Making a success of the securitisation process

Aidan O'Neill and Ronan White, of Anglo Irish Bank Corporation plc, chart the bank's debut into securitisation and provide some tips for first-time issuers.

The September 2000 edition of *The Treasurer* carried an article dealing with the increasing use and benefits of securitisation. A further article in the October edition pointed out some of the drawbacks of transactions.

Anglo Irish Bank Corporation plc (AIBC) completed its initial securitisation of UK investment property loans last September. This article provides an overview of securitisation from the point of view of a first time issuer.

Anglo Irish Bank Corporation plc (AIBC)

Anglo Irish Bank Corporation is an Irish publicly quoted company engaged in lending, treasury, private banking and funds management. Investment property lending is a key focus in the UK.

Pre-tax profits for the year end 30 September 2000 were €133.6m (1999 €89.1m). At that date its balance sheet stood at €11.047bn (1999 €7.935bn).

The bank is rated by Fitch IBCA and Moody's. It has short-term ratings of F2 and P2 and long-term ratings of A– and Baa1.

The bank's first securitisation transaction, Monument Securitisation No1 plc, was completed in September 2000. ■

Reasons for undertaking the transaction

A comprehensive funding diversification programme and an enlargement of the bank's capital base has underpinned AIBC's strong growth in the past 15 years.

As a regulated bank and a publicly quoted company, return on equity and efficient use of capital are key considerations for management and for market assessment of the bank's performance. AIBC's capital base has grown through a combination of rights issues, retentions, preference share and subordinated debt issues.

While securitisation was a capital and funding mechanism considered from time to time, it was only in late 1998 that a decision was made to proceed. Notwithstanding anecdotal evidence as to the difficulties and complexities surrounding such a transaction there were a number of evident benefits.

- **Regulatory capital release –** the transfer of assets off balance sheet reduces the amount of capital required in support of these assets. Return on capital can be increased, and new lending business can be written against the capital released.
- **Broadening the funding base –** because the bonds issued in a securitisation transaction tend to be purchased by specialist investors, AIBC was tapping into a new source of funding. The profile of the bank in the wholesale markets was further enhanced.
- **Risk transfer, relationship management –** a bank must operate from a prudential and a regulatory point of view on the basis of approved limits for each client. A client relationship can be broadened and the overall return from that relationship can be increased, if some of the risk is transferred off balance sheet.
- **Validation of business methods –** a benefit not originally identified was the validation of business methods arising from the comprehensive due diligence exercise undertaken as part of the overall process. While this was a qualitative feature, it nevertheless gave a clear demonstration to AIBC's management as to the effectiveness of its lending operations in the UK.


Aidan O'Neill


Ronan White

Transaction structure

AIBC sold a portfolio of £375m of UK investment property loans to Monument Securitisation No 1 plc (Monument). Monument funded the purchase through the sale of rated bonds in the open market. Four tranches of rated bonds were sold to outside investors, and a fifth tranche of unrated bonds representing its capital investment in the transaction was taken up by AIBC.

An equitable assignment and a declaration of trust were key components of the transaction. AIBC retained legal title to the loans and the underlying security to ensure that its relationship with its clients was not significantly altered. A power of attorney provided for a full legal transfer in the event of default or non-performance by AIBC under the terms of the servicing agreement.

The servicing agreement provides for the continuous management of the loan portfolio by AIBC. The bank is also entitled to the surplus income arising on the loans after all costs have been discharged. This is released to AIBC on a delayed basis.

So, that's the theory.

But what did the securitisation process entail?

- **Selecting the working group –** we needed a project team to manage the transaction. The team needed to be small, but given the complexity of securitisation, it also required people with expertise in banking, treasury, IT, legal documentation and finance.

  Each transaction needs a lead manager and we considered a number of investment banks for this role. In making our decision, we considered the size and scope of each investment bank's securitisation department, the number of individuals with commercial mortgage securitisation experience, specific transactions they had brought to the market in the past, and their availability to the project team. Another key factor was their ability to market and distribute the issue.

  We wanted to work with lawyers who were familiar with every aspect of commercial mortgage securitisation and who were prepared to work with us in a proactive manner. We had to be confident in the lawyers' ability to anticipate any likely legal or tax issues and design appropriate solutions.

  Most securitisations have ratings from two agencies but, in reality, there are only three ratings agencies to choose from. The beauty parade was therefore small and price competition was limited.

  The Bank's auditors undertook the role of validating all financial information and the integrity of our systems.

- **Asset selection and due diligence –** as investment property lending represents a significant portion of our UK business, this was the obvious pool of assets to be securitised. Within the pool, the individual assets had to meet certain criteria. First, loans had to be as standard as possible, so that they could be grouped together easily. We also considered, inter alia, the probability of prepayment, the mix of property types, geographical diversity, tenant mix, the period remaining until maturity and the duration of contracted rental income.

  Prior to issuing details to the lawyers, accountants and ratings agencies, we undertook a thorough internal due diligence. This had the dual result of ensuring that data was clean when it was handed over and of validating our internal processes.

- **Selling the issue –** a sales roadshow followed closely on the release of a research paper by the lead manager and the preliminary offering circular (Red Herring). We put two sales teams together, each made up of AIBC and lead manager personnel. The roadshow covered 11 European countries and was particularly targeted at investors in the junior bonds sector. Some 60 institutions were met during this process.

Lessons learned

The above can only give a snapshot of the transaction. While we started with a basic knowledge of the theory of securitisation, we learned a number of practical lessons during the process that may be of use to other first-time issuers.

- **Get your IT right –** you need to be sure that your systems can deliver information to ratings agency specifications. At the start we had too much manual intervention in the preparation of our database, resulting in a slow turnaround of information and a high error rate. Automating the process provided rapid access to information and maintained data integrity.
- **Manage expectations –** nearly every investment bank we met suggested a project timetable of between 16 and 20 weeks. We now know, with the benefit of hindsight, that very few – if any – first-time issuers will be able to meet this timetable.

  A 16-week turnaround assumes that all internal systems and procedures are in place and that a pool of assets has already been selected and optimised. It is therefore vital to manage the expectations of senior management with regard to delivery dates. As a rough guide, everything will take at least twice as long as you thought!
- **You know your business better than any third parties –** investment bankers, lawyers, accountants and ratings agencies will all look at aspects of your business in order to make their own assessments. Ultimately, the success of the issue in terms of ratings, pricing, and structure will depend on the opinions formed by these parties. Therefore, it is important to spend time taking them through your business and

Monument Securitisation No 1 plc

Bonds	***Class***	***£ (m)***	***Rating***
	Class A	297.2	AAA/Aaa
	Class B	44.0	A+/A2
	Class C	24.4	BBB+/Baa2
	Class D	9.4m	BB+/Ba2

Lead manager	Merrill Lynch
Co-leads	ABN Amro, Barclays, Deutsche, HSBC, ING BBL
Lawyers	Clifford Chance
Accountants	Ernst & Young
Ratings agencies	Fitch, Moody's

showing them how it differs from others in your field. Challenge their basic assumptions – they may not understand your business as well as they think.

- **Every deal is different –** issuers have different reasons for securitisation, different assets and different business structures. In our case, for example, relationship management is key, so we needed to retain a degree of flexibility in dealing with our customers. Structuring the deal in this way involved a lot of negotiation with ratings agencies to demonstrate to them that this flexibility did not have a negative impact on the transaction.
- **Get your project team right –** the people you select to run the transaction will require a variety of skills and a high level of commitment. They will also need to dedicate several months to the transaction and should be freed up totally from other assignments for the duration of the project. The mix of skills is important – you need to have at least one person capable of negotiating each part of the transaction.
- **Get your back-up right –** you will need priority access to back up departments such as administration, finance and IT in order to have rapid access to all the information you may require.
- **Ask questions –** before appointing professional advisers, have preliminary meetings with as wide a selection as time allows. Interview them in detail and make sure you ask tough questions about costs and limitations on liability. Then prepare a short list and meet each on several occasions.
- **Meet other issuers –** we found it useful to meet with other issuers, most of whom were happy to share their knowledge and experience with us.

Repeats are easier

Much has been written about securitisation and much securitisation business is now being written. The cliches suggest that it is a painful and onerous process and that it puts additional demands on the treasurer and his staff going forward. The first transaction is likely to be time consuming, at times frustrating and does involve a steep learning curve on the part of the project team.

However, a repeat issuer can expect to see efficiencies coming through in subsequent transactions, and we are looking to future issues to derive further benefits and cost efficiencies.

Securitisation opens up a new vein of funding and capital and gives access to an increasingly sophisticated investor base. While it is not going to be suitable for everybody, in terms of their funding needs, it has certainly paved a path for us as we plan for the future funding for AIBC. ■

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