18 June 2013 - 20 June 2013

Summary Notes from the IMN Global ABS Conference, Brussels, Europe

1. Introduction and Summary

The theme of the 2013 IMN Global ABS Conference ("Conference") "*Delivering Funding for Growth with Stability*" was appropriate given recent statements by the European Central Bank ("ECB"), national central banks and politicians ("policy makers") that securitisation could be a valuable tool to facilitate funding of inter alia SMEs to generate economic growth in the European Union ("EU"), which is so desperately needed.

The Conference was attended by about 2,800 delegates (slightly up from 2012) and had just under 100 sponsors (PWC Inc. was main sponsor) from across the EU and the United States of America ("USA"). Four separate tracks ran concurrently, except for when there was a keynote address or plenary session (54 sessions in total were held). The keynote addresses were presented by Ms Sharon Bowles (MEP and Chair of the European Parliament's Economic and Monetary Affairs Committee), Mr James B Lockhart III (Former Director of the Federal Housing Finance Agency) and Mr Emil Paulis (Director European Commission's Directorate-General for the Internal Market and Services).

In addition to the normal sessions dealing with an overview and outlook for the mainstream securitisation asset classes, the Conference also explored other topics such as the potential for renewable energy and project finance type securitisations. These sessions were of great personal interest following the recent financial closure in South Africa of a large number of renewable energy projects, with more to come in the foreseeable future.

A large part of the debate that took place related to the "conflict" between policymakers disproportionately "penalising" and regulating securitisation based on past problems rather than looking at securitisation as one of the potential ways to solve the region's economic and funding challenges. The discrepancy between the level of capital that securitisation attracted vs. holding the same exposure on bank and/or insurance company balance sheets or via a covered bond, was indicative hereof.

Securitisation industry ("industry") participants were mostly *ad idem* that the form and impact of existing, draft and potential regulations in the EU ("EU Regulations") were currently the number one challenge facing the industry. It was also generally agreed that the industry is likely to have a good year measured until the 2014 IMN Global ABS Conference (to be held in Barcelona) if the impact and unintended consequences of existing regulations could first be bedded down and assessed, before adding any more.

Related inconsistency between the EU and USA created uncertainty and adverse arbitrage scenarios. The encouraging message from the EU policymakers, viewed as cautious optimistic by the industry, was the "tone" in which the industry was being requested to proactively engage with policymakers to find best balanced solutions, rather

than only criticising from the side-lines. Policymakers were steadfast that their objectives aimed at stamping out reckless underwriting practises, risk retention and transparency would not be compromised. Policymakers also touched on the professional responsibility of industries linked to financial services, such as law and accountancy.

Attending the Conference, again made me realise the differing dynamics of the global securitisation village (especially between the EU and the one side and the USA on the other) we are all part of. It was also clear to me that the standard of the South African securitisation participants, are on par with any of their EU and USA based counterparts, a status quo we can also be proud off. Let us continue to be at the forefront of developing our industry, seeking to implement innovative debt capital market funding solutions in Africa - the growing continent. More importantly though, let us ensure that there is proactive, informative communication with all interested role players alike, especially the policymakers, on the value that securitisation can add to the real economy. There is no doubt that a robust regulatory landscape is required to protect and monitor all the interests of all participants.

Given the size of our South African and the African debt capital markets against those of the EU and USA, we can take pride in the over 600 delegates that attended the 2013 IMN African DCM Conference that took place in Cape Town during November 2012. We look forward to an even bigger, successful and more topical relevant African related event end October 2013 in Cape Town, South Africa.

2. Securitisation Related Regulations and Impact

The Conference took place against the backdrop of a large number of EU regulations as referred to above. These regulatory developments are important, as most of them ultimately find their way into the South African environment in one form or another.

Indicative of the extent, relevance and importance of the potential impact thereof, was that the agenda of the Conference featured no less than 11 stand-alone regulatory topics and discussions (in addition to the keynote addresses) covering the following:

a) Understanding the new Basel Capital approaches: the “black boxes” of regulatory determination

   During this session, the shortcomings of the Simplified Supervisory Formula Approach (“MSFA”), the Simplified Supervisory Formula Approach (“SSFA”) and the Revised Rating Based Approach (“RRBA”) and their impact on the capital levels that the various investors in securitisation had to hold, were discussed. The need for a simpler alternative had pre-empted the development by industry participants of the Arbitrage-Free Approach (“AFA”), a model that still needed to be discussed in more detail with policymakers. One of the main aims of the AFA is to achieve equal capital treatment for all investments with the same risk profile, which is currently skewed against securitisation.

b) ABS regulations 101: what investors need to know

Not able to attend.

c) Assessing the effectiveness of global regulations

On a question whether regulations on the two sides of the Atlantic needed to be harmonised to create level playing fields, the view was expressed that immediately after the credit crisis the answer would definitely have been “yes”. More recently, however, the answer was not that clear anymore.

Speakers were in agreement though that it would have been most sensible to have agreed a framework (on two sides of a floor rather than two sides of the sea) which set minimum standards without being too specific, and for policymakers thereafter to apply these standards in a way that best fits their respective jurisdictions. Regulations, however, were contaminated when local politics came into play.

d) New Basel RWA proposals for ABS: solving for the last crisis, not the next one?

A number of speakers and delegates described the proposals as “regulating in the past”, given that the securitisation industry had, in most instances, taken the initiative to reinvent itself. It was felt that policy makers were not doing the same with regards to the balance sheet treatment if the same securitised assets were still on the books of the originators and the investors.

The general view was that bad assets were located in the USA, the “overreaction” however occurred in Europe. The new Basel proposals have been a lot more punitive on securitisation than new regulations introduced in the USA a year before.

Locally, the trend has been for the South African Reserve Bank (“SARB”) in some cases to “jump the gun” in the implementation of new Basel requirements. The new Basel securitisation proposals published in draft form during 2012 were discussed and commented on by a Banking Association Workgroup. Further update publications are awaited.

e) Solvency II

Investors generally commented that Solvency II was skewed against securitisation and that if the regulations were implemented in their current format (to inter alia hold capital against market volatility), it did not make economic sense for them to invest in securitisation, *inter alia*, due to the “cliff effect”.

It was mooted than only bigger investors would be able to incur the costs required to build and run sophisticated models, which would remove a large number of the smaller type investors from the potential securitisation investor base.

f) CRD IV and Basel III

In terms of the current EU Capital Requirements Directive ("CRD"), third-party EU regulated credit institutions are restricted from taking a securitisation credit risk exposure unless the originator, sponsor or original lender ("parties"), retain a net economic interest of at least 5%. In addition, CRD imposes increased due diligence requirements on EU regulated investors.

Under CRD IV, planned to apply from 2014, retention of a first loss exposure of at least 5% of every securitised exposure was added as a 5th retention option (thus a vertical slice vs. the other horizontal slices). Certain changes made to the general due diligence requirement suggest that policymakers intend it to apply more widely.

Ms Sharon Bowles, in her key note address, mooted that parties may need to be expanded to include all participants that play a role in setting up a specific transaction. She was very critical of a recent CLO transaction that had come to the fore where an SPV falling outside the scope of the above parties, was set up to originate a specific exposure and sell 100% of the exposure to the investors. This was unacceptable and clearly against the spirit of the legislation. One of policymakers' securitisation "swear" words has been "tranching", and she made it clear that policymakers did not want to see more than three tranches. This was part of simplifying the complexity of securitisation. The EIB was described as a potential successor to the monolines with it wrapping notes, rather than credit-enhancing them by taking mezzanine risk.

g) Swaps and derivative regulation update

Not able to attend.

h) Market transparency: loan level data and disclosure developments

One previous structuring expert turned investor mentioned that market transparency and the issue of loan by loan data had been resolved. The industry was previously at fault to accept any collateral and data, but that industry players and technology had come around. It was felt that the industry had done its part to address the aspects that were previously lacking.

i) CRA regulatory developments

The intention of the latest amendments to the EU Regulations on Credit Rating Agencies ("CRA"), are to address the risk of over-reliance on credit ratings by financial market participants. The amendments are also aimed at reinforcing competition between credit rating agencies, potentially leading to an increase in the number of unsolicited credit ratings. The reforms introduce requirements for the rotation of credit rating agencies for re-securitisations, for structured finance instruments to be rated by at least two rating agencies and new on-going disclosure requirements.

The South African equivalent to the EU Regulations, the Credit Rating Services Act (24 of 2012) (the "Act"), came into effect on 15 April 2013. The Act ensures that South Africa has legislation in place on an "at least" equivalent basis with international regulatory requirements and in line with the G20 requirement of regulated and accountable credit rating agencies at a global level.

The Financial Services Board ("FSB") has been tasked with administering the Act and the supervision of credit rating agencies. With subordinate legislation and the registration of the credit rating agencies still to be finalised, it is only as from 17 December 2013 that no person may perform credit rating services, or issue a credit rating in South Africa unless such a person is a registered credit rating agency in terms of section 5 of the Act.

j) Dodd-Frank Update

Not able to attend.

k) Risk retention rules: an update

A huge discrepancy between the EU and the USA positions were noted, in that the USA currently had little or no risk retention rules, with any potential requirements only to crystallise over the next three years, depending on the asset class.

To date no formal "skin-in-the-game" regulations have been proposed for South Africa. A reason for this could be that there is not an "originate and distribute" model and culture in South Africa. , Originators have normally originated assets with the intention to retain the economic risks and rewards thereof for themselves. Local South African originators have in most cases retained the 1st and 2nd loss tranches which have been in excess of the EU's 5% requirements.

A regular question that came up was how to interpret the perceived "conflicting" messages from policymakers regarding the positive contribution that securitisation could make to revitalise the EU on the one hand against the above regulations being implemented on the other hand. It was conceded that a possible cause was that various divisions within the policymakers were not adequately communicating with each other. This has the potential to cause certain regulations to be written in silos without the required skill and full understanding of possible unintended consequences.

The keynote speakers suggested that what the industry had to do was to focus on educating and assisting the policymakers, as the industry had access to the required specialists and expertise. It would take time and be a process to deal with the policymakers' wariness of the perceived downside and side effects of securitisation following the credit crisis.

Concerns, however, were how much time the industry still had until the securitisation market just "amortised away and died"., How long will it take to reach a compromise and listen enough to enable the industry to do what it wanted and could do, i.e. to fund the

real economy? It was agreed that the potential window of opportunity that might have existed to rebrand securitisation, and other related terms such as "tranching", had passed.

3. Worlds Apart – The Approach in the EU and the USA

An interesting debate took place around whether the EU or the USA had adopted the best approach to deal with the fallout from the credit crisis. Unfortunately this would only be revealed in time, with the benefit of hindsight of course.

One needs to appreciate, however, that the dynamics on the two sides of the Atlantic were very different. One was the size of the real economy vs. the size of the financial sector. In the USA, its real economy was bigger than its financial sector and a significant part of USA mortgage market exposure was already indirectly on the USA Government's balance sheet (via Fanny Mae and Freddie Mac). The contrary was true in the EU and UK, where the financial sector was bigger than the real economy and exposed to the bulk of local as well as some USA mortgage market exposure.

The USA's approach was to write down assets and realise the losses upfront. The USA private sector was involved to fund and "trade out" of the difficulties. To date, the USA's TARP bailout program has not "cost" the USA Government anything, due to the mentioned approach it has realised a "profit". The EU on the other hand chose to ring-fence contaminated assets and set up insurance schemes and "bad banks", thus "delaying" the timing of write downs and losses.

Securitisation was more widely used in the USA than in EU, where covered bonds played a bigger role and had more "corporate history" than the much younger securitisation asset class. USA policy makers thus recognised the importance of securitisation more that their EU counterparts. Covered bonds has a strong German (the EU's leading economy) based legacy and support, where it is a *de facto* investment instrument, whereas securitisation is still sometimes considered more of a boutique than mainstream financing option.

4. Securitisation and Covered Bonds

A comparison between securitisation and covered bonds featured regularly and the question why policy makers were more comfortable with covered bond exposures than with securitisation. Some argued that had covered bonds been more prevalent in the USA, that these would have been tainted in a similar way as securitisation. The severe securitisation losses had been mostly incurred on USA sub-prime exposures, and not on other asset classes. These losses were tail-end and not mainstream.

Promoters of covered bonds have been more protective of what assets could underlie covered bonds, whereas securitisation was willing to accommodate most type of assets. It was mooted by investors that securitisation had not marketed and presented itself as proactively and prudently as covered bonds has done since the credit crisis.

Since 2008 though, the performance of securitisation relative to covered bonds in terms of rating direction has been superior. This has been due to the impact of sovereign and bank downgrades, a trend that could continue. Conference delegates' view was that the two asset classes have been converging in terms of risk retention and transparency.

5. Renewable energy

Twenty year fairly predictable and reliable cash-flows, under-pinned by government feeding tariffs that are index linked, make renewable energy projects, more specifically involving solar plants, an attractive securitisation candidate and investment option for pension and provident funds. Solar related cash flows are fairly seasonal - however, they are less volatile that wind energy related cash-flows.

There is currently around EURO 100bn worth of solar plants operating in Europe and the USA. Germany is the biggest user whilst the USA is relatively small at around 11% thereof.

Green energy is expected to get continuously increasing attention going forward. Evidence thereof, as mentioned above, is the recent financial closure in South Africa of a large number of renewable energy projects, with more expected to come in the foreseeable future.

Renewable solar energy securitisations have typically in Europe been structured as a double SPV structure - with a SPV in the jurisdiction where the solar panels are located and an off-shore based Issuer SPV.

To date, the lack of a proven track record, limited historical information and data for the rating agencies as well as education of a specialised investor base have provided structuring challenges. One of the main questions has related to what the applicable government might do and what the risk was of these governments not sticking to the predetermined arrangements. So far, however, everything relating to the securitised solar projects has transpired as predicted.

The South African banks that have funded the renewable energy projects, view these as good long term assets which they might not want to securitise. The long duration of these assets might, however, cause them to rethink their position, depending on how the new liquidity requirements under Basel 3 ultimately pans out.

6. Outlook

During the Plenary session to recap the major points from the Conference, the speakers were asked what they saw as the number one challenge currently facing the industry, how they would measure a good next year and what they expected the theme for the 2014 Conference to be.

A summary of the speakers' views are set out below:

	Challenges	**Measure**	**Theme**
1	Regulations.	If the impact and unintended consequences of existing regulations could first be bedded down and assessed respectively, before adding any more. No new regulations.	Regulation.
2	Simplification is difficult to achieve.	Simplify regulations and make them functional by thoroughly thinking them through first.	Deregulation.
3	Lack of growth – the pressure to cure securitisation will not be adequate until there is a better understanding of what is required to grow the real economy and a coherent European approach to facilitate same.	Growth.	Financing growth in the real economy.
4	Securitisation is currently a niche funding alternative that needs to become part of the mainstream again.	Not increased volumes or robust pricing, but securitisation gets recognised for its credit robustness and defensiveness.	Regulation.
5	Unlocking investors to return to the securitisation market. Growth comes from having supply and demand which have both been lacking.	Investors returning to the securitisation market.	Securitisation's survival because it is creating value and getting the various pieces to fit properly together.
6	Achieving a balance between securitisation issuance and investors' appetite.	Balanced a more market place between growing investor and issuance bases.	Capital.

With regards to the outlook for securitisation spreads, asset managers noted that spreads had been reducing due to a technical squeeze to replace maturing assets whilst the market was deleveraging. Setting of spreads, however, would normalise when the economy started taking off and once available central bank funding was reduced.

At current spreads, the asset class was still considered to offer value. In the short term, however, rates and spreads could be volatile due to a breakdown in normal market correlations. Currently "bad news" was "good" for markets, as central bank funding would be maintained, and vice versa.

7. Closing

It was a privilege to attend the 2013 IMN Global ABS Conference. I trust the above summary notes will give you a broad indication of the trends currently prevailing in the European securitisation industry.

As you will appreciate, the regulations comprise extensive details where the full interpretation, application and unintended consequences often still need to be determined. I found useful summaries of the various regulations at Allen & Overy display stand which should also be available on their website at www.allenovery.com.

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