets, and the prospects for issuance growth and price appreciation across asset classes.

The prospects for CLOs, ABS, and RMBS in the U.S., and nonbank lending in the U.K. and Europe are bright, even as most agree that the economic cycle is moving into the final stages. At a high level, survey participants indicate that CLOs present the greatest relative value by far in the near term. This was confirmed by data from the survey and in-depth interviews with CLO market participants, who added that central bank easing of interest rates, and the subsequent

What asset class provides the best relative value in the next one to three years?

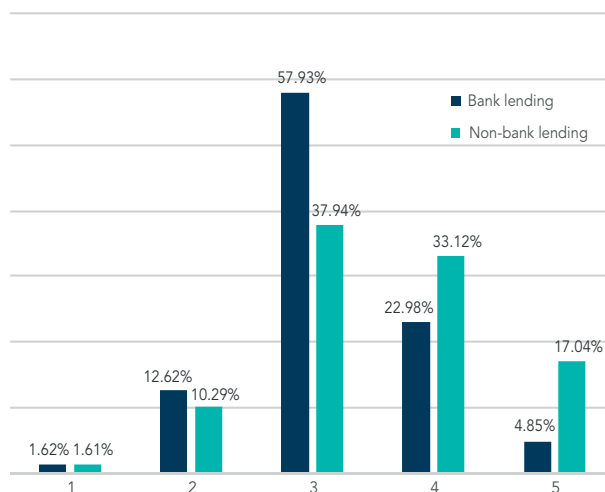


shift away from floating rate products, could present buying opportunities for both CLO bonds themselves and the underlying leveraged loans.

CMBS was at the other end of the spectrum, in that survey respondents, as well as players active in the space separately interviewed, indicated that they are taking a more defensive stance on the asset class as the credit cycle ages.

The story in Europe has largely been focused on the NPL sector, which has been seeing increased securitization

Global expectations for bank and non-bank lending on a scale of 1 (bearish) to 5 (bullish)



volume as banks look to shed these assets and de-recognize them from their balance sheets. A large portion of NPL securitizations are likely to come from private equity funds that acquired portfolios and are now looking to exit via the capital markets. The alternative lending sector is also on the rise, as banks shift away from many of their traditional consumer banking roles and non-banks step in to fill the void, aided by algorithmic underwriting and increased use of a wider range of data points to assess borrower creditworthiness.

Given the changes on the horizon for these sectors globally, the responses are perhaps unsurprising. The securitization market in the U.S. has been on a tear over the past five years, and any uncertainty is borne of macroeconomic and policy headwinds, rather than fundamental issues with collateral or structures. In Europe, the market has also come a long way from the the financial crisis. While market participants in the U.K. and on the continent are hopeful for renewed momentum, the continued belief is that there are still significant regulatory hurdles to overcome—primarily clarifications around the EU Securitisation Regulation that went into effect on January 1, 2019—if securitization is to grow into a long-term funding tool for the real economy.

THE U.S. SECURITIZATION MARKET

Securitization in the U.S. is approaching a decade of post-crisis expansion. Even as some markets, like private label RMBS, are still a fraction of their pre-crisis volume, the market as a whole has largely been rebuilt. Securitized products today are looked at by investors as strong, higher yielding alternatives to corporate debt in many cases, and even as fixed income investors look far and wide for yield, pockets of opportunity in ABS remain.

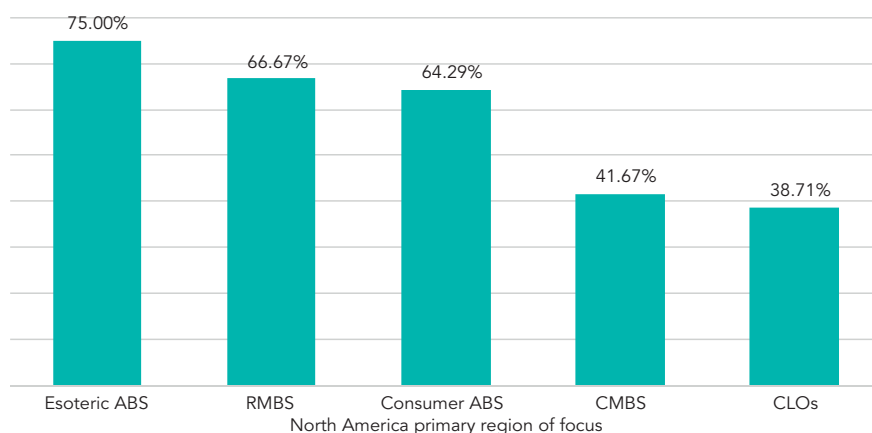
That does not mean, however, that investors act without caution. Survey respondents and market participants that were interviewed were quick to point out that the credit cycle is likely in its final stretch, and preparing for a downturn means shifting focus, in many cases away from subordinated debt tranches and long duration bonds, and into higher rated and shorter dated paper.

The outlook for U.S. commercial and consumer ABS markets

The U.S. economy has enjoyed the longest period of economic expansion in its history. But beneath the veneer of strong labor market conditions and upbeat consumer fundamentals, there is a growing uncertainty among ABS market participants, namely around trade wars and a slowdown of economic expansion globally.

The two macro factors have emerged as key themes that drove the bulk of conversation among ABS market participants in the first half of 2019. The market at the end of July was tuned into the Federal Reserve as it announced a 25bp cut to the federal funds rate. Most investors

Percent of respondents projecting increased U.S. securitization issuance by asset class in the next 12 months



had anticipated this, but with Fed Chair Jerome Powell suggesting that this would not be the beginning of a greater easing cycle, there is still some fog around the direction of rates for the remainder of 2019.

“It seems more and more like what is driving the Fed is less necessarily growth or inflation, and more trade uncertainties,” says Philip Armstrong, portfolio manager at Invesco. The Fed’s willingness to cut rates in the near term, if need be, could potentially extend the economic expansion for another one to three years, according to Clayton Triick, portfolio manager at Angel Oak.

“It really is about the curve,” says Jennifer Thomas, portfolio manager at Loomis Sayles. “Demand is very much in the short, yield-ier stuff, the double-Bs and one-year products.” On the other hand, longer duration, benchmark, higher quality bonds have been softening. Prime auto and credit cards, for example, have suffered the most in terms of spread widening, given where they are at the bottom of the yield curve, said John McElravey, analyst at Wells Fargo.

Survey respondents cited an economic recession as their top concern for consumer ABS

asset classes, while ABS players interviewed also cited consumer finance regulation, such as true lender cases similar to Madden vs. Midland, to be a risk in the sector. Still, 40% of respondents said that they would increase allocations to consumer ABS in the coming 12 months, while roughly 55% said they would maintain current levels. For the time being, investors can afford to be less discerning when choosing which issuers to invest with, but the flight to higher quality sponsors will intensify as recession fears grow.

“More familiar issuers are getting premium in the market. You’ll definitely see that exacerbated in a downturning market,” says Tom Rutledge, senior strategist on Magnetar’s alternative credit and fixed income team.

“People will continue to reach for yield by a few basis points by investing in names the world doesn’t know quite as well, but in a downturn, people will go with familiar issuers.” After lagging 2018 levels for much of the year, issuers rushed to market with a dozen deals in the week of September 16. The wave of new deals pushed year-to-date issuance past last year’s volume for the same period, to \$187.5B, compared to \$182.4B.

“So far issuance is on par, but if I’m an issuer and I see these yields and have been holding back in terms of going to the securitization market, I would come to market now,” said Paul Norris, managing director and head of structured products at Conning. “I would expect issuance to ramp up, seeing the tighter spreads and the yield.”

Opportunities in the market

Performance outlook varies by asset class, but consumer debt is expected to outperform commercial ABS in general due to escalating trade disputes and lower GDP growth. Meanwhile, as investors continue to reach for yield and securitization provides cheaper funding than high yield, esoteric sectors like whole business and aircraft leases have popped up in the market more frequently, driving issuance volume for the ‘other’ ABS category.

“Whole business ABS had a very good run,” said Armstrong, of Invesco. “I think in this sort of hunt for shorter duration as lower rates persisted, whole business securitization is one area where you see a lot of transacting occurring. I’d tend to agree it is the most liquid of esoterics. As a result, a lot more folks come into the market, pushing prices.” Aircraft ABS has also seen a surge in issuance, as more low-cost airlines enter the space with global air traffic on the rise, particularly in Asia.

“Demand for aircraft and pilots is going through the roof, and I think that will continue, so the fundamentals are very good for the space,” says John Kerschner, head of structured products at Janus Henderson. “Yet the bonds are still relatively cheap because the sector is still relatively new so we do like that space.” Approximately 66% of respondents in the survey said that they plan to modestly or substantially increase allocations to esoteric ABS asset classes in the next 12 months. Over 30% of respondents said they expect esoteric ABS bond valuations to increase over the same period, while around 44% said they expect prices to remain flat.

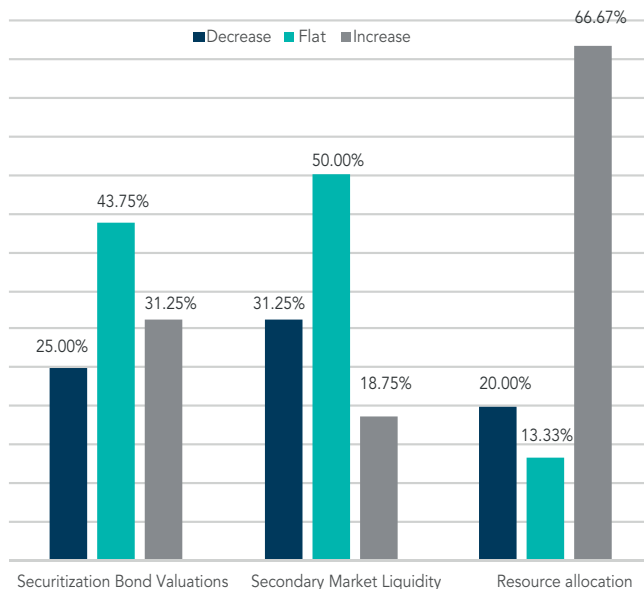
“I don’t think there’s anything on the horizon that could seriously derail [the economy]...”

Two-thirds of respondents said that they expect liquidity among esoteric ABS subsectors to remain flat or increase in the coming 12 months.

Pockets of risk

On the other hand, unsecured consumer loans, including credit card ABS, are being watched closely by investors.

Investor expectation for esoteric bond valuations, secondary market liquidity, and resource allocation



“Marketplace lending is one place where, when the bottom does fall off, it will be one of the first places to experience widening.”

“I don’t think there’s anything on the horizon that could seriously derail [the economy], but I would say if there is some volatility and we see uncertainty, more pure, unsecured consumer like credit cards, will potentially underperform,” says Rutledge.

Marketplace lending is also somewhat of a wildcard in the unsecured consumer space, and its performance in a downturn will largely depend on the underwriting standards of originators, most of which were formed in the post-crisis years. There are also relative value concerns; some believe personal loans are overvalued and vulnerable to losses when the market turns.

“Marketplace lending is one place where, when the bottom does fall off, it will be one of the first places to experience widening,” says Armstrong.

Investors cited the student loan ABS market as a sector they are “less inclined to invest”. With the 2020 U.S. election season approaching, numerous headlines have surfaced about the future of U.S. student loan debt.

Commercial ABS sectors like container and rail are “flashing mixed signals” following tariff disputes, according to BAML research. The sector’s performance may become increasingly issuer-dependent as trade war talks continue.

The U.S. CLO market outlook

The later stages of the credit cycle have caused CLO market participants to become quite anxious. Though the market is mixed on how much time remains in the current economic run, there is a consensus that it is in the final stretch. The Federal Reserve could help put some wind back in the sails of financial markets by cutting rates—the market is pricing in 100bp of easing over the next 12 months—but this would certainly dent demand for floating rate products.

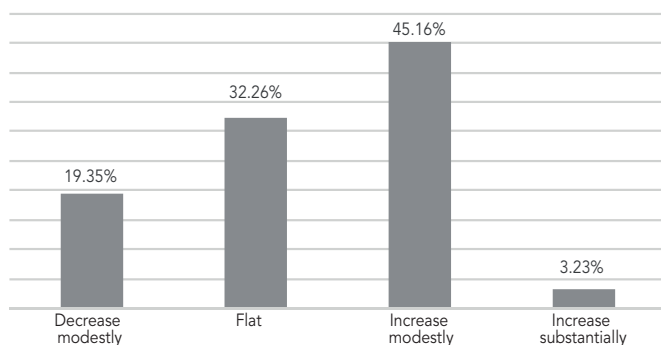
This has already played out in leveraged loan markets. The end of the second quarter marked 30 consecutive weeks of leveraged loan outflows. Issuance of leveraged loans through the end of May, meanwhile, was down 68% compared to the same period in 2018. That said, a selloff can be a feeding frenzy for CLOs, which on average, constitute 50% of the leveraged loan buyer base at any given time. In the first six months of the year, that number has been closer to 65%, according to JP Morgan analysts, though it is expected to level off to around 53% by the end of 2019.

Unlike most other asset classes, survey respondents did not consider economic recession to be at the top of the list of concerns for CLO players. Rather, respondents listed credit quality and underwriting as the biggest challenge in the next 12 months, followed by asset fundamentals, with the possibility of a recession in third place.

This is roughly in line with the market sentiment over the past 18-24 months, as covenant-lite loans proliferate and creditor protections deteriorate. CLO managers and investors say that a particularly offensive covenant allows borrowers to put collateral, such as intellectual property or real estate, into separate ring-fenced entities out of the reach of creditors. Market players frequently cite clothing retailer J.Crew as the most high profile example of the practice, though they concede that it is still relatively uncommon.

Investors and managers say they are still bullish on the asset class generally, and that it is expected to continue a long bull

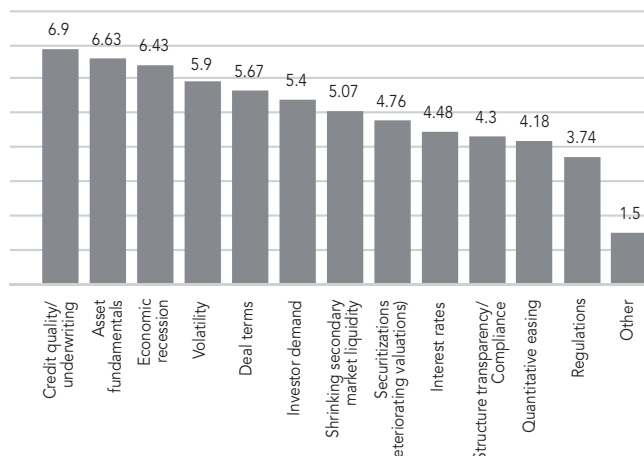
Expectations of CLO market participants for resource allocations in the next 12 months



run that commenced in 2014, when the market set a postcrisis record for issuance at \$124B. The record was surpassed last year, when managers sold over \$125B of the bonds.

As of the last week of June 2019, \$60B of new CLOs have been priced, and manager and investors expect at least \$120B to be issued this year. About 55% of respondents in the survey expect CLO issuance to increase over the next 12 months.

Concerns of CLO market participants on a scale of 1 (not at all challenging) to 10 (most challenging):



Despite a crowded marketplace, first-time managers are still looking to crack into the CLO sector. As of this writing, four new names have come to market in 2019, compared to six first-timers in all of 2018.

From an investor standpoint, buyers say that they still see good value at the top of the CLO capital stack, especially as large anchor buyers from Japan appear to have pulled back somewhat in the second quarter of the year, causing a slight widening in spreads. As of late June, the senior bonds of CLOs issued by top-tier managers are pricing in the 135bp area, compared to around 120bp at the start of the year.

Approximately 48% of survey respondents said that their institutions will increase allocations to CLOs in the next 12 months, while around 32% said they remain flat, and less than 20% stated that they would modestly decrease allocations to the sector. Players on both the buy and sell side have been firm in their assessment that the CLO market's performance in the last crisis—losses on the senior bonds during the crisis were close to zero—prove that the bonds are well protected in the event of a downturn. Managers, arrangers, and some investors have complained bitterly about the media's portrayal of the asset class as a crisis-era instrument capable of wreaking widespread havoc on financial markets.

Investors add, however, that they are vigilant when it comes to assessing strengths of individual managers. Price tiering continues to be a big theme in the market in 2019, with about 10bp of spread between first and second tier issuers.

The outlook for U.S. commercial and residential MBS

Commercial MBS

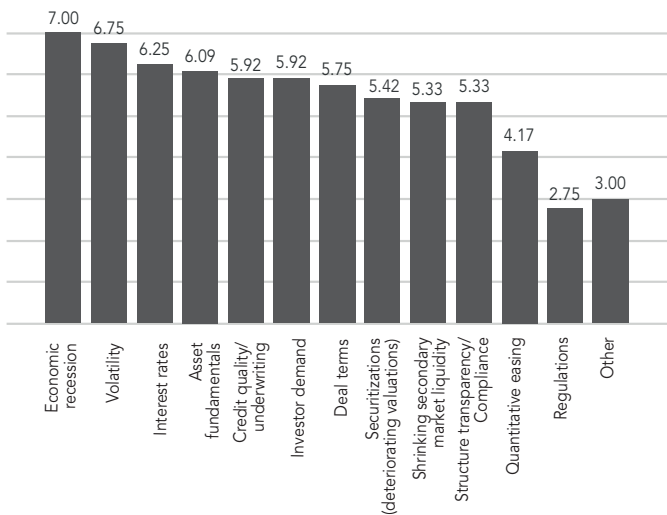
Commercial mortgage backed securities (CMBS) as a source of commercial real estate debt capital has been on the defensive for the past two years, ever since the wave of 2007 maturities rolled out in 2017.

The market since that time has become more heavily segmented, with conduit issuance making up a much smaller share of the overall CMBS pie.

Market participants say that, in general, they do not expect conduit CMBS to retrace lost issuance volumes, and that the rising share of single asset-single borrower and commercial real estate CLO issuance is a trend that is here to stay.

It's not surprising that 60% of respondents said that they expect issuance of CMBS in next 12 months to be either flat or to decrease.

Concerns of CMBS market participants on a scale of 1 (not at all challenging) to 10 (most challenging):



In the conduit segment, the drop in issuance since 2017 has been driven primarily by heightened competition among commercial real estate lenders, particularly balance sheet lenders like insurance companies, as well as a growing number of debt funds. Conduit CMBS issuance has declined by 15% since 2017, according to JP Morgan researchers.

With regards to liquidity, an even higher percentage of survey respondents—over 80%—said that they expect liquidity of CMBS paper in the next 12 months to decrease or remain flat to current levels.



Investors say that the corresponding drop in liquidity is indeed tied to lower issuance volume, but they also specifically focus on the decline in average deal size of conduit CMBS transactions that has been observed since the end of 2016. Smaller deals have meant fewer investors making markets in the bonds.

However, the decline in conduit issuance has been accompanied by a rise in single asset-single borrower volume and a surge in demand for floating rate paper in the form of commercial real estate CLOs. This, too, is set to change, though. With the Federal Reserve widely expected to cut rates twice in 2019, investors are less engaged with floating rate assets across fixed income sectors.

As one securitization analyst puts it, “floating rate products have been completely annihilated”, a development that has been almost exclusively influenced by the new direction of the Fed.

Investors are broadly cautious on the CMBS sector as the economic cycle moves into late stages. Head of Securitized Products at Janus Henderson, John Kerschner, says that the investment manager has been stepping back from the asset class. “In general, we’ve been paring back on CMBS. Some areas like cold storage or warehouse deals still look pretty good, but most of CMBS isn’t looking great to us,” referring to recently issued single borrower deals that have been backed by storage and warehouse properties.

Other buysiders have similar thoughts on the asset class, citing broad weakness in the retail sector as a leading factor in their outlook.

Residential MBS

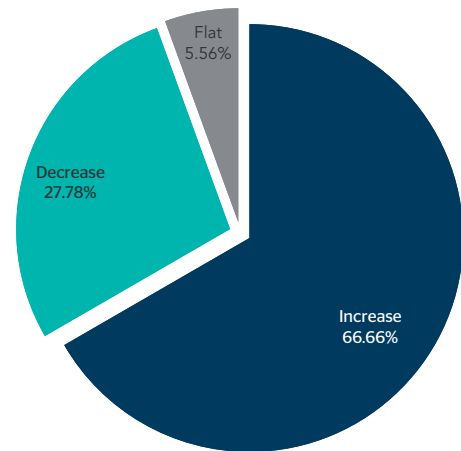
In residential mortgage backed securities (RMBS), the outlook is fairly strong across the sector. Though a fraction of its pre-crisis size, private label RMBS now comprises a range of deal types that have found a niche with investors of varying risk appetites.

The survey data shows that the majority of respondents—approximately 65%—think that issuance of RMBS will increase in the next 12 months. This would be in line with the past three years, which have all seen issuance increase across private label segments.

As of June, roughly \$9.5B of non-qualified mortgage deals have been issued by 16 different issuers, compared to \$11B from 16 issuers in all of 2018. According to Lauren Hedvat, managing director at Angel Oak Capital, volumes in that corner of the RMBS market are expected to roughly double this year.

“Angel Oak generally feels that with the increased number of issuers in 2019, the market gains greater awareness

Expectations for U.S. RMBS issuance in the next 12 months



about the asset class and products. Generally, increased frequency of issuance and volume helps build liquidity,” says Hedvat. Issuance, liquidity, and performance projections are being boosted by the relatively healthy consumer credit picture. Consumer debt has increased only modestly, compared to corporate debt, which has increased by 120% since the financial crisis. Residential mortgage debt has gone up by only about 3% in that timeframe.

“The fundamentals for the consumer sector appear strong with household balance sheets having decreased leverage since the crisis due to both lower credit card debt and less mortgage debt outstanding,” says Hedvat. “The combination of better discipline in consumer credit underwriting along with the lower household debt as a percentage of GDP positions consumers well for a downturn environment.” Over 50% of respondents surveyed expect RMBS bond valuations to increase over the next 12 months.

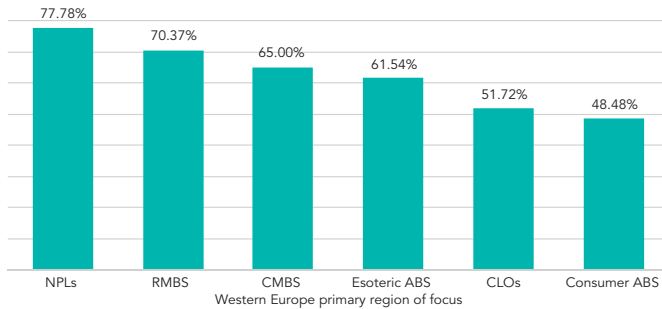
“Mortgage credit looks very solid,” says Kerschner. “Home price appreciation looks to be coming down a bit but no one is calling it to go negative. The mortgage space still seems like a pretty good place to hang out to us.” With Fed easing on the horizon, prepayment speeds will be closely watched, though observers say that the 10-year Treasury may not have much room to drop further, hovering around 2% as of the end of June, though it dipped beneath that threshold, to 1.97%, briefly earlier in the month.



THE EUROPEAN SECURITIZATION MARKET

While a general bullishness across securitized products characterizes the narrative in the U.S., there is less of a unifying theme in Europe. ABS, RMBS, and CLO sectors look similar to their U.S. counterparts, but Europe diverges in a few important areas, namely in the alternative lending sector and in the securitization of NPLs.

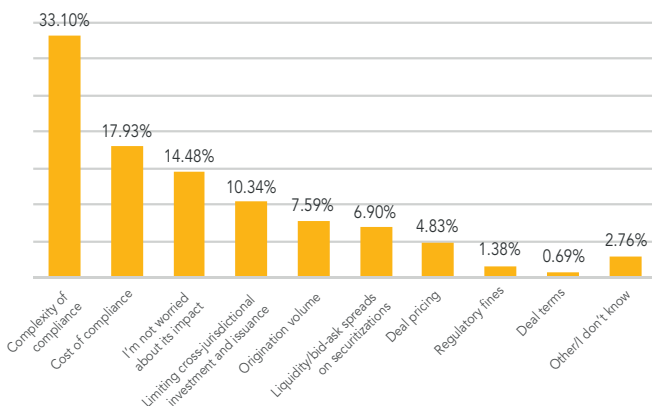
Percent of respondents projecting increased European securitization issuance by asset class in the next 12 months



In Europe, the new Securitisation Regulation, which has been touted as the way forward for the market nearly a decade since the crisis tarnished the reputation of securitized products, proved a challenge for issuers. The 'regulatory and technical standard' (RTS) template on data disclosure was released on October 16, and clarified what information issuers must provide. The template is now with the European Council and Parliament and is set to become law in February 2020. Homogeneity templates are still outstanding, though STS deals issued in the fall suggested that RMBS portfolios with mixed buy-to-let and owner-occupied collateral are STS-eligible, contrary to early market feedback.

When asked about the biggest regulatory concern, participants surveyed said that complexity of compliance was at the top of their list, followed by costs associated with compliance (see chart). In terms of impact, participants in the survey said that they were mostly unsure of how the new regulation would affect their businesses, with the bulk of responses neutral for now, followed by slightly negative, with less than 10% answering that they think the new regime would be a positive development for their firms.

What is your biggest concern regarding the Securitisation Regulation



The outlook for European non-bank, specialist, and alternative lenders

Non-bank and specialist lending has grown to take up a sizeable portion of the European loan market ever since new regulations and capital requirements were imposed on the banking sector following the global financial crisis.

Integer Advisors estimates that the size of the alternative lending market is around £100B (€127.4B) in terms of outstanding stock in the U.K., or around 6-7% of the total loan market.

These lenders often lack the means to easily raise funds available to banks, such as deposit funding, and are turning to securitization to compete with larger institutions.

“[Securitization] is the life blood of a number of these businesses. If we look at that market, there have been times in the past where non-bank lenders have struggled to find warehouse financing,” says Arun Sharma, product and proposition delivery partner at Shawbrook Bank. “Today is not one of those times.”

“Securitization is non-recourse,” adds Alex Maddox, capital markets and product development director at Kensington Mortgages, a U.K. non-bank mortgage lender. “That is the key source of funding, so if the investors want their money back they either wait for the bonds to redeem or sell them in the market—there is no obligation for the sponsor to pay them back.”

Compared with 10 years ago, there is a much more diverse group of issuers active in the market, and in the U.K., a large number of the top 10, pre-crisis originators either no longer exist or have significantly downsized. Meanwhile, the rise of fintech has meant that small firms are able to originate loans and deliver financial products at a rate with which high-street banks simply can’t compete.



“For about €10M, you are talking four to eight months [for] a bank to have that executed,” says Oliver Fochler, managing partner and CEO of Stone Mountain Capital. “I think on our side in the alternative fund industry, we can execute from first contact, full due diligence, deal executed in one-and-a-half to two months.”

Data need

A lack of historical data has been highlighted as a key hurdle and an issue that market participants will need to pay close attention to as the cycle progresses.

“Historic data is obviously something which needs to be kept and managed to make sure it is available by the time you do a full-term securitization,” says Reinald de Monchy, managing director of wholesale solutions at the British Business Bank, which provides smaller warehouse facilities to smaller asset finance providers and peer-to-peer lenders.

Respondents in the alternative lending space said they are most bullish on consumer assets and mortgages over the next 12 months. Indeed, alternative and non-bank mortgage lending has accelerated in 2018 and 2019, while marketplace loan securitizations have become more frequent, albeit still far behind what has been seen in the U.S.

“The fact that these institutions are able to complete transactions means that liquidity is available to them, meaning they have the firepower to grow origination volumes.”

In Europe, French online lender Younited sold a €156M deal in April. Though it has been the only non-U.K. deal to date, speakers at the Global ABS conference in June said that they expected an uptick in issuance of online loan ABS on the continent in the next year.



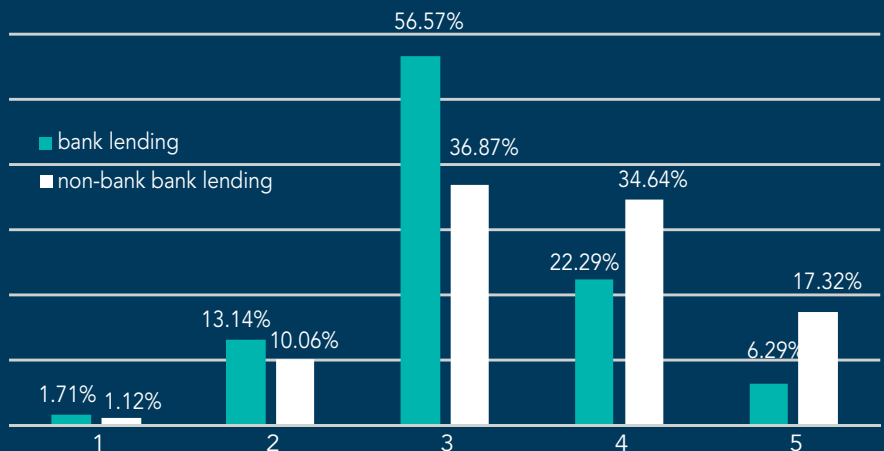
More than 50% of participants were bullish on non-bank lending, responding with a 4 or 5 on a 1 (bearish) to 5 (bullish) scale. This percentage jumps to approx 60% among the investor cohort. Only about 5% answered with a 1, with the remainder responding that they were neutral on the sector.

With regards to SMEs, however, some issuers advise caution.

“Historic data is obviously something which needs to be kept and managed to make sure it is available by the time you do a full-term securitization.”

“When we move into our area, SMEs, and actually middle market, I think you should not automate the underwriting process,” says Fochler. Being able to monitor the management accounts of the company is stressed

Expectations for bank and non-bank lending in Western Europe on a scale of 1 (bearish) to 5 (bullish)



as a relationship which can only be developed on a face-to-face basis.

For the U.K., a window of issuance is predicted to drive volumes before the Brexit deadline.

“The fact that these institutions are able to complete transactions means that liquidity is available to them, meaning they have the firepower to grow origination volumes,” says Matt Blake, director of treasury at Together Money.

But as competition among lenders increases, so does risk, as lenders move down in credit quality to grow origination volumes, adds Blake. This may deliver acceptable shareholder returns in a benign environment, however with growing political uncertainty, he suggests that now is the time for heightened prudence. “We will not entertain a race to the bottom,” says Blake. “Lenders who are primarily focused on origination growth may entertain such a race, but that does not work for our business model.”



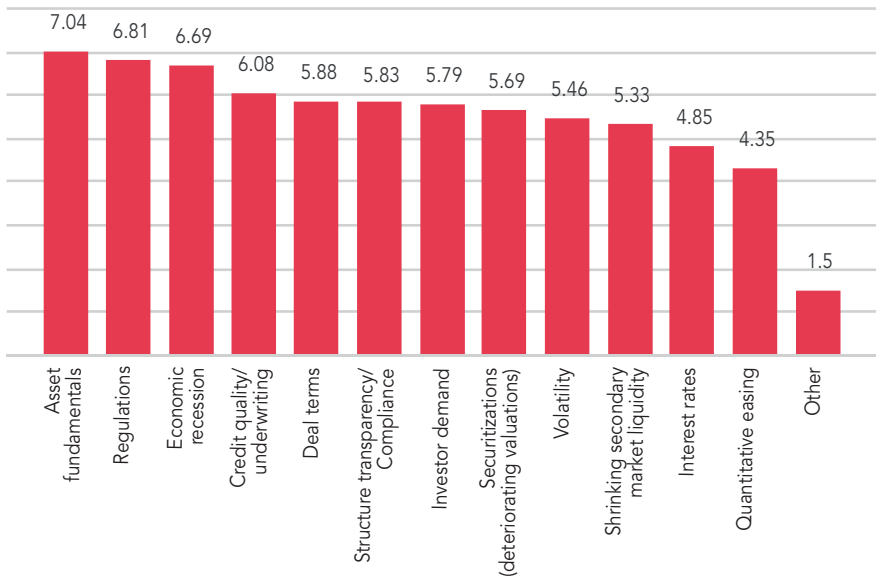
The outlook for European non-performing loans

The securitization of non-performing loans is expected to accelerate in the next 12 months. The assets are a drain on the financial health of the institutions that hold them, while high volumes of non-performing loans (NPLs) weigh on investor confidence in banks, especially in southern European countries.

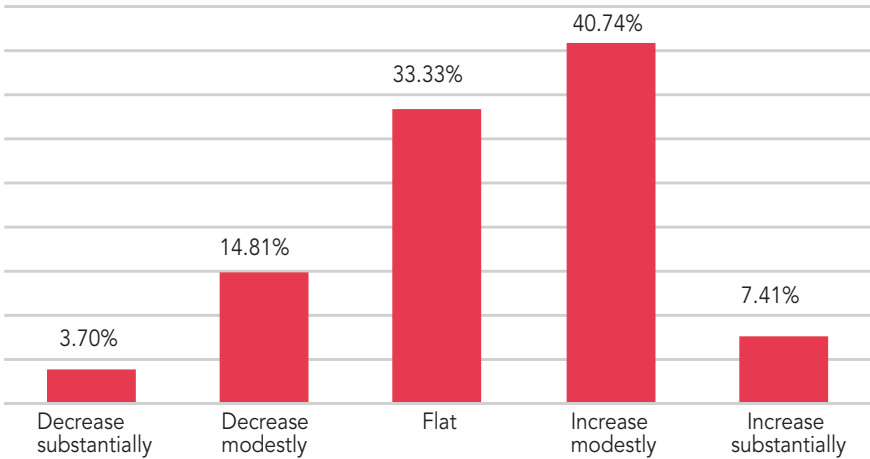
Despite this, banks are often not well incentivized to work out NPLs in a timely and efficient way on their own. A sale of these portfolios, therefore, has been recognised as the best route forward for institutions with large holdings of soured loans.

“Banks are not always the most efficient in dealing with NPLs, and it’s really to do with having the right incentives,” says Stephan Plagemann, CEO of Mount Street Portfolio Advisors. “As a bank, you are in a regulated environment, and that environment does not always give you the right incentives to do what is economically the best in terms of recovery. Banks are often not very strict or aggressive when it comes to enforcing with clients, because

Challenges for European NPLs on a scale of 1 (not at all challenging) to 10 (most challenging):



Expectation for European NPL securitization bond valuations in the next 12 months



obviously there are a lot of things to consider in terms of the relationships.”

“Securitization can complement NPL sales,” adds Udit Samghi, director of Europe ABS at Deutsche Bank. “The biggest benefit of securitization structure is that it expands the universe of distressed debt investors.” More than €200B of NPL sales were generated in 2018 alone. Gross volume of NPL stock is about €650B across Europe, with distribution skewed towards Southern Europe.

According to the survey, nearly 75% of respondents said that they expect issuance of securitizations backed by NPLs to increase over the next 12

months, the highest across all asset classes.

With pressure from regulators, banks will continue to shed their NPL holdings, though regulatory incentives driven by central banks often comes into conflict with legislation proposed by fringe political parties, as has been seen recently in Ireland.

The far left Sinn Féin party has proposed a bill dubbed “No Consent, No Sale” that would stop all sale of NPLs to third parties. The move would have all but ended the NPL securitization market in Ireland, but there was quick pushback from the Central Bank of Ireland to ensure the market stayed up and running. The bill is technically still alive, and the episode is a reminder that NPLs are among the most politicized asset classes in the securitization universe.

Regulation of the NPL sector was cited as a top concern among survey respondents, along with asset fundamentals and possibility of a recession. Meanwhile, many recently issued portfolios have been cemented into re-performing deals, a subasset class which is being explored both in Spain and in Italy. Non-banks have also been financing such deals, and more secondary trades are expected.

Private equity has played a pivotal role in the development of the asset class in recent years, whereas 2019 has seen more funds entering the NPL space, particularly in the Spanish market.

Italian success

Italy is often cited as the biggest success story for NPLs, and has been one of the most advanced jurisdictions in terms of exploring NPL technology, the most obvious example being the GACS government guarantee scheme. Since 2016, Italian banks have whittled down their NPL ratios from 16% to 9%.

Continuing the evolution of the asset class, unlikely to pay (UTP) NPLs are at the forefront of discussions around next steps for the market. Thus far, Italy is the only country to have servicers with sufficient experience to be able to identify and properly service the sub-asset class. The servicing market is expected to further evolve, as research firm KPRM reports a sharp rise in the price of listed servicers, noting that the sector is seeing more competition.

In the latest renewal of the GACS programme, an initiative started by the Italian state to encourage the securitization of NPLs, the Italian government did not include a provision for UTPs, defying widespread market expectation. Since the programme was renewed, though, the government has made amendments aiming to facilitate further UTP development. These amendments were put in place on May 1.


Italian banks, as a result, are able to continue decreasing their stock of nonperforming exposures.

According to a Moody's report released in May, the amendments are also credit positive for securitizations backed by loans to small and medium-sized enterprises. In the survey of the market, nearly 50% of respondents said that they expect to increase allocations to NPL securitizations in the coming 12 months, compared to less than 10% who said they would decrease allocations.

Disappointingly, there has been little talk in the market about a provision under the 'Simple, Transparent and Standardised' (STS) regulatory framework being included for NPLs, and any such discussions are likely to take place in 2020 at the earliest.





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