

Recent developments in the Swiss ABS market in 2015/16

by Lukas Wyss, Johannes A. Bürgi and Maurus Winzap, Walder Wyss Ltd.

IN 2015 THE SWISS ABS MARKET ATTRACTED NEW ORIGINATORS. MOST IMPORTANTLY, AMAG LEASING AG (THE AUTO LEASING COMPANY OF THE AMAG GROUP, THE EXCLUSIVE IMPORTER OF VOLKSWAGEN BRANDED VEHICLES IN SWITZERLAND) ENTERED THE MARKET BY LAUNCHING AN INAUGURAL THREE-YEAR SOFT BULLET REVOLVING TRANSACTION IN DECEMBER 2015, FOLLOWED BY A TWO-YEAR AND A FOUR-YEAR SOFT BULLET REVOLVING TRANSACTION IN APRIL 2016. AS EVERYWHERE, THE MARKET IN SWITZERLAND CONTINUES TO BE DRIVEN BY THE LOW (OR RATHER NEGATIVE) INTEREST ENVIRONMENT. HOWEVER, OTHER THAN IN RECENT GERMAN TRANSACTIONS, ORIGINATORS HAVE NOT BEEN ABLE TO PLACE SWISS ABS TRANSACTIONS IN PRIMARY MARKETS AT NEGATIVE YIELDS. THIS MIGHT WELL BE DIFFERENT, IN CASE THE SWISS NATIONAL BANK (SNB) WOULD ADD ABS TO ITS LIST OF COLLATERAL ELIGIBLE FOR REPOS.

Overview

Swiss ABS market in general

The Swiss ABS market was again growing in 2015 and the first half of 2016, both for public and private transactions. AMAG Leasing AG, the auto leasing company of AMAG Group (the exclusive importer of Volkswagen branded vehicles in Switzerland), launched its inaugural auto lease ABS transaction (CHF310.4m, three-year soft bullet) in December 2015, followed by a dual tranche CHF215m (two-year soft bullet) and CHF300m (four-year soft bullet) transaction in April 2016. Cembra Money Bank AG refinanced its 2012 auto lease ABS transaction in June 2015 and its 2013 auto lease ABS transaction in June 2016. Swisscard AECS GmbH refinanced several transactions in 2015 and 2016. Overall volumes in Swiss public ABS transactions amounted to CHF933m in 2015 and to CHF930m in 2016 (YTD). It is expected that market

activities will continue to grow as there is more activities on both, investors and originators side.

A number of private ABS transactions (i.e. transactions that are refinanced through ABCP platforms or through direct investors or banks) have been extended and renewed. Also, the number of trade receivable securitisation transactions involving Swiss receivables and/or Swiss sellers has increased.

Negative interest rates in particular

Swiss markets continue to be driven by the negative interest environment. The Swiss National Bank (SNB) charges negative interests on bank deposits at currently minus 75bps. It cannot be expected that this will change in the near future. To the contrary, in its statement of September 26, 2016, the International Monetary Fund (IMF) even suggested that the SNB shall consider deeper negative rates or cutting the existing threshold for deposits now exempt

from negative interest in order to make the Swiss franc even less attractive as a safe haven currency. The three-month LIBOR CHF target range declared by the SNB is between -125bps and -25 bps. In the last couple of months, three-month LIBOR CHF fluctuated between -70 bps and -80bps.

A substantial number of Swiss franc bonds are trading at negative yields in secondary markets, but only a limited number of issuers were able to issue Swiss franc debt securities to primary markets at negative yields (i.e. the securities have been issued with a very low or a zero coupon, but above par). The group of such issuers includes the Swiss Confederation, certain Cantons, certain Swiss Cantonal Banks, the Swiss Mortgage Bank (*Pfandbriefbank schweizerischer Hypothekarinstitute*) and the Swiss Mortgage Centre (*Pfandbriefzentrale der schweizerischen Kantonalbanken AG*).

However, neither corporate issuers nor ABS issuers have been able to issue securities to primary markets at negative yields in the Swiss franc market so far. This is surprising as some corporate issuers and ABS issuers have been able to issue securities at negative yields in the euro market just recently, even though interest rate levels are still higher in the euro market as compared to the Swiss franc market.

Investment bankers close to the industry are of the opinion that one main reason is the fact that ABS are not included in the list of eligible collateral for repo transactions with the SNB. Therefore, it is worthwhile elaborating in more detail on SNBs eligibility criteria for collateral and on the position taken by other central banks.

The Swiss National Bank and its position towards ABS

The Swiss National Bank: Background

In pursuing the Swiss monetary policy, the SNB may enter into credit transactions with banks and other market participants, provided that the counterparty provides sufficient, eligible collateral (art. 9 al. 1 (e) of the Swiss Federal Act on the Swiss National Bank). Normally, open market transactions and standing facilities are carried out by means of repo transactions.

Only securities that fulfil stringent requirements with regard to credit rating and liquidity are accepted as collateral by the SNB. Even though the criteria for the eligibility of securities are further outlined and described in instruction sheet no. 5 of the SNB (*"Instruction sheet on collateral eligible for SNB repos"*), only those securities included in the list of collateral eligible for SNB repos may be pledged as collateral for repo transactions. Despite the guidelines issued, the SNB may reject securities or exclude securities previously accepted, without justifying its decision (section 2. of the instruction sheet). However, as a public institution, it cannot be ignored that the SNB is subject to certain general principles of law, such as equal treatment of market participants.

Position of SNB towards ABS

Historically, the SNB added some ABS transactions to its list of eligible collateral (e.g. credit card ABS, issued by Citibank Credit Card Issuance Trust, issue date February 23, 2005, which was included in the CHF GC Basket). However, since the market has seen more Swiss ABS transaction as from 2011, ABS have no longer been accepted by the SNB.



Lukas Wyss



Johannes A. Bürgi



Maurus Winzap

Lukas Wyss

tel: +41 58 658 56 01

email: lukas.wyss@walderwyss.com

Johannes A. Bürgi

tel: +41 58 658 55 59

email: johannes.buergi@walderwyss.com

Maurus Winzap

tel: +41 58 658 56 05

email: maurus.winzap@walderwyss.com

It would appear that there are no objective reasons for not putting Swiss ABS on the list of eligible collateral, as all criteria set up appear to be satisfied. Also, there is no obvious reason to prefer an institution holding mortgage bonds (*Pfandbriefe*) to an institution holding Swiss ABS, given that both instruments provide for a very high credit quality. This raises questions around the basic principle of equal treatment of market participants.

Adding ABS to the list of eligible collateral would add liquidity to the ABS market and further stimulate activities in that area. Additional activities in the ABS market would facilitate structuring and placing transactions with new underlying asset categories. So far, there has been a strong focus on auto lease and credit card transactions, but other underlying categories such as SME loans could be set up and placed in the market. Ultimately, access of SMEs or other consumer categories could be facilitated, which would stimulate the economy more generally.

The position of the European Central Bank towards ABS

The position of the European Central Bank (ECB) (and other central banks) towards ABS is very different. The ECB accepts ABS as eligible collateral. It has introduced a specific asset-backed securities purchase programme (ABSPP) in September 2014. The purpose of the ABSPP is described as follows “..... the ABSPP will further enhance the transmission of monetary policy, facilitate credit provision to the euro area economy, generate positive spill-overs to other markets and, as a result, ease the ECB’s monetary policy stance, and contribute to a return of inflation rates to levels closer to 2%.” (see ECB/2014/45). Given the low inflation in Switzerland, it is not obvious why the SNB should take a different approach.

In addition, in its Guideline (EU) 2015/510 of December 19, 2014 on the implementation of the Eurosystem monetary policy framework (General Documentation Guideline) (ECB/2014/60) (art. 72 et seqq.), the ECB introduced specific eligibility criteria for asset-backed securities.

SNB eligibility criteria and Swiss ABS

Even though the SNB may reject securities or exclude

securities previously accepted, without justifying its decision (as stated in its instruction sheet no. 5), the SNB still has published a list of eligibility criteria. It would appear that standard Swiss ABS structures meet all of these requirements.

Type of collateral

- (i) Securities with a fixed-principal amount and unconditional redemption.
- (ii) Securities with fixed rate, floating rate or zero coupon interest.
- Even though Swiss ABS typically provide for a soft bullet structure, other securities with identical redemption structures have been added to the basket. Accordingly, Swiss ABS would meet this criterion.

Currency of issue

Securities denominated in Swiss francs, euros, US dollars, pounds sterling, Danish kroner, Swedish kronor or Norwegian kroner.

- Swiss ABS have typically been issued in Swiss francs.

Eligible issuer

- (i) Securities issued by central banks, public-sector entities, international or supranational institutions and private-sector entities. Securities issued by financial institutions are, as a rule, not eligible as collateral for SNB repos. This exclusion does not apply to covered bonds issued by financial institutions, provided the issuer is not a domestic financial institution or its foreign subsidiary. Neither does it apply to securities issued by the mortgage bond bank of the Swiss mortgage institutions and the mortgage bond institute of the Swiss cantonal banks (*Pfandbriefbank schweizerischer Hypothekarinstitute AG and Pfandbriefzentrale der schweizerischen Kantonalbanken AG, the Swiss Pfandbrief institutions*).
- (ii) Issuers of foreign currency securities domiciled in Switzerland or in a member state of the European Union (EU) or European Economic Area (EEA). Securities issued by international or supranational

organisations may be admitted as eligible collateral even if the issuer is domiciled in a third country.

- There is nothing in the guidelines, that would make an ABS SPV ineligible.

Credit rating requirement

- (i) Requirements in terms of country or securities rating are based on the credit rating from Standard & Poor's, Moody's and Fitch.
- (ii) The defining criterion in the credit rating assessment is the second-highest rating awarded; this must be at least AA-/Aa3. If only one credit rating is available, this shall be used as the defining criterion.
- (iii) For securities issued by public-sector entities and the Swiss Pfandbrief institutions which do not have a securities rating, the issuer rating may be used instead. In such cases, the rating shall be based on the

issuer ratings of the three rating agencies mentioned above. For public-law institutions which are domiciled in Switzerland and which have neither a securities rating nor an issuer rating from one of the three aforementioned agencies, the credit rating awarded by the Fedafin agency may also be taken into account.

- (iv) Securities issued by the Swiss Confederation, SNB, European Central Bank, EU, Bank for International Settlements, International Monetary Fund and certain multilateral development banks designated by the Swiss Financial Market Supervisory Authority can be admitted as eligible collateral irrespective of the rating requirements.
- Swiss ABS have typically been rated by S&P and Fitch or by Moody's and Fitch. The senior tranches of Swiss ABS's have always been rated AAAsf/Aaa(sf).

Walder Wyss Ltd. Zurich, Geneva, Basel, Berne, Lausanne, Lugano Phone + 41 58 658 58 58 www.walderwyss.com



**Your business
is our expertise.
We see your business
the way you see it.**

A dynamic presence in the market – over 150 legal experts and six locations in all language areas make **Walder Wyss** the second largest law firm in Switzerland. Continuous growth, dedication and proximity to our clients determine our success. Meet a law firm which sees your business the way you see it!

walderwyss attorneys at law

Eligible markets

- (i) As a rule, the securities are traded on a recognised stock exchange or a representative market in Switzerland or an EU or EEA member state, where price data are published on a regular basis.
- (ii) Swiss franc securities of foreign issuers must be quoted on the SIX Swiss Exchange.
- Swiss public ABS transactions have all been listed on the SIX Swiss Exchange in the bond segment.

Issued volume

The minimum volume of an individual Swiss franc-denominated security must amount to at least CHF100m at the time of its admission to the list of collateral eligible for SNB repos. For securities denominated in foreign currency, the minimum volume is CHF1bn. The minimum volume is determined on the basis of the issued volume.

- Swiss public ABS transactions have always met these volume requirements.

Settlement procedure

The securities can be delivered through SIS. The intermediate and ultimate securities depository is in Switzerland or an EU or EEA member state.

- Swiss public ABS transactions have all been listed on the SIX Swiss Exchange in the bond segment and delivered through SIS SIX.

Conclusion

The broad public remains critical towards complex structured instruments, in particular towards ABS. ABS is still seen as the cause of the financial crisis back in 2007 and 2008. During the financial crisis, the Swiss Confederation and the SNB had to bail-out UBS. The bail-out was a major shock for the public in Switzerland, who, until that point, had a strong confidence in the Swiss banking market. Also, the bail-out was major, considering the volumes involved compared to the Swiss Gross Domestic Product (GDP).

Therefore, it appears that the rejection of ABS to be added to SNB's list of eligible collateral is also driven by a potential political exposure. However, the SNB should not support this approach as there is no actual reason:

- Swiss public ABS structures typically provide for a direct investment in one asset pool with one asset category only. Such structures are transparent and relatively straight forward. The historical data for such asset pools is comprehensive and of high quality.
- The senior tranches of Swiss ABS transactions have always been rated AAAsf/Aaa(sf). Given the very cautious approach taken by rating agencies after the financial crisis, it is fair to say that the rating is a strong argument toward the quality of the asset pools and the ABS structures as a whole.
- ABS structures have proven to be more stable than unsecured bond structures. As an example, the first AMAG Leasing AG transaction has been launched only weeks after the Volkswagen emission scandal evolved and has been placed successfully (like the VCL 22 transaction of Volkswagen Leasing GmbH in Germany and the Driver España two transaction of Volkswagen Finance S.A. in Spain); at the same time, Volkswagen itself had difficulties tapping the unsecured bond market. Accordingly, ABS is an important instrument to diversify funding sources and add stability to market players; the SNB should support this.
- Adding ABS to the list of eligible collateral adds liquidity to the ABS market and to the markets of the underlying assets. A further development of the ABS market would allow other originators to tap the capital markets. In turn, SMEs and other borrowers under the underlying assets would be granted indirect access to capital markets. This would stimulate the over-all economy. The ECB summarised this as follows:
"..... the ABSPP will further enhance the transmission of monetary policy, facilitate credit provision to the euro area economy, generate positive spill-overs to

other markets and, as a result, ease the ECB's monetary policy stance, and contribute to a return of inflation rates to levels closer to 2%."

Of course, the SNB, like the ECB, would have to introduce a regulatory framework outlining specific eligibility criteria for ABS. This would address the concerns of the SNB and limit the risk of objectionable ABS being added to the list. This is the approach taken by the ECB and it should be followed by the SNB as well.

Contact us:

Walder Wyss Ltd.

Seefeldstrasse 123, P.O. Box
8034 Zurich, Switzerland

tel: +41 58 658 58 58

fax: +41 58 658 59 59

web: www.walderwyss.com