THE SECURITISATION & STRUCTURED FINANCE HANDBOOK
2020

10th Edition

Growth of ABS opportunities in Asian markets

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Securitisation benefits the economy by bringing financial markets and capital markets together. Financial assets are created in the financial markets, e.g. banks or mortgage financing companies. These assets are traditionally refinanced on on-balance-sheet means of funding of the respective banks. Securitisation connects the capital markets and financial markets by converting these financial assets into capital market commodities. The agency and intermediation costs are thereby reduced. It is clear, however, that the securitisation markets in Asia are not as deep as those in the US or Europe, though there is now significant increasing interest, on the one hand, among investors in Asia looking at investing in US and European securitisations and, on the other hand, among issuers in Asia putting in place securitisation structures which will appeal to US and European investors. 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 economies have learnt from the past and have taken measures over the years to make their markets more resilient.

Securitisation creates an alternative investment product for investors. By repackaging assets which would otherwise be illiquid (such as auto-loans or infrastructure debt) a securitisation opens up these types of investments to a range of participants in the capital markets who would otherwise not have been able to have that exposure. In some economies around Asia, banks are highly leveraged and there is a desire on the part of governments, regulators and the banks themselves to reduce that leverage. Securitisation can be a very useful tool to help achieve that.

In the decade following the 2008 global financial crisis, securitised assets in the US have undergone significant reforms. Changes to market practices and regulation have resulted in greater transparency and reduced risk. As a result, interest in securitised products is beginning to grow among Asian institutional investors keen to juice up their portfolio.

Securitisation is a developing financing tool in Asia; the method of its adoption has varied throughout the region, where some jurisdictions, such as China, Korea and Japan, have implemented special legal regimes, while others, such as Hong Kong and Singapore, have made use of existing laws, with some special cases, such as the regulatory covered bond regime in Singapore. Financial institutions

and corporates equally make different uses of securitisation, with some using it for funding, others for regulatory capital relief and others for balance sheet management. Regulators in Asia are taking a balanced and thoughtful approach. In Hong Kong and Singapore, for instance, the HKMA and MAS have been implementing the Basel securitisation framework, and in China, using a quota system to try our different types of securitised product before making them more widely available.

Asian markets have the greatest growth opportunity and could gain the largest share of global capital markets over the next few decades. The average global share of Asian capital markets is expected to increase from 31% in 2017 to as much as 49% in 20 years, with half the growth expected to come from China, according to a global capital markets index.

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 securitisation markets in some of Asia's key regions.

China

China is a new frontier for foreign investors, with complex regulations yet very traditional and familiar ABS assets. The Chinese ABS market represents a unique opportunity for those seeking yield and volume. China's securitisation industry continued to enjoy growth in 2018 and is providing an increasing share of debt funding for the Chinese economy. When China started their crackdown on shadow banking, many companies struggled to raise capital through conventional source of finance. This led to many companies adopting to ABS route as preferred source of finance during the China's official deleveraging campaign. Subsequently, China's ABS market has exploded over the past few years. 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.

China had the second largest securitisation issuances volume in the world, the new issuances in 2018 grew by 10% to about US$260bn – over double the volume issued in Europe. In 2017, the volume of new issuances surged by 65% to about US$236bn. The total outstanding securitisation notes stood at approximately US$400bn, making China the largest securitisation market in Asia.

Securitisation accounted for 4.6% of the total debt capital market new issuance in 2018, up from 3.7% in 2017. Overall, the volume of securitisation is still small in relation to the combined balance sheets of Chinese banks, financial institutions and corporations.

The booming market was largely driven by the growing issuance of securities backed by consumer debt as domestic consumption became an increasingly important driver of China's economy. 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.

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. Chinese residential mortgage-backed securities issuance registered a record high in 2018, making it the single largest securitisation asset class. Auto loan asset-backed securities issuance volume also increased, pumping a large deal of money to the auto finance sector.

China's securitisation market has also deepened foreign-investor participation, with the State Administration of Foreign Exchange increasing the qualified foreign institutional investor investment quota to US$300bn from US$150bn. There have also been approximately 50 ABS deals amounting to CNY375bn utilising China's Bond Connect scheme since its launch, including 19 RMBS deals and 24 auto-finance deals. Bond Connect reported 467 registered overseas institutional investors as of November 2018. Broader participation from foreign investors will help China's securitisation market align with international standards and practices and will provide a positive feedback loop for market development.[1]

The government has also made efforts to regulate shadow banking, promote ABS information disclosure and step up transaction-party scrutiny. China's crackdown on consumer credit in the shadow-banking sector and tighter regulations on non-bank lenders should support ABS transaction performance over the long term, despite the slight near-term deterioration in the performance of existing consumer ABS asset pools and a drop in issuance.

The China Stock Exchange Market (CSEM) has issued new disclosure requirements on SME loan securitisations in 4Q18, following similar requirements on financial-lease, infrastructure and receivable ABS. Regulators have also increased checks of ABS transactions and have published guidance to further define roles and responsibilities for key securitisation counterparties.

Macroeconomic trends, such as continued normalisation of growth, reduced liquidity due to policy-driven credit adjustments, uncertainty from the trade tensions with the US, and the rate hike environment outside China, may pose a threat to the performance of some industries. However, securitisation remains largely shielded by conservative asset selection and transaction repayment structures. We expect China's ABS market to continue the upward momentum in 2019, as cumulated asset default rate in auto loan ABS vintages kept improving, mortgage default rates in most RMBS transactions remained below 0.5%, rising household income and full-amortisation nature of most loans support debt serviceability for these sectors.

Singapore

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. Another unique feature of the securitisation market in Singapore is the buy-back option embedded in the asset-backed securities (ABS). This feature allows the originator to retain a contingent claim on the upside potential of the asset price.

Specific legislation governing securitisation in Singapore was enacted by the MAS in September 2000, when MAS Notice 628 (as amended in 2006 and 2007) was promulgated. Strong internal managerial control and the establishment of systems for managing and monitoring risk, in relation to asset-based transactions are critically important and regulated bodies must obtain the approval of the MAS before entering into ABS transactions.

Singapore has the largest real estate investment trusts (REIT) market in Asia ex-Japan and is increasingly becoming a global REIT hub. S-REITs are an important component of Singapore's stock market and comprise 8% of the Singapore Exchange's market capitalisation. Market capitalisation has grown at a compound annual growth rate

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of 25% over the last eight years. As of September 2018, over 75% of S-REIT and property trusts own properties outside Singapore across Asia Pacific, South Asia, Europe and US.

The Monetary Authority of Singapore (MAS) has made constant efforts to strengthen corporate governance in the S-REIT industry, including, among others, requiring REIT managers and directors to prioritise investors' interests over those of the manager and the sponsor in the event of conflicts of interest. Good corporate governance helps to provide safeguards for investors and unitholders while facilitating the growth of the REIT market in Singapore. S-REITs have provided long-term sustainable total returns and dividend yields which are generally more favourable compared to REITs in other established markets.

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.

In Japan, issuance grew about 10% in 2018 to US$55bn and we expect the upward trend to continue in 2019. RMBS and ABS continue to be the dominant asset classes in Japan, making up about 95% of total issuance. Within the RMBS sector, the Japan Housing Finance Agency is by far the largest originator, accounting for more than one-third of overall issuance of Japanese structured finance in 2018. Within the ABS sector, various originators were behind transactions issued in sectors such as auto loans and consumer loans. In 2019, the issuance of Japanese structured finance transactions is expected to be between US$57bn and US$60bn, 10% higher than the level seen in 2018.

The rating performance of Japanese securitisation transactions was stable in 2018. Most surveillance actions affirmed existing ratings based on the stable performance of the underlying collateral pool, with a limited number of rating upgrades and downgrades. We expect the stable rating performance to persevere in 2019. However, the Japanese economy faces headwinds in 2019: The government plans to hike consumption tax in October and the US-China trade dispute could exert downward pressure on businesses in Japan. These headwinds may hurt the performance of the underlying loan portfolios of RMBS and ABS transactions. But we expect any impact to be relatively limited, as we forecast major macroeconomic factors, such as GDP, the unemployment rate, foreign exchange rates, and policy rates, to stay near the levels seen in 2018.

India

Retail securitisation volumes in the Indian market more than doubled to INR1.9 trillion in fiscal year 2019 (April–March 2019), compared with INR850bn for fiscal year 2018, driven substantially by mortgage lenders.[2] There were three main drivers behind the massive spurt in the volume:

- in the second half of the fiscal year, driven by the liquidity crisis which forced non-bank finance companies (NBFCs) and housing finance companies (HFCs) to rely heavily on portfolio loan sell-downs to raise funds;
- relaxation in the minimum holding period (MHP) criteria for long-tenure loans by the Reserve Bank of India (RBI) also helped, as it increased the supply of assets in the system; and
- a few large mortgage players returned to the market in the first quarter of fiscal 2019 after clarification that securitised assets are not liable to Goods and Services Tax (GST).

Fiscal year 2019 also witnessed some innovative transactions being executed – the country's first covered bond issuance and replenishing securitisation structure involving vehicle loans as the underlying. Traditionally, in India, priority sector lending (PSL) requirement of banks has been the primary driver for securitisation volumes. However, in recent years, there has been greater

participation by mutual funds, NBFCs, and even FPI investors to some extent, resulting in increased share of non-PSL transactions in the market.

We expect securitisation volumes to moderate in fiscal year 2020, compared to FY 2019, as the quantum of assets eligible for securitisation have come down in the system, given the higher-than-usual volumes seen in FY 2019; and the incentive for higher-rated entities to undertake securitisation has reduced, given that the liquidity position has improved, and the on-balance-sheet borrowing costs have come down in recent months.

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 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.

Notes:

1 Source: Fitch Ratings.

2 Source: CRISIL.

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