VISTRA

Growth of ABS Opportunities in Asian Markets

Securitisation has played a vital role in the developed markets for an extended period of time. As the range of securitised products and markets have grown in terms of variety and sophistication, a wider range of investors and market participants have recognised the potential for securitisation to meet the objectives of enhanced return and portfolio diversification. Several markets in Asia have established securitisation frameworks with varying degrees of sophistication over the years, but the fact remains that it is an under-utilised market. Asia's local debt markets undoubtedly have taken on a greater importance with offshore issuance being pre-eminent. Asia's economies have learnt from the past and have taken measures over the years to make their markets more resilient. Given that the central issue in the Asian market remained that of attracting investors, the focus in that region has been on credit enhancements and risk repackaging.

The global capital market landscape has gone through a tremendous transformation with the Asia region developing into a more sophisticated market. In 2013, when the US Federal Reserve reduced quantitative easing, that was followed by a shut down in Asia's bond markets for months. In mid-2015, Greece's financial crisis rocked the industry, and Asian firms held off from issuing for a couple of weeks. In June 2016, issuers jumped into the bond market within days after the UK voted for Brexit in a referendum. Even in November 2016, with a newly elected US President, the Asian market was going strong. Asia's economies have learnt from the past and have taken measures over the years to make their markets more resilient to the global factors whether by relying more on the regional investor base rather than the international buy-side, or by giving a boost to the local currency debt markets to curtail exposure to foreign exchange risks.

In Asia, the regulatory and market frameworks governing securitisation are relatively nascent. Domestic securitisation markets are more active relative to their cross-border counterparts. Cross-border issuance, which is only a fraction of US and European issuance, dropped sharply post 2008 as the market for CDOs (which accounted for the bulk of Asian issuance pre-2008) virtually shut down. It is worth noting that, as long as Asian corporates will be able to obtain cheap funding in their local capital markets, they will not look to cross-border securitisation deals. China has certainly stolen the show being the front runner, but across all of Asia regions there has been noteworthy progress. India has put in place key reforms, policies and some bold moves like prescribing minimum borrowings through debt capital markets while further opening up to foreign investment, Myanmar launched its stock exchange in Yangon in December 2015 and has since hosted a number of IPOs. Vietnam is still divesting the state's holdings in some of its biggest conglomerates, while countries such as Indonesia, the Philippines and Malaysia are making strides towards infrastructure development. Let us take a deep dive into the securitisation markets in some of Asia's key regions.

China

China's securitisation industry has seen explosive growth in recent years. China's asset-backed securities (ABS) market saw tremendous growth in 2017, driven by a rise in issuance of consumption-related securitisations. Securitisation was first introduced through a pilot programme in 2005 and was suspended in 2008 following the onset of the global financial crisis amidst concerns relating to securitised assets. The pilot programme was subsequently restarted in 2012 with an initial quota of RMB50bn.

In 2017, the volume of new issuances surged 64.7% to about RMB1.5 trillion yuan (about US$236bn), making China the world's second largest securitisation market in terms of new issuance volume, according to a report by Pengyuan International, a credit rating company. In 2017, the total volume of ABS issuance in China reached US$230bn, marking a 65.86% increase compared to 2016. The total outstanding volume of ABS by the end of 2017 stood at US$326bn, a 66.41% increase from 2016. Overall, the volume of securitisation is still small in relation to the combined balance sheets of Chinese banks, financial institutions and corporations.

From a product perspective, corporate ABS and credit ABS account for 55% and 41% of the issuance volume in 2017 respectively. Among the various corporate ABS, small-loans, account receivables and corporate debts were the more popular underlying assets. For credit ABS, securitisation was heavily seen for residential mortgage-backed securities, collateralised loan obligations and auto-ABS. ABS issuance has blossomed in China since the government relaxed rules some years ago. Property-backed ABS are treated as a quasi-real estate investment trust in the country, given that REITs – entities with real estate holdings that sell units to investors – are not permitted at present.

The sharp increase in the issuance of consumption-related securitisation was driven by China's transition to a consumption-based economy and firms' incentives to diversify their funding sources and lower funding costs through securitisation. China's consumption growth and e-commerce development contributed to a rise in consumer loans, which in turn fed consumption-related ABS issuance growth. We expect China's ABS market to continue to grow in 2018, but at a moderate pace. Due to the new policies on regulating consumer-loan originations, consumer loan ABS issuance in 2018 might not able to keep pace with the robust previous year's numbers. The issuance of transactions backed by commercial real estate assets will continue to increase, driven by favourable policies in the housing rental market and property developers' incentives to diversify their financing channels.

South Korea

The South Korean securitisation market has expanded since the introduction of ABS transactions but the size of the non-ABS Act securitisation market remains much larger than the ABS Act securitisation market. This is mainly due to the fact that ABS Act securitisation involves certain procedural requirements under the ABS Act, such as registration of a securitisation plan. Thus, unless the deal is looking for special benefits under the ABS Act, such as more lenient perfection requirements; most securitisations are non-ABS Act securitisations

South Korea also maintained an active securitisation market after the financial crisis, as demonstrated by high volumes of RMBS and credit card ABS funding. The securitisationdomestic market in South Korea has developed into one of the most sophisticated in Asia-Pacific. Today, South Korea has one of the most developed securitisation frameworks in Asia. Cross-border securitisation transactions remain quite low because originators can source local currency funding by issuing bonds and because the Korean government has encouraged Korean companies to reduce their foreign exposure due to the volatility of the global economy.

Asset-backed securities (ABS) issuance in South Korea fell in 2017 on lower growth of mortgage loans amid the government's measures to control speculative investment in the property market.

Sinagpore

Commercial Real Estate (CRE) has been the mainstay of securitisation activity in Singapore, with the bulk of the structures consisting of on-balance-sheet MBS, CMBS and REITS. Other securitisation structures include credit card receivables, asset-backed CP and loans. Up to 2006-07, in the years prior to the Global Financial Crisis, securitisations in Singapore were focused on structures that incorporated Structured Investment Vehicles (SIVs) and conduits. Post crisis however, the market went into hibernation for a period of about five years till 2013, when the need for funding diversification on the part of issuers looking at more efficient capital structures, has become the key driver. Instead of having a mix of straight loans, bonds and equity, issuers are looking at securitisation to diversify their sources of funding as banks run up against single-borrower limits and as they review their risk-weighted assets amid tighter banking regulations.

Singapore is the largest real estate investment trusts (REIT) market in Asia, excluding Japan, and there are an extensive offering of business trust listings on SGX of shipping, aviation and infrastructure assets. REITs are an asset class that investors in Singapore are highly interested in with the opportunity to own properties, not only in Singapore, but the rest of the world is enticing. The first Singapore-listed REIT was in 2002, and Singapore has gone on to see its REITs and business trusts market grow both in breadth and depth, to a combined market capitalisation of close to US$100bn.

Japan

The securitisation market is very well developed in Japan, though demand for securitisation products has decreased sharply since the Global Financial Crisis. During 2006, the actual issuance of securitisation products on an announced basis reached about ¥11 trillion. However, following the Global Financial Crisis originating from the subprime mortgage crisis, the demand for securitisation products decreased (despite no issues having arisen relating to securitisation products themselves in the Japanese market).

Since the start of 2008, the scale of securitisation business shrunk so much that, during 2009 to 2015, the actual issuance of securitisation products per year on an announced basis was between ¥3 trillion to ¥5 trillion (not including Japanese real estate investment trusts).

However, residential mortgage-backed securities (RMBS) originated by the Japan Housing Finance Agency (JHF RMBS) continue to be steadily issued and the Japanese real estate investment trusts (J-REITs) market has been brisk recently. Securitisation is governed by or regulated under various sectoral laws. The Act on Securitisation of Assets was introduced to incentivise and enhance securitisations, and special entities for securitisation are formed under, governed by, and regulated under it. Of the total volume of issued securitisation products, the products originated by government-affiliated institutions have made up about half of the total issued amount for several years. The remainders are originated mostly by consumer credit companies, banks and leasing companies.

Across Asia, China remains the largest and most important fixture in the auto loan ABS market, but Japan continues to grow at a fast rate, according to a report from S&P Global. The Japanese auto loan ABS market issued approximately US$8.4bn in 2017, up 12.6% compared with the previous year.

India

The Indian securitisation market evolved in the 1990s with the main objective of meeting the priority sector shortfall in the Indian banking system, both for scheduled commercial banks and foreign banks. For many non-banking finance companies (NBFCs) which act as an issuer in these transactions, securitisation has provided an alternative source of capital at a cheaper rate and played a crucial role in their growth. With the clarity on taxation of pass-through certificates (PTCs) and interest shown by mutual funds, the securitisation market holds the promise to go beyond meeting the priority sector lending requirement of banks.

India's securitisation market surged to an all-time high in the financial year 2016-17 despite a marked slowdown due to demonetisation and the introduction of a new debt instrument which allows banks to buy priority sector loans directly from each other. The value of securitisation transactions in India rose 47% to INR1.02 trillion in 2016-17, according to report by ratings agency CRISIL. This tremendous growth is mainly due to significant priority sector lending targets of private sector and foreign banks, and industry-wide chase for retail credit growth meant securitisation of retail assets soared. However in 2017-18 securitisation volumes declined by 7.2%, after two consecutive years of impressive growth mainly due to ambiguity on goods and services tax (GST) applicability. The GST council's clarification that securitised assets are not liable to GST, and robust demand for non-priority sector lending (PSL) securitisation should bring back participants and support transaction volume after the deceleration seen last fiscal year.

Banks are currently the dominant investors in Indian securitisation deals and a major share of this investment are made to satisfy public-sector lending (PSL) targets. Indian Bond issuances have also grown exponentially at a compounded annual growth of approximately 20% over the past decade.

The Indian central bank, the Reserve Bank of India (RBI), has supported the securitisation market. In what was a fairly unregulated market, the regulator has now started providing clarity on possible structures. The RBI has also significantly contributed to the market by constantly reviewing and strictly implementing the Priority Sector Lending (PSL) norms. The other change imposed by RBI is that the monitoring of compliance with PSL norms is now on a periodic basis, as opposed to the earlier annual compliance. This has given rise to regular securitisation transactions in the market.

Conclusion

Although structured finance volumes in many markets in Asia have been limited, there is significant potential in the larger emerging markets in particular. Securitisation has the potential to outstrip GDP growth rates in emerging Asia capital markets. Market participants and regulators in Asia are becoming more familiar with securitisation and structured debt transactions and the way they can be and are being used to benefit the region.

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