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Consolidation call

Protectionism and political risk threaten Euro ABS recovery

The recovery of the European ABS sector visibly lags that of the US, as signified by the disparity in public issuance and in the fast-paced tightening of benchmark spreads. A growing number of market participants believe that an approach similar to the US' TALF and PPIP programmes is necessary for the re-opening of the European primary market – with issues over political risk and protectionism hindering any progress.

Numerous programmes have been set up across Europe in the form of country- or bank-specific 'bad banks' or SPVs, asset protection schemes and government guarantees for triple-A rated ABS paper (SCI passim). However, the failure to consolidate such programmes could ultimately be detrimental to the revival of European ABS.

"Political risk and protectionism is delaying recovery in the European ABS markets," says Douglas Long, evp business strategy at structured finance software firm Principia. "Until there is greater clarity and more unity across the European initiatives, investors will be wary of making a wholesale return."

He continues: "Industry bodies like the ESF have helped overcome some of these issues, with recommendations for standard RMBS issuer reports across Europe, for example. This is now a requirement in the UK asset guarantee scheme and demonstrates how a more unified approach can help build investor confidence."

According to one UK-based ABS investor, preliminary discussions concerning the debut UK government-guaranteed RMBS issues are underway, with the first deals likely to come to market after the ESF-IMN Global ABS conference next week. But, at the same time, issues over price discovery and the availability of funds for investors remain problematic.

Long says that while the UK guarantee system for RMBS is great in principle, in reality it only addresses one aspect of the problem. "The inability to raise cash to purchase these assets in the first place still remains. US investors are being offered leverage to do this. In Europe, countries have adopted individual programmes to support local ABS and MBS markets, but a more consolidated approach is needed to encourage the European securitisation market as a whole."

According to Conor O'Toole of Deutsche Bank Research, the European market continues to face the twin challenges of a lack of substantial depth in bid-side liquidity and an unwillingness to sell down at distressed levels. "Indeed it could be argued that the absence of government-provided leverage via a TALF/PPIP-like programme is inhibiting a more orderly US-style asset unwind – one where buyers' return hurdles can more easily be matched with acceptable seller write-downs," he says.

After a cautious start, TALF appears to be gaining momentum and is driving continued tightening across asset classes and increased investor appetite down the capital structure, as investors seek greater yields. For example, US auto ABS issuance volume in May stands at US$15.9bn, according to Glenn Schultz, md and head of ABS and mortgage research at Wachovia Capital Markets.

While this figure is less than the US$27.7bn seen for the same period in 2008, it is a substantial increase from Q208 when the credit crunch took hold and issuance fell to only US$6bn, he notes. It is also US$15.9bn more auto ABS issuance than that seen in the public European ABS market during the same period.

“Many regular issuers have returned to the ABS market, though these have mainly been lenders to prime borrowers,” Schultz adds. However, he concludes that companies that primarily service subprime borrowers have still not accessed the market, even with the support of TALF.

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