THE SECURITISATION & STRUCTURED FINANCE HANDBOOK
2018

APSA
Asia-Pacific Structured Finance Association

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Origination by: Truprint Media
Printed by: Wyndeham Grange Ltd, Brighton, W. Sussex, UK

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Recent developments in the Swiss securitisation market in 2016/17

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In 2016 and 2017 the Swiss ABS market again attracted new originators. Most importantly, Multilease AG (the auto leasing company of the Emil Frey Group, a significant importer of Toyota, Suzuki, Subaru, Land Rover and Jaguar branded vehicles in Switzerland) entered the market by launching an inaugural 2½ years soft bullet revolving transaction in April 2017. There appears to be a lot of activity around RMBS and covered bonds transactions and it is expected that a number of transactions might come to market within the next 18 months. Also, market lending platforms continue to grow and are eagerly looking at refinancing opportunities, including ABS or ABS like structures. As everywhere, the market in Switzerland continues to be driven by the low (or rather negative) interest environment. In Switzerland, originators, however, have not been able to place Swiss ABS transactions in primary markets at negative yields. This could be different, in case the Swiss National Bank (SNB) would add ABS to its list of collateral eligible for repurchase transactions.

The Swiss securitisation market 2016/17 – overview

The Swiss ABS market again attracted new originators in 2016 and the first half of 2017. Most importantly, Multilease AG, the captive leasing company of the Emil Frey Group closed its inaugural transaction involving the issuance by First Swiss Mobility 2017-1 AG of CHF260,700,000 0.14% asset-backed Class A Notes, due in 2027; CHF22,200,000 1.75% asset-backed Class B Notes, due in 2027; and CHF14,100,000 2.75% asset-backed Class C Notes, due in 2027. All three classes of notes have been placed with third-party investors.

In July 2017, BMW (Schweiz) AG closed a new public ABS transaction involving the securitisation of auto lease assets originated in Switzerland. The transaction features the issuance of €325,000,000 Class A Floating Rate Notes via BMW's Luxembourg platform Bavarian Sky Europe S.A. (acting in respect of its Compartment Swiss Auto Leases 2). ING Bank N.V. and Merrill Lynch International acted as Joint Lead Managers.

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.

Recently, a fair number of market lending platforms have been looking at refinancing their portfolios. As most of the portfolios are still very small, most of the (potential) transactions involve the refinancing of the portfolios via single investor structures. Most notably, Cembra Money Bank AG refinanced a Swiss SPV that acquired a lending platform originated consumer loan portfolio from eny Finance AG. The transaction is structured as a revolving transaction so that eny Finance AG's growth will be financed over the next few years. It can be expected, that a number of similar transactions will follow and might be taken out by public or private ABS transactions at some point.

Finally, there appears to be a lot of dynamic in the residential mortgage loan space. Various players in the market seek at refinancing their mortgage loan portfolios. Structures that have been implemented include one-to-one refinancing transactions, fund structures, pension funds structures and others. Also, originators are looking at covered bond and RMBS transactions and it can be expected that a number of transactions will come to market during the next 18 months.

Trends and hot topics

Negative interest rates

Background

Swiss markets continue to be driven by the negative interest environment. The Swiss National Bank (SNB) continues to charge 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. However, there was less pressure on the Swiss franc during the last two months and exchange rates of the euro against the Swiss franc recovered slightly to about 1.14.

The three-months LIBOR CHF target range declared by the SNB remains between -125bps and -25 bps. In the last couple of months, three-months LIBOR CHF fluctuated between -70 bps and -80bps.

ABS not eligible for SNB repos Switzerland

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, ABS issuers have not been able to issue AAA tranches to primary markets at negative yields in the Swiss franc market so far, even though some corporate and ABS issuers have been able to do so in the euro market. Investment bankers close to the industry are of the opinion that the main reason is the fact that ABS are not included in the list of eligible collateral for repo transactions with the SNB. There is still hope that the SNB will accept ABS as eligible collateral at some point and follow the position of the European Central Bank (ECB) and other Central Banks. This would broaden the investor base substantially.

Structural challenges as a consequence of negative interest rates and mitigants

Structurally, rating agencies became more and more concerned about negative interest rates being charged on transaction accounts. Negative interest rates exert downward pressure on cash amounts or eligible investments held within a deal structure. However, rating agencies generally consider this impact to be negligible because cash amounts tend to be small compared to the notes' amount. However, for deal structures with higher cash amounts standing to the credit of reserve accounts, deposit accounts or similar accounts, rating agencies kept a close eye on the account bank arrangements. Account banks normally refuse to agree to a floor on the interest rates, given the exposure they have themselves to fluctuation of interest charged by the SNB on bank deposits.

As a consequence, structural features have been developed to address negative interest rates. As an example, some originators structured the transaction to avoid high cash amounts by accepting lower advance rates on the asset pool which results in lower reserve amounts being required.

Also, account banks sometimes are willing to offer account products with more attractive interest rates. However, these accounts normally provide for longer notice periods for withdrawals. Therefore, the structuring process for the account mechanics are relatively challenging, as longer notice periods are normally of concern in light of liquidity requirements. Therefore, the reserve and deposit cash amounts that are permitted to stand to the credit of such special accounts are typically subject to rather complex calculation and monitoring mechanisms.

Marketplace lending platforms

Also in Switzerland, the direct lending market is growing rapidly, even though over all volumes are still considerably low.

Whilst marketplace lending platforms are generally aiming at financing the assets directly via lenders over the platform, some platforms have been looking for larger single investors in order to ensure full funding when needed.

Some of these structures were set up as direct transfers of the assets to the investor, but some other transactions were set up under "ABS like" structures. In particular, Cembra Money Bank AG refinanced a consumer loan portfolio originated by a Swiss personal loan online provider. For purposes of the refinancing, an SPV was set up as a wholly-owned subsidiary of Cembra Money Bank AG. The SPV is purchasing the loan receivables from the loan provider and is financed by Cembra Money Bank AG. Similar structures included the issuance of notes or certificates by the platforms themselves or by SPVs that have purchased the underlying asset.

Even though debut European marketplace originated loan securitisations have successfully come to market (namely the Funding Circle (SBOLT 2016-1) transaction and P2P Global Investments Plc and Zopa Ltd. (Marketplace Originated Consumer Assets 2016-1) transaction), we believe that it still takes time until the first Swiss ABS transaction will be launched involving assets originated by marketplace lending platforms. However, we expect this market to grow over the next 12 months and further refinancing transactions to a broader investor base to be set up. We trust that some of these portfolios will grow over time so that take out transactions by ABS would be feasible.

No ABS specific legislation

Jurisdictions across the globe as well as the European Union have enacted legislation that specifically deals with ABS and securitisations more generally. Legislation addresses disclosure requirements, distribution, "skin in the game rules", investor suitability and many other topics.

In Switzerland, there is no ABS or securitisation specific legislation and ABS transactions are structured within the

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general legal framework. Whilst structures have been developed that are compliant with regulatory requirements and meet the criteria set up by rating agencies, it would nevertheless facilitate the structuring and execution process in case certain topics would be addressed by specific legislation.

Looking at the Luxembourg Securitisation Act of March 22, 2004, the following topics are of interest:

- Under the Luxembourg Securitisation Act, compartments can be formed relatively easily. Under Swiss corporate law, the segregation of assets within the same legal entity is challenging. Accordingly, the predominate view is to form new legal entities for each single transaction so to avoid any discussions in this respect.
- The Luxembourg Securitisation Act explicitly confirms that limited recourse, non-petition and subordination clauses are legal valid and binding. In Swiss transactions, legal opinions have been provided that sufficiently address the validity of such clauses, but explicit legislation would simply eliminate any remaining uncertainty.
- Under the Luxembourg Securitisation Act, licensing requirements for ABS issuers are clearly defined and a number of exemptions are explicitly provided for. In Swiss transactions, ABS issuers are subject to the general regulatory legal framework. There is some uncertainty around the regulatory treatment of securitisation structures and accordingly, it became standard that the regulatory treatment is pre-discussed and preapproved with the competent regulator, namely the Swiss Financial Market Supervisory Authority (FINMA).

- Under the Luxembourg Securitisation Act, services rendered to securitisation SPV issuers are exempt from VAT. In Swiss transactions, it is questionable which elements of the cash flows may become subject to VAT (if at all). It would be desirable if a pragmatic approach could be taken.

Swiss withholding tax

In Switzerland, ABS and securitisation transactions are generally treated as regular bonds. As mentioned above, there is no ABS specific legislation. This also holds true, when it comes to Swiss withholding tax.

Interest payments by Swiss issuers under collective fundraising transactions (such as bonds) are subject to Swiss withholding tax at a rate of 35%. Whilst Swiss investors may claim back the 35% relatively easily, but with a delay as to timing, the reimbursement process for foreign investors is more burdensome. Also, depending on the jurisdiction of the investors and further depending on the legal structure of the investors, Swiss withholding tax may be claimed back only in part, if at all. This imposes a limitation on Swiss ABS issuers to access the international debt capital markets. Exemptions are only available (temporarily) for certain types of debt qualifying as regulatory capital (such as CoCos issued by systemic relevant banks ("too big to fail" banks) as well as certain write-off and bail-in bonds).

In an attempt to strengthen the Swiss market, Switzerland is about to consider fundamental changes to its withholding tax system. On August 24, 2011, the Swiss Federal Council proposed new legislation under which the current deduction of Swiss withholding tax of 35% by the issuer of bonds on interest payments at source would have been substituted for by a respective deduction by Swiss paying agents (subject, in principle, to an exception for foreign investors). It was initially expected that the new regime would enter into force in the course of 2015 or 2016. However, in view of the negative outcome of the consultation on the draft legislation in the course of 2014 and 2015, the Swiss Federal Council decided, on June 24, 2015, to postpone a complete overhaul of the Swiss withholding tax regime, as originally planned. It now remains to be seen when and, if so, under which form, the withholding tax reform will be launched again.

The substitution of the Swiss withholding tax regime by a more investor friendly regime would allow Swiss originators to attract more international investors and the investor base would be substantially broadened. The currently limited number of Swiss ABS investors sets limitations to the volume that the market is able to absorb within a certain time period. In case Swiss ABS transactions could attract more foreign investor, it is expected that the Swiss ABS market would grow even more rapidly.

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