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COMMENTARY

European Structured Finance and Covered Bond Survey Results

Contact Information

Gordon Kerr
Senior Vice President
Global Structured Finance
+44 (20) 7855 6667
GKerr@dbrs.com

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DBRS has completed its second annual survey of market participants in European structured finance and covered bond markets. The results of the 2017 survey show both some positive and concerning information with some generally interesting insights. Surveys, by their nature, are not a representation of definitive answers to the questions posed, but they do offer insight in aggregate into the market's attitude and perceptions. Most importantly, they give those of us involved in research plenty of opportunity to create a lot of pretty graphs. Get ready for loads of charts!

It should be noted that this survey was conducted ahead of recently announced European regulatory changes on 31 May[1]. The regulations for simple, transparent and standardised (STS) securitisations going into the survey were expected to be much harsher on the securitisation market than has been suggested, following the conclusion of negotiations between the European Parliament and European Commission (the final text of the agreement has yet to be approved and published).

In summary:

- The number of investors is expected to grow, more so in securitisation than in covered bonds
  - This is supportive as investor participation is highlighted as a priority to support the securitisation market after regulatory changes
- 2017 Issuance expectations have marginally increased over 2016 expectations
  - Issuance growth is expected to come from non-traditional markets
    - Alternative collateral securitisation types from Italy and Spain
    - France is a growing presence in securitisation
    - Non-European growth in covered bonds
    - Italy and the UK are the largest securitisation regions for expected issuance
- Recent STS changes will hopefully support concerns
  - 5% risk retention is viewed as adequate protection
  - STS changes are ranked as high priority along with Solvency II
  - As expectations initially stood (pre-changes), STS was thought to be an impediment to the growth of the securitisation market

1. http://europa.eu/rapid/press-release_IP-17-1480_en.htm

Divergent Issuance Picture

Securitisation

Starting with the important part of the market in the current environment: issuance. Survey participants were asked about their view on expectations for issuance in 2017, both distributed issuance and total issuance. Given that the survey was conducted in advance of the recently announced STS news, they could be considered to have a slightly more conservative view than they might have had post-STS announcement.

In terms of distributed issuance, most survey participants predict a range below EUR 90 billion. In total, 62% predict less than EUR 80 billion, and 89% believe that issuance will be less than EUR 100 billion. Calculating an average of the scores, expectations are for EUR 76 billion in 2017, only EUR 1 billion more than survey participants' predictions in 2016 (Exhibit 1).

Analysing this further, we can see that investors and market participants solely involved in the securitisation market are more bearish than those active in both securitisation and covered bonds, with EUR 73 billion versus EUR 78 billion, respectively. Issuers are even more bullish than securitisation-only participants, predicting EUR 76 billion (Exhibit 2).

Exhibit 1: Expectations for Distributed European Securitisation Issuance in 2017

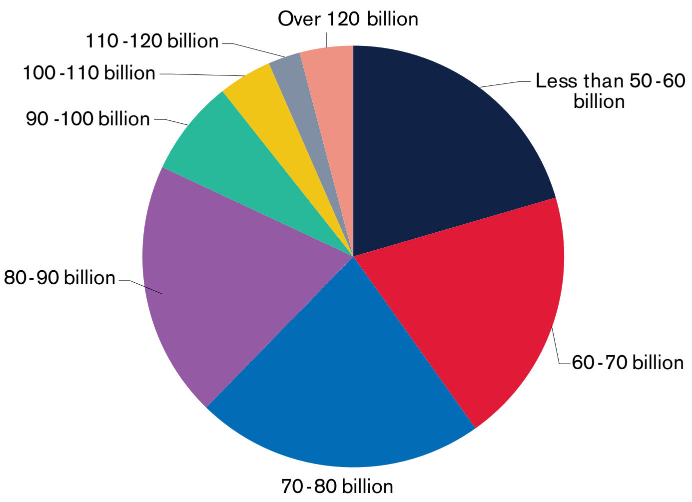
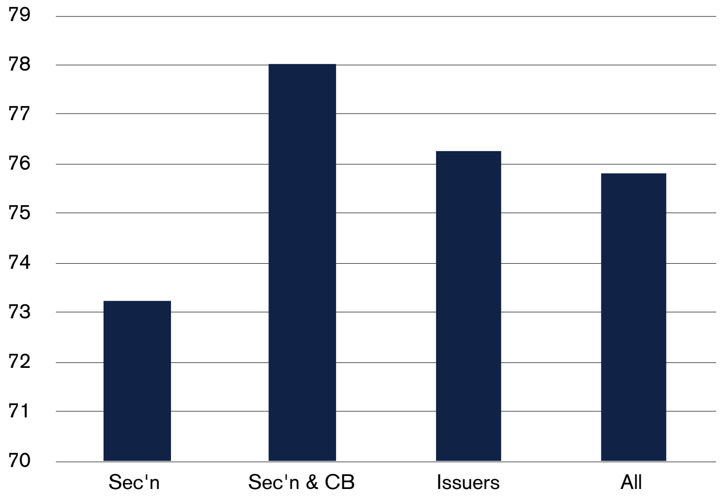


Exhibit 2: Breakdown of Average Distributed European Securitisation Issuance by Market Participation in 2017

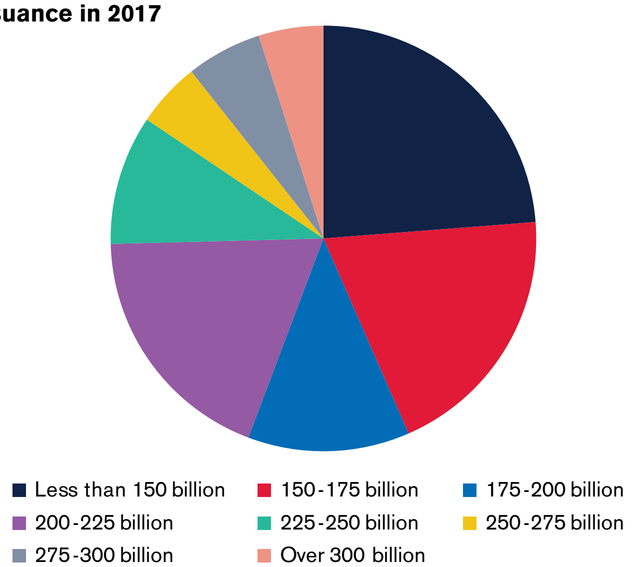


Source: DBRS.
Note: 'Sec'n' = Securitisation Only, 'Sec'n & CB' = Securitisation and Covered Bonds, and 'Issuers' includes Bankers and Arrangers.

Total issuance for the market shows a similarly muted picture for expected issuance in 2017, with 56% expecting less than EUR 200 billion in total issuance and 75% predicting less than EUR 225 billion. Taking an average of the voting, issuance expectations are for EUR 198 billion in 2017, EUR 3 billion more than in 2016 (Exhibit 3). The distribution of those surveyed for total securitisation issuance is similar to that for distributed issuance with issuers and combined securitisation and covered bond investors more bullish than dedicated securitisation investors.

Both are well below DBRS's original expectations for 2017 (approximately EUR 95 billion and EUR 225 billion, respectively)[2].

Exhibit 3: Expectations for Total European Securitisation Issuance in 2017

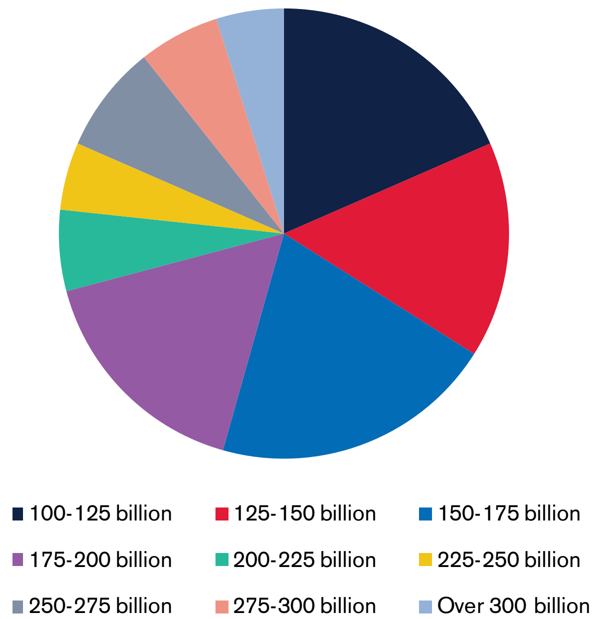


2. http://dbrs.com/research/305191/2017-outlook-for-european-structured-finance-and-covered-bonds.pdf

Covered Bonds

For covered bonds, there is a more varied picture of views on expectations for issuance in 2017. The bulk of respondents chose beneath EUR 200 billion, representing 71% of respondents. The remaining responses are roughly evenly distributed with 5% to 8% for the segments above EUR 200 billion. The overall average is for a total of EUR 182 billion (Exhibit 4). This is above DBRS's expectations of EUR 130 billion published in January[3].

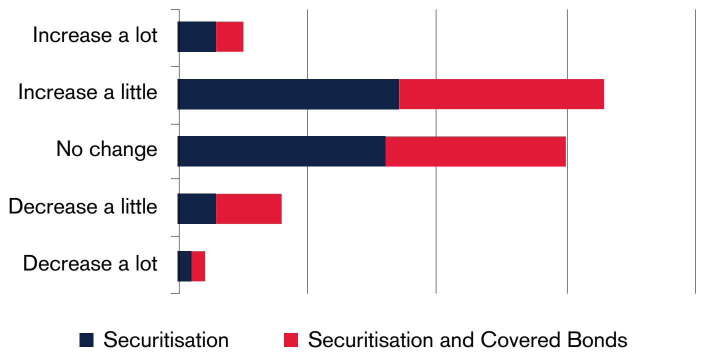
Exhibit 4: Expectations for Benchmark Covered Bond Issuance in 2017



Positive Market Expectations (Sort of)

Overall, market participants expect their participation in the securitisation and covered bond markets to 'increase a little', or to experience 'no change'. In the securitisation market, 42% expect to 'increase a little' their participation, while only 13% expect to decrease their participation. This may be because of the removal of more of the legacy books that were steadily decreasing their market participation. 6% are very bullish and expect their participation to 'increase a lot' (Exhibit 5).

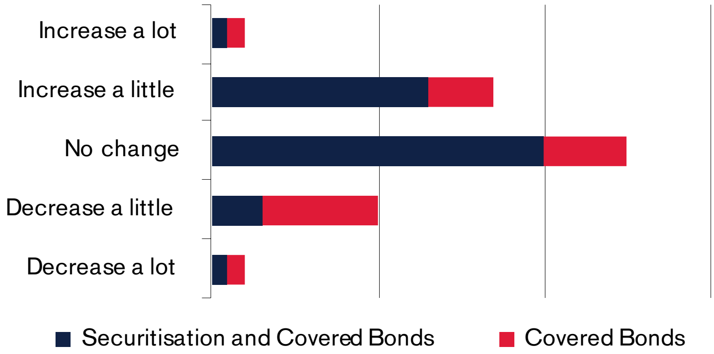
Exhibit 5: Responses to the question: 'What are your securitisation market intentions in the next 12 months?' (by investment coverage)



3. http://dbrs.com/research/305191/2017-outlook-for-european-structured-finance-and-covered-bonds.pdf

Covered bond market participants are more stable in their views, with the largest group representing 45% expecting 'no change' in their covered bond market intentions. A total of 30% are expecting to 'increase a little', and only 4% expecting to 'increase a lot'. Interestingly, there is a higher percentage of covered bond market participants than securitisation market participants that intend to decrease participation with 21% (18% 'a little' and 3% 'a lot'). Of the 21%, covered bond-only participants are notably the largest proportion expecting to decrease their participation in comparison to participants that also are involved in securitisation.

Exhibit 6: Responses to the question: 'What are your covered bond market intentions in the next 12 months?' (by investment coverage)



Growth of Investor Base

The number of investors is expected to either grow or remain the same in the next 12 months for both securitisation and covered bonds. For securitisation markets, 41% of those surveyed expect an increase in the number of investors versus 39% to remain the same, while 18% expect fewer investors and 1% expect a lot fewer (Exhibit 7). Covered bond market participants are a little more conservative in their expectations, with 43% expecting no change, only 41% expecting more investors and 0% expecting a lot more investors. A total of 14% expect fewer investors, and 2% expect a lot fewer investors (Exhibit 8).

Exhibit 7: Expectations for change in the number of securitisation investors (by investment coverage)

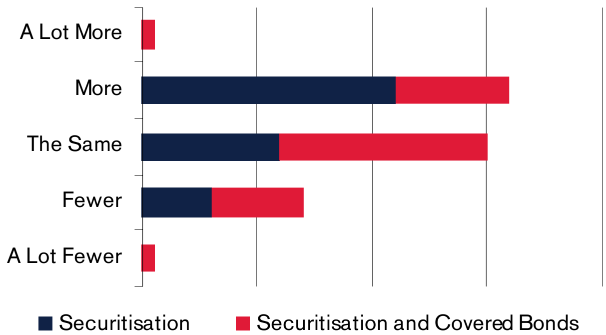
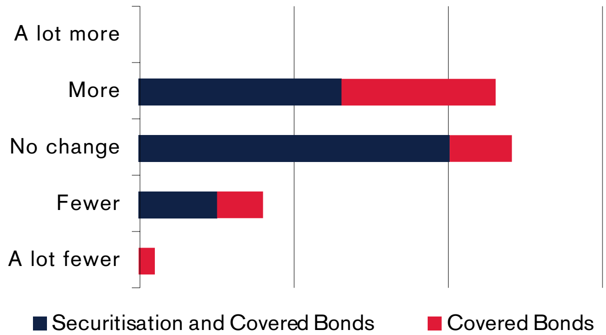


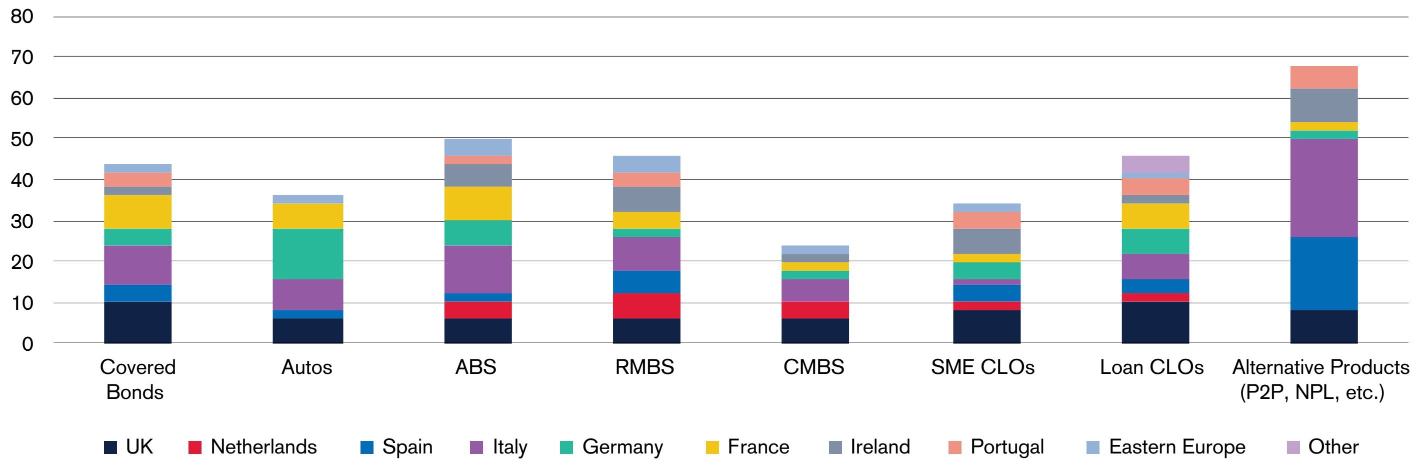
Exhibit 8: Expectations for change in the number of covered bond investors (by investment coverage)



UK, Italy and France Regions of Future Growth; Alternatives and ABS dominate

The prospect for growth may be somewhat limited but there are sectors which are expected to expand more than others. When asked the question, *'Are there any sectors where you expect to see an increase in issuance in the next 12 months?'*, market participants picked out 'Alternative Products' as the winner with 20% of selections, most notably from Italy and Spain. This is likely due to an ongoing expectation for NPL or RPL transactions to come from these countries. Next most popular is the ABS sector, with 14%, and a diverse regional expectation, but most notably from Italy and France. Next are RMBS, leveraged loan CLOs, and covered bonds all with 13%, followed by Autos and SME CLOs with 10%, and lastly CMBS at 7%. The level of expectation for CMBS is the most surprising, given the current lack of supply, but there are slivers of positive momentum in the sector.

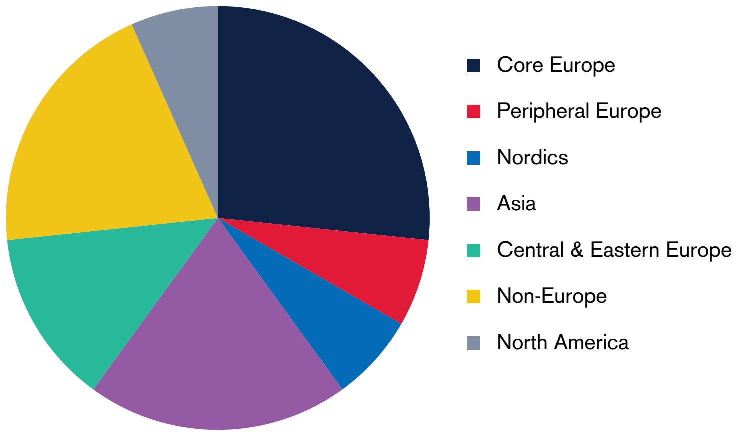
Exhibit 9: Responses to the question: 'Are there any sectors where you expect to see an increase in issuance in the next 12 months?'



Non-Traditional Covered Bond Markets Dominate Expectations

For those involved in the covered bond market, participants responded to a question about their expectations for supply by region. Respondents expect that the largest volume of deal will come from core Europe, followed by non-European supply with Asia and Non-Europe following suit. Central and Eastern Europe is also expected to see an increase in supply. Peripheral Europe, North America and the Nordic regions are expected to have the lightest growth in supply (Exhibit 10).

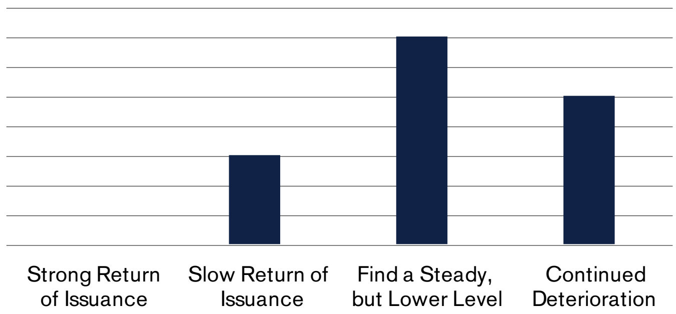
Exhibit 10: Responses to the question: "Where do you expect to see the growth of new issuance to come from in the next 12 months?"



Public Sector Covered Bond Issuance to Stabilise

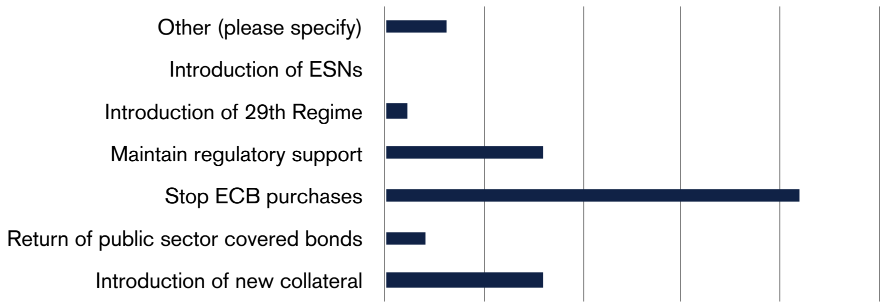
In the covered bond market, public sector covered bonds outstanding have been shrinking since the onset of the financial crisis with ongoing supply from this section of the market limited. In the survey, the question was asked, '*What is the prospective future for public sector covered bond issuance?*'. Most participants believe that the market will find a steady but lower level of issuance, and expect no strong return. Second-most popular was the suggestion of continued deterioration of the market, and a few that expect a slow return of the market (Exhibit 11).

Exhibit 11: Responses to the question: 'What is the prospective future for public sector covered bond issuance?'



An effort to find out what could be changed to help support the covered bond market reveals the strong impact the ECB purchases, as a part of its quantitative easing programme, are having. Participants are keen for the ECB to step back from the market to help support covered bonds. Second, participants suggest both the maintenance of regulatory support and the introduction of new collateral as important (Exhibit 12).

Exhibit 12: Responses to the question: 'What would you prioritise as the most important thing to change in order to support the covered bond market?'



Issuers prefer unsecured; bankers covered bonds; and bank treasuries securitisation

Given a choice of funding, there is a divergence in terms of priority based on job roles within the industry. Retail deposits are preferred by bankers and arrangers over securitisation and covered bonds, but issuers and bank treasuries prefer to make use of capital market instruments. The choice of instrument varies, but whole loan sales are clearly lowest on the list of priority. Issuers currently prefer senior unsecured, arrangers and treasuries prefer securitisation, and bankers prefer covered bonds (Exhibit 6).

Exhibit 13: Responses to the question: 'Given choice of funding, which is preferred to use to fund collateral?' by function

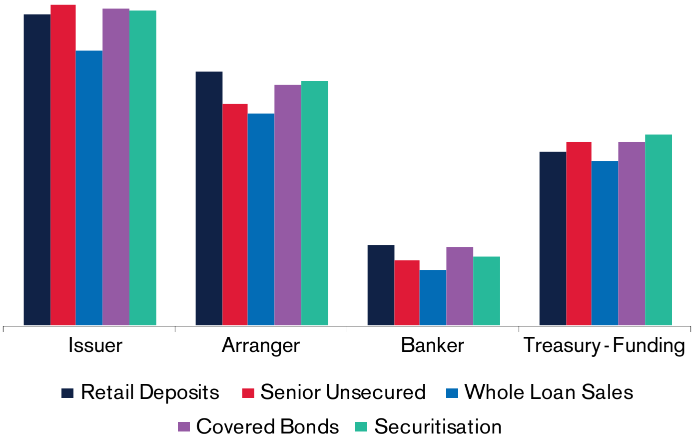
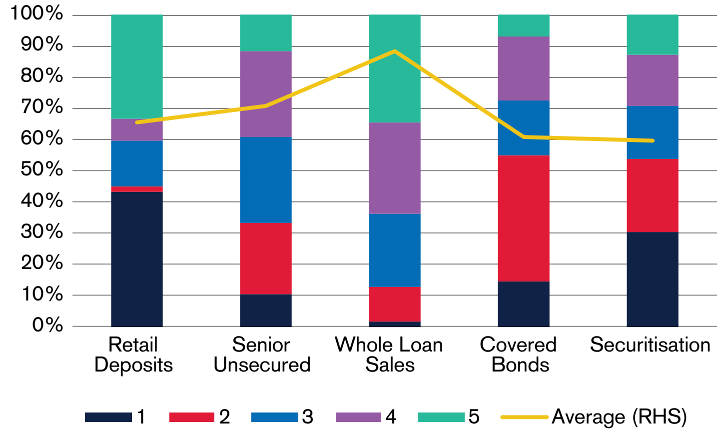


Exhibit 14: Responses to the question: 'Given choice of funding, which is preferred to use to fund collateral?' by funding type

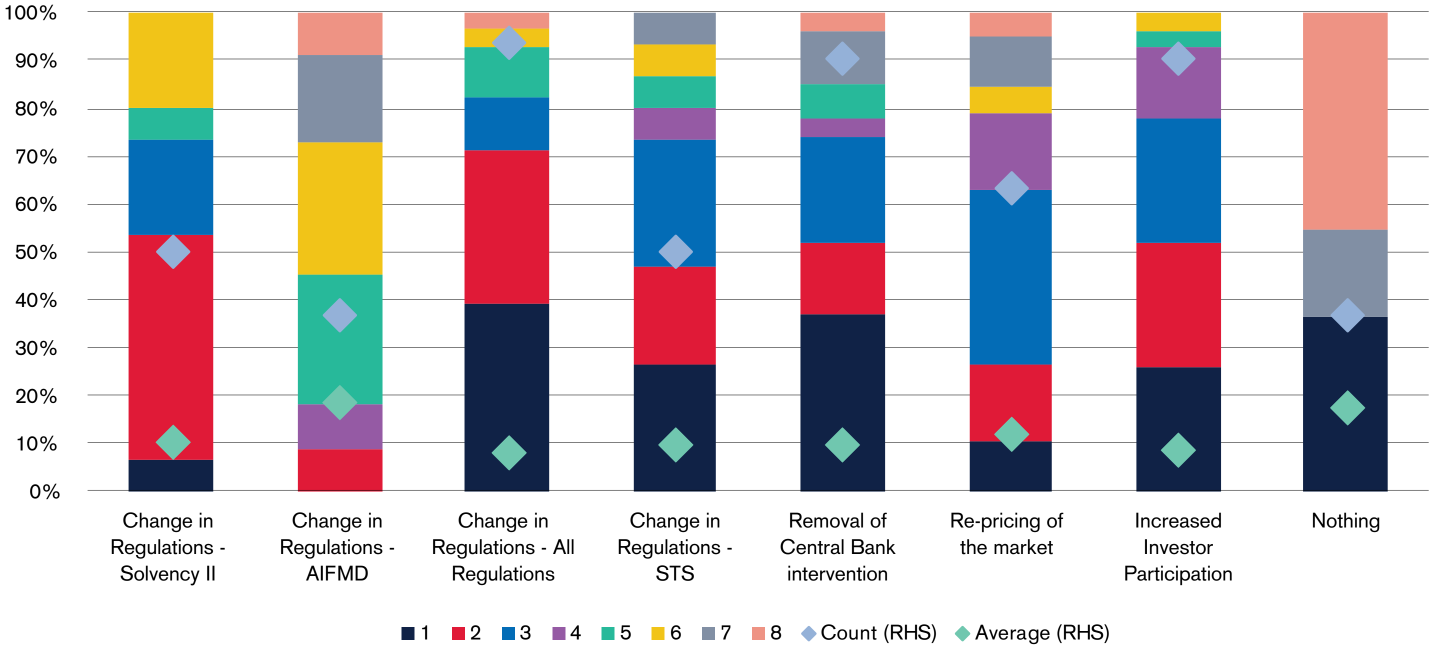


Regulation and Investor Participation the Main Impediments as Market Looks Forward

It is little surprise that regulations are considered the largest impediment to the development of the securitisation market. Survey results further emphasise this, with 'All Regulations' receiving the highest number of votes and the highest-average priority rank. Of the regulations that are most important to change to support the growth of the market, STS and Solvency II are considered high priority items to adjust. However, the question was posed prior to the negotiated adjustments approved in the European Parliament earlier this month (Exhibit 7).

Interestingly, after the regulations focus, participants prioritised an increase in investor interest, and the removal of central bank intervention as high priority items to address. In terms of the number of votes, after 'All Regulations', these two items received the next highest number of votes. Increased investor participation had a higher average rank, with more participants prioritising it within their top three.

Exhibit 15: Responses to the question: 'What would you prioritise as the most important things to change to support the growth of the securitisation market?'



STS changes should appease concerns

Going into further detail with respect to the regulations, when asked about the topic of STS, participants were rather negative regarding its impact. Most suggest that STS will not change the current pace of supply, or feel that it would likely impair some of the markets. This is counter to hopes for Capital Markets Union project, with expectations for the release of EUR 150 billion in new funding. The minority felt that it would actually improve issuance. Again, it is worth highlighting that the voting on this topic was done prior to the recently announced agreement, which has been heavily adjusted from the draft version previously seen by the market (Exhibit 16).

Exhibit 16: Responses to the question: 'Do you think that the securitisation market can survive under STS and other regulatory proposals?'

The recent regulatory agreement with respect to STS appears to have settled on only a 5% risk retention requirement, in line with other global initiatives. However, prior to this, the proposal included variable scenarios that could adjust this level up to 20%. From this initial proposal, the question was posed as to whether 5% risk retention was sufficient to safeguard the alignment of interests between the issuer and investor. The majority felt that 5% risk retention was either absolutely adequate, or thought an option based on asset type would be appropriate. A small minority actually agreed that it was too low. Interestingly, there were more votes for a dependency upon the issuer than those that felt 5% was even too high (Exhibit 17).

Exhibit 17: Responses to the question: 'Do you think 5% risk retention in securitisation is sufficient to safeguard an alignment of interest?'

Summary

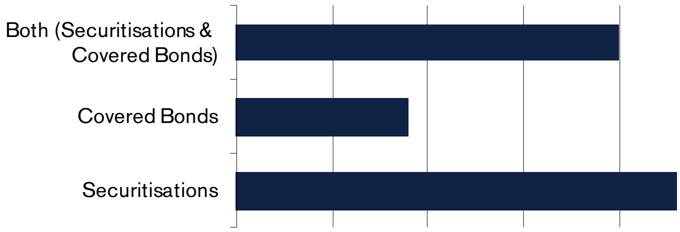
Change in sentiment year over year appears to show positive signs for the securitisation market. The number of investors is expected to grow and participation by those involved is expected to increase, though more so in securitisation than in covered bonds. This should be supportive overall as investor participation is highlighted as a priority to support the securitisation market after regulatory changes.

Regulatory changes are again highlighted as a priority, and hopefully recent changes in the STS regulations will be supportive for the market. Adjustments such as the 5% risk retention requirement should be positive given that, prior to the announcement, participants largely felt that it was adequate to align investor and issuer interests.

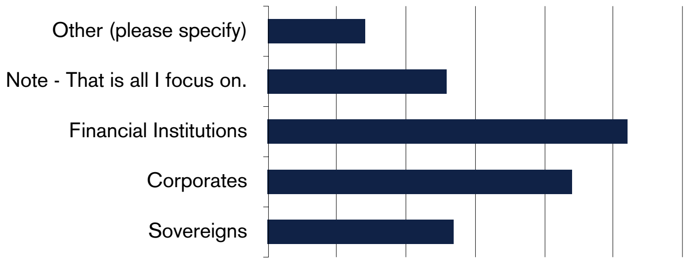
2017 Issuance expectations show a positive increase over 2016 expectations, though only marginally. Issuance growth is expected to come from non-traditional markets, such as alternative collateral securitisation types from Italy and Spain. Expectations are for an increase in NPL and RPL transactions from these areas. France is a growing presence in securitisation as it has become a regular region for market participation. In covered bonds, expectations are for growth outside of Europe.

Appendix A: Survey Participant Breakdown

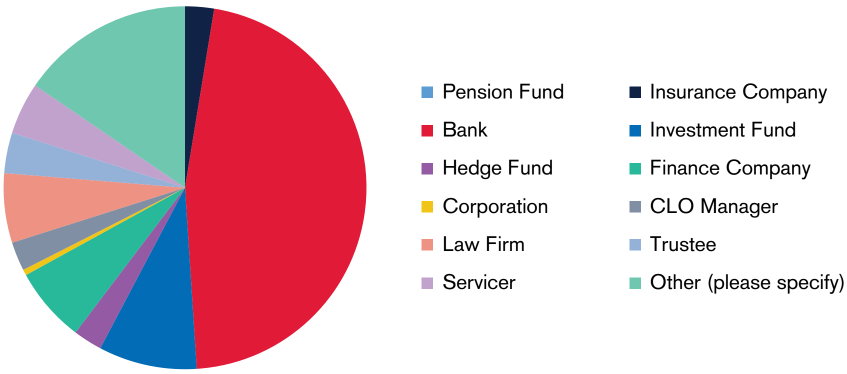
The survey was open to market participants, and a total of 204 responded (No Donald Duck this year), with the majority focused on the securitisation market, but a large number covering both securitisation and covered bonds.



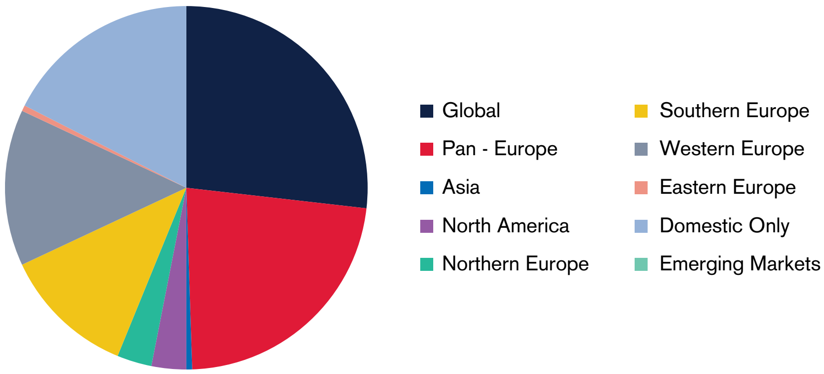
For those that also participate in other markets, Financial Institutions is the most common for market participants to also be involved in.



Most survey participants come from a bank, with investment funds, finance companies, lawyers and other the next most common participation.



Most participants are either Pan-European or Global in their focus of business. Many have only a domestic focus, which tends to be in either Southern or Western Europe.



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