Liquidity conduits

DENE WHITE ASSESSES THE RESILIENCE OF ASSET-BACKED COMMERCIAL PAPER AND EXPLAINS WHY IT IS STILL AN ATTRACTIVE SOURCE OF DIVERSIFIED FUNDING FOR CORPORATES.

During the lull in the securitisation markets following the 2007 sub-prime crisis and the ensuing financial markets dislocation, one securitisation market remained very much open and, for a time, was viewed as the bedrock of the securitisation arena: asset-backed commercial paper (ABCP). ABCP is the financing, on a non-recourse basis, of a portfolio of receivables generating a cashflow. It is similar to traditional invoice discounting, albeit on a larger scale and for a broader spectrum of asset classes.

While traditional investors shied away from most securitisation products between 2007 and 2008, particularly in Europe, investors could still be found for ABCP programmes. Such resilience was due largely to the flexibility and strong performance of ABCP securitisation structures, but also to liquidity support provided to ABCP programmes by the banks that run them – a comfort to investors that they will be repaid in a timely fashion should they choose not to roll over their investment and if alternative investors can't be found for the maturing paper. Consequently, ABCP securitisation has remained an attractive source of diversified and competitively priced funding for corporates.

ABCP tends to operate at the "short-end" of the securitisation market, and financed assets include trade receivables, factored/invoice discounted receivables, auto loans/leases, insurance premium funding loans, credit cards and equipment leases. The assets are usually sold to "multi-seller vehicles", which contain a mixture of assets from a number of originating companies, thus providing diversity.

Individual transactions are non-recourse to the originator and are usually structured to a minimum "deemed" AA/Aa2 level through the provision of credit enhancement facilitated by the originating company. Therefore, the rating of the transaction is often higher than that of the originating company, usually leading to pricing benefits over other sources of finance, as well as providing another source of corporate funding. The advance rate is determined by the structuring bank, which will use rating agency methodology based on the historic performance and composition of the receivables.

As the structure is non-recourse to the originator, ABCP investors stand to bear any losses not absorbed by the credit enhancement. Corporates benefit from a high level of confidentiality because investors don't know the identity of the originators of the underlying assets. Equally, in normal circumstances the corporate's debtors are not notified of the sale, so there is no disruption to client relationships. Periodic performance data relating to the portfolio is distributed to the rating agencies and ABCP investors on a no-names basis.

MORE FLEXIBLE Conduit securitisation offers increased flexibility (a consequence of the revolving nature of the structure), with new receivables generated and sold to the conduit on a regular basis (normally weekly or monthly). Should there be a reduction in the volume of receivables, excess collections are used to retire maturing ABCP. Should the available receivables pool increase, the special purpose vehicle will buy new receivables and fund them by the issuance of additional ABCP within the programme limit.

Use of collected funds between settlement dates by the corporate is dependent on its credit rating, the nature of the receivables and how

Figure 1: Asset class breakdown

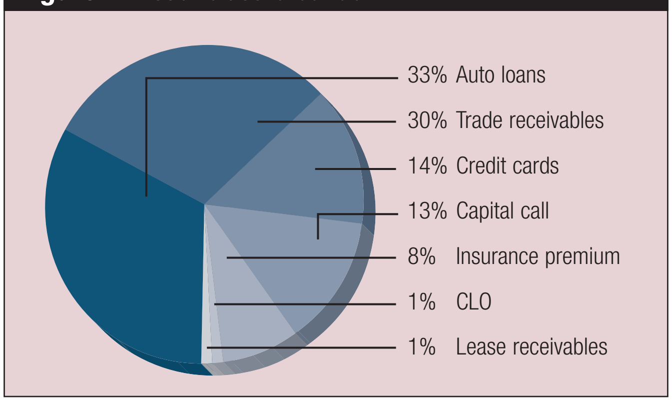
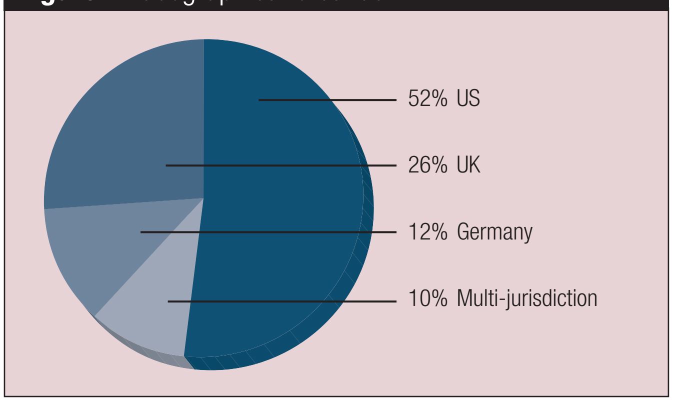
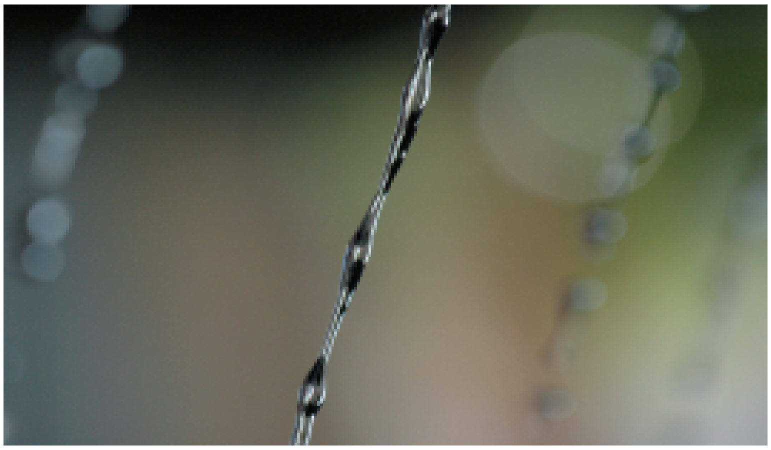


Figure 2: Geographical breakdown





the deal has been structured. Therefore, ABCP securitisation provides a very efficient tool for funding a corporate's working capital requirements. The conduit passes on to the client its funding cost, which normally tracks LIBOR and EURIBOR quite closely.

STILL ROBUST At the end of June 2010 the ABCP market totalled \$398bn in the US and €30bn in Europe. Although down from the market peak in August 2007 of \$1,200bn and €100bn respectively, much of the decline is due to a reduction in the number of asset-backed securities (ABS) being funded in structured investment vehicles, which became a high-profile casualty of the credit crunch. The market for ABCP conduits that primarily focus on financing banks' client receivables remains robust, however, and is expected to settle in the \$350bn-\$400bn and €30bn-€35bn range for the foreseeable future, providing a deep pool of liquidity.

Following the credit crunch of 2007 and financial crisis of 2008, the summer of 2010 saw financial markets rocked by the concerns over European sovereign debt, which resulted from the ballooning budget deficits of peripheral members of the Eurozone. The associated and well-publicised ratings downgrades and weakening public finances of Portugal, Italy, Ireland, Greece and Spain have had an extremely limited impact on ABCP securitisation markets. This is due to the small amounts of exposure to assets from these jurisdictions within ABCP programmes, with the majority of these assets being short-term trade receivables traditionally seen as very low risk. Furthermore, ABCP markets remained open during the crisis, with continued high investor demand for paper from conduits supported by strong banks. Due to this, funding rates for prime ABCP programmes have remained relatively stable over 2010, and have tightly tracked LIBOR.

With continued investor demand for ABCP backed by "vanilla" short-life asset classes, ABCP securitisation will remain a feature on the money market landscape for the foreseeable future. The continued high demand for ABCP issued by programmes supported by highly rated banks means that securitisation is set to remain a valuable, and often lower-cost, funding proposition or working capital management tool for larger corporates going forward.

While securitisation is more complex than typical syndicated loans or bond solutions, the technology is increasingly commoditised and software systems are available to help with reporting. Upfront legal costs are not as high as many might expect. Because the multi-seller conduits are established vehicles with their own funding, the cost is limited to the legal cost of adding a new portfolio of receivables.

Case study

Lloyds Banking Group has been arranging ABCP securitisation facilities for its clients since 2002.

THE CLIENT: A UK insurance broker with a substantial business in insurance premium funding loans (to let customers buy motor and home insurance via monthly instalments).

THE CHALLENGE: Financing the purchase of a rival company. The acquisition needed to be completed within a tight time frame and in the aftermath of the Lehman bankruptcy. Lloyds Banking Group was able and willing to provide bridging facilities over the year-end. The aim was to refinance the bridging facilities at a later date by a lower-cost debt package that included an ABCP securitisation facility. The client also required ongoing working capital facilities to fund its expanding insurance premium funding loan operation.

THE SOLUTION: The conduit securitisation team had been engaged in discussions with the client before it had identified the acquisition target. From this early stage the value that an ABCP securitisation solution would offer the client was recognised. The client was impressed by the team's expertise in ABCP securitisation, with the bank having previously closed three insurance premium funding loan receivables-backed transactions. The acquisition provided the client with the critical mass of insurance premium funding loan receivables to invest in a securitisation programme. The ABCP securitisation facility financed both the client's working capital requirements and refinanced the takeover-related debt.

RESULT: The funding package structure provided the client with the facilities to execute a successful acquisition within a very difficult credit environment. The securitisation facility that was structured to take out the bridge financing meant the customer benefited from funding that was significantly below bank rates and matched funding to the asset base, limiting the risk of negative carry in a volatile credit market. Although this facility financed insurance premium funding loans, it could also have been used for other asset classes such as trade receivables.

Total upfront fees for a £250m transaction, covering structuring, legal, rating and audit fees, are usually in the range 30bp-40bp.

While securitisation in Europe remains on a path to much needed rehabilitation both with investors and issuers, the ABCP market continues to offer a strong alternative source of finance, and is often used to warehouse assets before being "termed out" in the public ABS markets. When it comes to funding, resilience and competitive pricing don't always come together, but the last few years have demonstrated that treasurers can rely on the ABCP market for both.

Dene White, head of origination, conduit securitisation, Lloyds Banking Group.
+44 (0)20 7158 1931
dene.white@lloydsbanking.com

LLOYDS BANKING GROUP