Banks hunt new buyers for assets hit by crisis

News analysis

'Real money' investors are the best hope for banks selling asset-backed securities, writes **Tracy Alloway**

The days when banks could create billions of dollars worth of complex securities out of dodgy loans and mortgages, and then sell them to each other, may be behind us.

New regulations aimed at cracking down on this type of financial "self-dealing" that exacerbated the financial crisis will simply make it uneconomic for banks – especially European ones – to hold many types of securitisations.

So while issuance of such asset-backed securities remains in the post-crisis doldrums, banks are seeking new buyers for the packaged loans, as well as staging a last-ditch effort to overturn the rules that make it difficult for them to buy the assets.

"Banks will still be holders of some parts of the structured finance universe but nothing like the extent that has been seen since the market started," says Mark Hale, chief investment officer at Prytania Investment Advisors. "The gamut of real money from large pension funds, insurers (albeit less true in Europe), sovereign wealth funds, credit funds, private banks and so forth, will need to take up the baton."

In the three years leading up to the subprime financial crisis, Europe's banks sold more than €1,000bn worth of asset-backed securities, packaging a variety of loans into securitisations and structured credit.

Much of that was sold to other banks, sometimes after being transformed into even more complex securities. But when the subprime panic began in 2007, trading in the securities suddenly froze, leaving banks with vast swathes of illiquid products on their books.

But new regulation aimed precisely at deterring this activity is expected to hit hard the structured credit business. Basel III rules, for instance, will make it more expensive for banks to hold securitisations by requiring more capital to be held against them. A new European directive also requires issuers of structured finance to maintain an economic interest in the product they create.

In a recent report, McKinsey predicted that banks' structured credit businesses would be "hardest hit" by the incoming regulation, adding that returns earned could fall by as much as 85 per cent. "It is conceivable that some of these businesses will not continue in their current form," it said.

"Real money" investors are now the biggest hope for banks seeking new purchasers of asset-backed securities. However, for many of these funds, the idea of buying crisis-tainted ABS is still unfathomable. Meanwhile, severe uncertainty over the fate of the eurozone and the global recovery means many are sitting on the investment sidelines – in cash.

To attract new buyers, the structured finance market has launched a public relations offensive, trying to shed the "toxic" association that seems to have tainted much of the market, in even relatively simple securitisations such as residential mortgage-backed securities. Many of these have managed to perform well over the crisis.

Fitch, for instance, unveiled a tool for investors in RMBS this week, which will allow them to plug in their own economic predictions when running the agency's model for predicted RMBS losses. Rating agencies and issuers are busy providing reams of loan-by-loan data or economic assumptions for mortgage-backed securities, to boost transparency.

But if new buyers do not emerge, banks have a contingency plan in place.

Two industry bodies, the European Financial Services Roundtable and the Association for Financial Markets in Europe, have started a project with the ultimate aim of convincing regulators to allow banks to include high-quality ABS in their 'liquidity buffers' – the war chest of liquid assets banks will be required to hold under Basel III in an effort to prevent the kind of market turmoil seen at the peak of the crisis.

Their prime collateralised securities initiative might make it easier for banks to hold each other's ABS again by boosting confidence in – and ultimately the liquidity of – the ABS market. The PCSI will act as a sort of labelling system reserved for high-quality and transparent ABS.

But this initiative is attracting criticism. "The idea of trying to provide a 'gold standard' to me is completely pointless and actually could be dangerous," Ian Hares, deputy treasurer of Santander UK, told RMBS experts at a conference this week.

Making matters worse for ABS issuers is the increasing competition with covered bonds, another way of packaging loans. Unlike the subprime securitisations that blew up in the financial crisis, the loans in these bonds remain on banks' balance sheets.

Investors in covered bonds also have recourse to the issuing bank's other assets if the loans in their bonds sour, providing added security that ABS lacks. Unlike ABS, covered bonds will be allowed in banks' liquidity buffers under incoming Basel III rules.

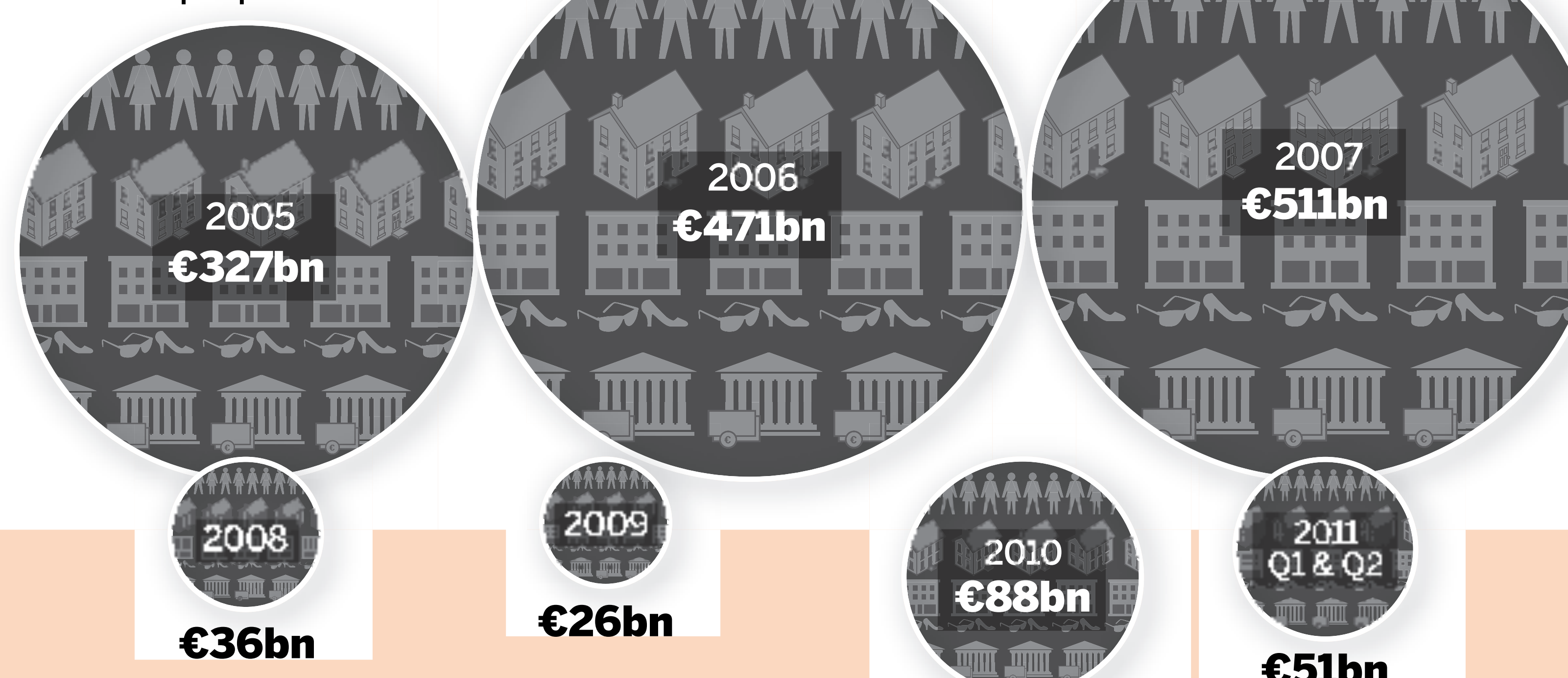
"If you think of these securities as having more or less the same risk – they are often backed by the same type of assets – then obviously you are creating an artificial incentive to buy certain products and not others," says Fabrice Susini, global head of securitisation at BNP Paribas.

A mountain of ABS needs to be refinanced in the coming years, with commercial mortgage-backed securities particularly affected. That means banks will either have to sell more securities to replace maturing deals or shrink their balance sheets.

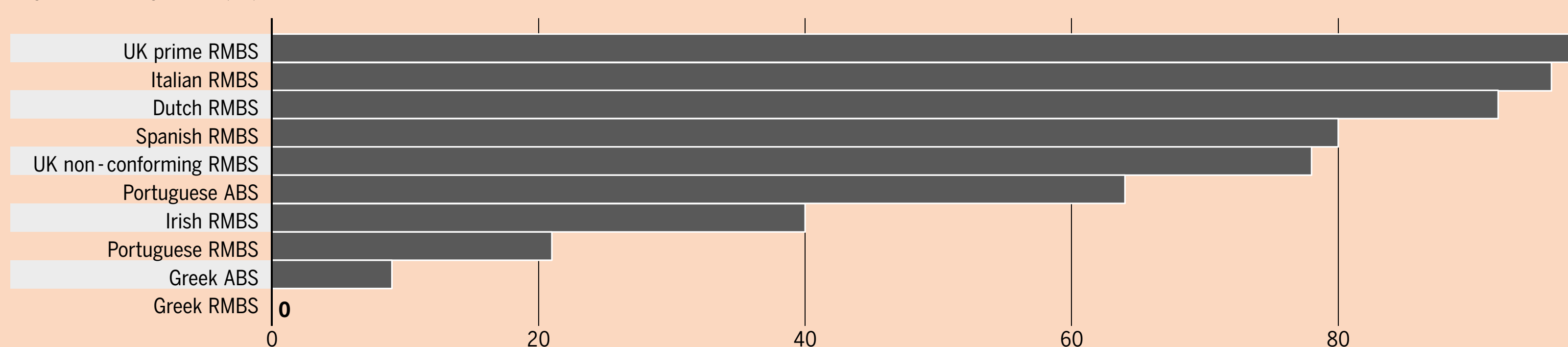
"One can imagine the banks will find ways of 'being creative' over time to get around the rules," adds Mr Hale. "But the current political climate suggests that discretion will be the better part of valour."

Dead and buried?

European placed issuance of asset-backed securities collapses post-crisis



Percentage of ABS and RMBS that maintained Aaa rating
May 2007 to May 2011 (%)



Trading post

Jamie Chisholm

A pattern emerged the first three days of this week that had some market watchers scratching their heads, but was tasty fodder for bulls.

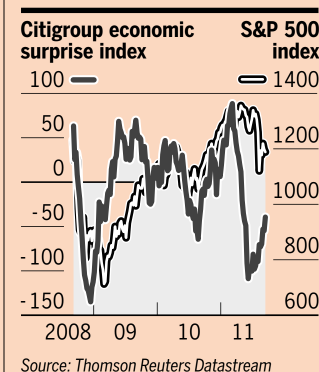
Wall Street would inherit a weak global performance, mainly on eurozone fears, but ended the session back in the black. Exasperated bears will moan that this reflects how, for all the brief periods of euro-funk, US investors refuse to accept that the bloc's fiscal woes have significant medium-term global implications.

For what it's worth, Trading Post agrees, and thinks the late summer swoon for the S&P 500 is mainly the result of worries about the economic outlook in the US. The euro mess is irritating noise to Wall Street.

We noted in June that the Citigroup Economic Surprise Index, which rises when economic data are tending to beat consensus forecasts, had slumped while equities were holding their own.

But there is a roughly two-to-three-month time lag. The CESI bottomed at the end of 2008 and the S&P 500 troughed in March 2009. The CESI hit a nadir this cycle in June and equities fell in August. Now the CESI is turning it suggests investors need the bad news to intensify if they are not to turn bullish.

jamie.chisholm@ft.com
Rolling global overview at: www.ft.com/markets



Source: Thomson Reuters Datastream

European lenders tap repo loans to beat dollar funding drought

By Tracy Alloway in London and Tom Braithwaite and Nicole Bullock in New York

European banks are tapping overseas financial groups for billions of dollars of loans to make up for a pullback from US-based money market funds, a traditional source of financing.

The private deals, which involve banks "repoing" some of their assets to other banks in return for money, are gaining in popularity as European financials try to replace lost dollar funding. Société Générale said on Monday it had €6bn worth of outstanding repo transactions, with packaged loans used as collateral.

It is thought that other French banks might be using similar loans, shining a spotlight on alternative ways for financials to source dollar-denominated funds in nervous markets. US money market funds, a traditional source of liquidity for many European banks, began cutting their exposure to some eurozone financials this year.

US money market funds reduced their exposure to BNP Paribas, SocGen and Crédit Agricole in August, continuing a trend over the past few months, according to Crane Data, a research firm. Money market funds reduced their holdings of BNP Paribas by 14 per cent, or $12bn, SocGen by 16 per cent, or $8bn, and Crédit Agricole by 8 per cent, or $3bn, Crane Data found.

A senior US banking executive said he expected the market for unsecured wholesale dollar funding to dry up completely. But his bank and others were increasing their secured lending to European counterparts via repo. "Someone who was lending money unsecured will take security but the security does not have to be dollar security," he said.

While repo transactions have always been an important financing source, more recent loans to European banks are thought to be a result of eurozone uncertainty hitting traditional funding markets. "The European banks are making decisions based on [the] prices," of funding options now available to them, one banking source said.

The loans, sometimes known as alternative capital market solutions, traditionally involve highly rated securitised assets being held as collateral. The European transactions are believed to involve higher haircuts to compensate for the perceived added risk of lending in the region.

Alongside collateral swaps, where banks strike deals with insurers or pension funds to swap their illiquid assets for other assets, the repo trades are a form of private interbank lending. One banker involved in setting up such deals said they were an example of liquidity acting as an asset class, with more liquid banks being able to capitalise on their positions.

Lex, Page 16

More news at FT.com

● **Markets Live**
Read Neil Hume and Bryce Elder every weekday from 11am

● **The killer wave**
Is the mystical world of technical analysis telling us to be prepared for substantial losses?
www.ft.com/alphaville

● **Risk management**
Quick view: The rogue trades at UBS throw up further questions about risk management. Were they asleep at UBS?
www.ft.com/tradingroom

● **The rogue returns**
Video: The FT's Lex team discusses what the events at UBS will mean for the Swiss bank and the investment banking industry
www.ft.com/lexvideo

● **The commodities note**
Sign up to have daily analysis from the fast-moving commodities world sent direct to your inbox
www.ft.com/commodsdaily

Hong Kong: calling the end of the peg

beyondbrics, the FT's emerging markets hub

William Ackman, founder of hedge fund Pershing Square Capital Management, has placed a bet that would profit if Hong Kong severed its 28-year-old peg to the US dollar, **writes Robert Cookson**.

The headline-grabbing move plays into the current debate about whether Hong Kong should rethink the mechanism that links its currency to the US dollar at a rate of HK$7.80 to US$1.

By automatically importing ultra-loose monetary policy from the US, the peg is contributing to soaring inflation and property prices in the Chinese city.

Ackman is buying Hong Kong dollar call options, which give investors the right to buy the currency at a set price at a specific date, because they are "inexpensive", according to Bloomberg, which reported: "The easiest way for the authorities to allow the currency to appreciate would be to change the peg to HK$6 per US dollar, a 30 per cent gain, and then link to the yuan [the Chinese renminbi] over three to six years, Mr Ackman said."

Ackman's bold call runs contrary to the views of the Hong Kong government and most residents and currency traders in the city, who think the peg continues to serve Hong Kong well and should not be changed.

Hong Kong's exchange rate mechanism, which has survived speculative attacks since its introduction in 1993, allows the Hong Kong dollar to trade in a narrow band from HK$7.75 to HK$7.85 against the US dollar.

Investors such as Ackman, who reckon the Hong Kong dollar will be allowed to break out of this range, can place a wager by purchasing HK dollar call options.

For example, a one-year option to buy the Hong Kong dollar at a strike price of HK$7.75 per US dollar costs 85 basis points, according to Gerrard Katz, head of FX Trading for Asia at BBVA. That means it costs just $8,500 to buy the right to exchange US$1m for HK$7.75m in a year's time.

In the unlikely event the HK dollar was revalued against the US dollar by, say, 30 per cent before the option expired, to a level of HK$5.96, the put option would result in a $292,000 profit, a 36-fold return on the original investment.

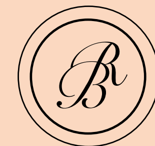
However, the reason these options are cheap is because the prospect of Hong Kong officials engineering a one-off revaluation against the US dollar is remote. While such a move could, in theory, damp inflationary pressures, it would also destabilise Hong Kong's export-driven economy and invite speculative capital inflows.

Also, there is no prospect of the Hong Kong dollar being linked to the renminbi soon, because the Chinese currency is not convertible.

If Ackman is right that the Hong Kong dollar could be linked to the renminbi by 2015, then buying five-year Hong Kong dollar call options would be a blockbuster trade. However, the heavy betting is that Ackman has been buying fool's gold; the dollar peg is here to stay.

Rethink: the 28-year-old link to the dollar is in focus

www.ft.com/beyondbrics



B R I J U N I   R I V I J E R A

Pursuant to Article 14, paragraph 1 of the Agreement on the implementation of the,'Brijuni Rivijera" Development Programme dated 29 July 2011 and the Decision of the Commission for the implementation of the public tender, the company Brijuni Rivijera d.o.o. (Ltd.) Pula hereby informs all the interested investors that the following has been published:

Public Tender
for the selection of the best investors for the implementation of the, 'Brijuni Rivijera" Development Programme according to the BOT Model

The subject of the tender is the selection of the best investors for the implementation of the ,'Brijuni Rivijera" Development Programme according to the BOT model in the locations Sv. Katarina Island-Monumenti (Pula), Hidrobaza (Pula) and Pineta (Fažana).

,'Brijuni Rivijera" Development Programme in the location Sv. Katarina Island-Monumenti (Pula) shall be implemented by granting concessions for the ports of nautical tourism and the rights of construction and easement on the mainland, all this for the period of 50 years.

In the locations Hidrobaza (Pula) and Pineta (Fažana) ,'Brijuni Rivijera" Development Programme shall be implemented through the model of the right of construction and the right of easement for the period of 66 years.

I.

The site Sv. Katarina Island-Monumenti is located in the northern part of the Port of Pula. Two ports of nautical tourism have been envisaged for the site Sv.Katarina Island-Monumenti, with the total capacity of 550 berths and 1200 dry docks with accompanying facilities, a 4 to 5 star hotel with 200 beds and a complex of various public facilities with a gastronomic centre.

The Government of the Republic of Croatia published the announcement on granting the concession in the Official Gazette of the Republic of Croatia – Narodne Novine no. 103/2011 dated 12 September 2011 (www.nn.hr), which announcement is also available on the official website of the Government of the Republic of Croatia (www.vlada.hr) and the company Brijuni Rivijera Ltd. (www.brijunirivijera.hr).

II.

The site Hidrobaza is located opposite the Brijuni Islands, 7 km away from the Pula Airport. 4 to 5 star hotels with the total capacity of up to 1000 beds have been envisaged for the Hidrobaza site, providing their guests with a unique holiday experience in the sun and on the beach along with top gastronomy. The remaining surface area in the location is the zone intended for sports and recreation.

The complete invitation to tender was published in the Official Gazette of the Republic of Croatia – Narodne Novine no. 104/2011 dated 13 September 2011 (www.nn.hr). The invitation to tender is also available on the official website of the Croatian Agency for State Property Management (www.audio.hr), the Croatian Chamber of Commerce (www.hgk.hr) and the company Brijuni Rivijera Ltd. (www.brijunirivijera.hr).

III.

The site Pineta is located opposite the Brijuni Islands, 500 m away from Fažana and 14 km away from the Pula Airport. 4 to 5 star hotels with the total capacity up to 650 beds have been envisaged for the Pineta site, providing their guests with a unique holiday experience along with top gastronomy. The remaining surface area, in the immediate vicinity of pine woods, is the zone intended for sports and recreation.

The complete invitation to tender was published in the Official Gazette of the Republic of Croatia – Narodne Novine no. 104/2011 dated 13 September 2011 (www.nn.hr). The invitation to tender is also available on the official web pages of the Croatian Agency for State Property Management (www.audio.hr), the Croatian Chamber of Commerce (www.hgk.hr) and the company Brijuni Rivijera Ltd. (www.brijunirivijera.hr).

For further information please contact us via e-mail: info@brijunirivijera.hr