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Securitised Assets Whitepaper

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+44 (0)20 7832 6517
info@camradata.com
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Welcome to CAMRADATA's Securitised Assets Whitepaper

In 2015, as the rumbles of the 2008/9 financial crisis were fading away, a paper from the International Monetary Fund noted that "placing private securitisation markets back on a firm and sustainable footing has never been more important".

It noted that financial risk-taking had resurfaced, "but securitisation has yet to retake its instrumental role in rekindling credit flows and diversifying risks".

After some of the worst portfolio losses in almost a century being attributed to asset-backed securities, investor reluctance was understandable.

Almost a decade on from that paper, however, markets, regulators and investors have begun to accept the reappearance of these assets. An article by Deutsche Bank in early 2023 even touted the rise of the CLO ETF as a natural evolution of an asset class that many had once consigned to history.

So what has changed since the MBS, CMBS and all the other acronymic pre-packed solutions wrought havoc on the investment landscape? And are investors and regulators ready to take the plunge again as they seek diversified and sustainable returns?

In this whitepaper, we will dig into the future of securitised assets, examining the game (rather than the player) and discuss how such strategies might fit into mid-21st century portfolios, which come under much more regulatory and sustainability scrutiny than their earlier cousins.

Meet the Team

Natasha Silva
Managing Director, Client Relations

Amy Richardson
Managing Director, Business Development

Sam Buttress
Associate, Business Development

Sarah Northwood
Marketing and Events Coordinator

Orin Ferguson
Associate, Business Development

Securitised Assets Roundtable

The CAMRADATA Securitised Assets Roundtable took place in London in November 2023

A new era for securitised assets

In 2015, as the tumult of the 2007/08 banking crisis was fading into memory, a paper from the International Monetary Fund noted that "placing private securitisation markets back on a firm and sustainable footing has never been more important". Almost a decade on from that paper, however, markets, regulators and investors have only just begun to accept the reappearance of these assets.

So, what has changed since MBS, CMBS and all the other pre-packed solutions wrought havoc on the investment landscape? And are investors ready to take the plunge again in the search for diversified and sustainable returns?

To find out, CAMRADATA invited industry leaders and experts to discuss how they are engaging with securitised assets and what these could offer investors' portfolios.

"Prior to 2018, this market was very niche," Xavier Lassau, senior portfolio manager at AXA IM Alts, says. "However, since then we have seen significant demand for securitised assets. To me, the main reason for this was, back then, rates were so low that investors were just looking everywhere for yield.

"Now, rates are at higher levels and securitised assets are much more mature. When we sit across from people [in pitches] they understand them more and benefits they can bring."

Due to the severity of 2007/8, the rehabilitation of securitised assets has required serious work; our panellists noted how negative perceptions are still being tackled. One key issue that had to be overcome, according to Chandra Gopinathan, senior investment manager at Railpen, was the perception people had about the homogeneity of this asset class.

"It is quite heterogeneous as an asset class," explains Gopinathan. "There is a whole bunch of variation – some are fixed rate, floating rate, callable and so on. Institutional investors have played and continue to play in a couple of these buckets."

The benefits of holding securitised assets

When asked what is increasingly drawing institutional investors towards securitised assets,

> *"The asset class has so much granularity and texture that you can really pick and choose. But that, of course, leaves a lot to do in terms of manager research. Going forward, we're going to use securitised assets much more as a cash flow source, given that generating cash flows is a very important piece for our clients. It's very productive from that perspective. "*

several of the speakers pointed to the asset class's contribution to diversification.

Panellist Steven Hickey, head of credit research and senior investment consultant at XPS Investment, works with pension schemes on their asset allocation plans. For him, including securitised assets is clearly an attractive choice, especially for those where liquid credit forms a large part of the overall strategy and/or is used to support LDI mandates as part of a scheme's LDI collateral waterfall.

"We think there's a strong investment case for the long-term strategic role of these assets within UK schemes," he says. "The addition of securitised assets can improve both the return and diversification of a portfolio, without compromising on liquidity."

Julita Perelgritz, senior investment manager at Cardano, pointed to the sheer number of securitised asset options available to investors.

The asset class has so much granularity and texture that you can really pick and choose," says Perelgritz. "But that, of course, leaves a lot to do in terms of manager research. Going forward, we're going to use securitised assets much more as a cash flow source, given that generating cash flows is a very important piece for our clients. It's very productive from that perspective."

For investors willing to do the preparatory work, there can be areas of securitised assets that offer attractive alpha-generation qualities. Gopinathan cites the example of credit card debt as an underlying asset to securitised instruments, explaining how American Express transactions offer attractive returns and benefit from a strong credit rating, especially if the borrowers are on top of their repayments.

"It's the most vanilla asset that you can have," Gopinathan says. "You have premium customers – people with high credit scores who pay their credit card bills every month – and you're still receiving 5.5%. Even compared to AAA-rated government bonds, there is a strong investment case for introducing AAA-rated credit card ABS."

The role of regulation

One issue that divided the panel – with some claiming it has opened the door for securitised assets and others arguing it remains an obstacle to them – is the role of regulation. Following the 2007/8 crisis, insurers across Europe cut back on securitised investments and this was further hampered by the introduction of Solvency II in 2016, which in effect penalised investments in this space.

Revised capital requirements were introduced in Solvency II amendments in late 2018. These new products were called simple, transparent, and standardised (STS) securitisations and were designed to encourage insurers to re-engage with securitisations. This new approach was welcomed by AXA IM Alts' Lassau: "From an investor point of view, and for my clients, I'm happy with the [revised] Solvency II treatment.

> ***"Securitised assets have become more attractive among institutional investors in recent years due to the diversification and alpha benefits they can offer – but they are not immune to the wider macroeconomic backdrop."***

"STS securitisations make sense and I'm in favour of more transparency. It's not perfect, but you get more comfort doing exactly what the standardised structure asks. It should be the same for every type of securitised credit product, to remove some of their complexity."

Others had a different take on the impact of regulation; James King, head of structured credit at M&G Investments, pointed to a mismatch of regulatory approaches for buyers and sellers of securitised assets. He notes that Solvency II requires the issuer to enforce the compliance of whoever it sells the assets to, which creates the opportunities for exploitation.

"Regulation in Europe has been a disaster for the asset class," King says. "It's been the single biggest aspect holding the asset class back over the years. There's no doubt the regulation is well-intentioned, but its execution is problematic."

One problematic area of execution the panel identified was the role of ESMA's templates, which are a framework for reporting any securitisation that meets the STS requirements. These were introduced to improve standardisation in the market and help regulators with risk monitoring.

"There has been changing guidance around the ESMA templates," says Hickey. "This has introduced a lot of uncertainty – to the point that some managers don't seem comfortable investing in large parts of the universe because the guidance is not straightforward."

Providing an asset management perspective, M&G's King explains how this confusion actively holds up client deals. He gave an example of a US transaction under discussion in the past few weeks where there was general confusion about what would be STS securitisation compliant and what would not be.

"They do the templates on day one, but they'll make no representation that if the regulations change, they will change their reporting," King says. "You've just got to make a judgment call – what's my ability to influence this bank in the future? What happens if this asset leads to a loss? Will I get sued?

"If you're spending half your day worrying about this, that's half a day you're not actually doing genuine credit work."

Further regulatory changes are proposed that could make investment in securitised assets more straightforward. Jack Edwards, Head of Credit Solutions at Phoenix Group highlights the area of matching adjustment (MA) reform, an area of Solvency II that is currently under review by the Bank of England and the Prudential Regulation Authority. He explains that under the current rules, asset classes without contractual cashflow certainty are difficult to include.

"The largest pool of capital that can be invested directly for many insurers is provided by MA funds, where typically long-dated liabilities are backed with long-duration cashflows. In order to be an eligible asset for these funds, certain criteria have to be met – most notably cashflow fixity," Edward says. "Elements of MA reform may allow for some form of cashflow uncertainty, this could result in more scope for securitised assets going forward."

Considering the macro impact

Securitised assets have become more attractive among institutional investors in recent years due to the diversification and alpha benefits they can offer – but they are not immune to the wider macroeconomic backdrop.

With the panel discussing how securitised assets would hold up in a more challenging economic environment, Edwards, argues they suffer from a changing interest rate outlook. "This is a tough asset class to invest in at the moment because of the rates environment," Edwards says. "Due to the fact rates have gone up and coupons are much higher than they were, the front end of our book is throwing off more cash than it did previously and therefore the requirement for short term assets is not as high.

"That reduces securitised assets' relative attractiveness for meeting our goals, as a very particular type of investor. It doesn't necessarily rule them out but makes it a much more difficult comparative discussion."

Perelgritz, who agrees with the benefits of holding these assets, points out that the new higher rates changed investors' perceptions of value across all asset classes, including securitised assets.

"Since the global financial crisis, spreads have compressed substantially across credit asset classes, so any incremental spread pick up was highly valued and pushed investors towards ABS," says Perelgritz, giving the example of substituting cash with high grade ABS for extra return pick up. "Now, with yields so much higher – across the board – there is less need to chase the yield."

In addition to the rate uncertainty, asset allocators are also having to contend with stunted growth outlooks in many major economies. As a result, the direct link between securitised assets and challenged consumer spending is causing caution in the market. This is where areas of securitised assets linked to mortgages and credit card spending have come under greater scrutiny, due in large part to the legacy of the [sub-prime] mortgage-led 2007/8 crisis, but M&G's King was more positive about the current health of the asset class and its outlook.

"We hear a lot from investors saying they like the asset class but they don't want to invest in a stressed consumer right now, which is interesting because the default risk associated with RMBS is extremely low as mortgages are the last thing anyone defaults on in Northern Europe, unlike other areas," King says, who argues there are clear caveats to an apparently bleak economic outlook.

"The idea that the consumer is under stress and debt repayments are now a bigger proportion of disposable income is a concern, but what we are seeing is consumers are pulling back from discretionary spending," he adds. "Consumers are still spending on their debt [repayment] but less on other areas. The only thing that really impacts debt serviceability is unemployment. The other parts of consumer lending I would pull back on is anything sub-prime, which even if we do get a soft landing may see some deterioration of conditions."

The resurgence of interest in securitised assets in recent years has also aligned with the explosion of ESG and sustainable investing, with the latter transforming from a niche discipline to a mainstream investment practice.

The panel also discussed the sustainability prospects of securitised assets. Although there are signs of progress around data transparency in this asset class, more transparency is needed for those that must adhere to sustainable investment criteria.

"Structured credit is behind other generic credit classes, and it will take time to get there. We are trying not to be perfectionists about this, as you need to start somewhere," Perelgritz says, explaining she and her team need to see more evidence of positive intent from issuers and managers.

"One of the things we are hoping to see is many more ESG-friendly ideas and mandates, given this is the direction of travel for our clients. We hope it matures in this way."

The nature of securitised assets can make sustainable investing difficult, and Phoenix Group's Edwards says the onus was falling upon identifying the motivations behind issuing these instruments – in a similar way to green bond due diligence.

"Think about other asset classes. We tend to look at the underlying organisations and what impact they are creating," Edwards says. "For some underlying asset types, this can be quite tricky as it may not always be clear that a positive impact is being created.

"But I can see how it could be relatively simple to make this distinction for an SME lending book with a social purpose for example. Thinking about of some of the ESG bonds UK banks have issued around house building or financing doctors' surgeries – that's the best example I can think of on the social side."

The securitised asset market is once again growing and gaining greater attention from institutional investors, but it is clear from our experts that much more is required to further support the development of this market. Current regulations may divide opinion, but the consensus is that more is needed to help securitised assets become a more viable – and obvious – choice for investors.

"The European market has a lot of room to grow," Lassau says. "But there needs to be a strong framework in place for securitisation, with effective regulation as well."

Roundtable Participants

Xavier Lassau, CFA
Senior Portfolio Manager, AXA IM Alts

Personal Profile

Xavier joined AXA IM in 2018 as a senior portfolio manager, responsible for managing the ABS and Secured Finance strategy. He plays a central role in the oversight, investment decisions and monitoring of the ABS and Secured Finance funds and mandates across the capital structure.

Prior to this, he spent 3 years as a portfolio manager at Amundi, where he co-managed a €2.5 billion open-ended ABS fund. He also advised the ECB on the ABS purchase programme for its QE, where he was instrumental in the purchase of €20bn of ABS.

Xavier started his career at Natixis Investment Management in the Portfolio Research and Consulting Group, where he was responsible for portfolio construction for institutional clients.

Xavier holds a Masters in Quantitative Finance from ENSAE and Paris Dauphine University. He is a CFA charterholder.

Company Profile

AXA IM Alts is a global leader in alternative investments with over €186 billion of assets under management comprising c.€90 billion of primarily private real estate, over €85 billion of private debt and alternative credit, as well as over €10 billion in Infrastructure, private equity, and hedge funds.

We take a 360° approach to real estate and infrastructure investing with over €132 billion of assets under management[1] in direct opportunities, held indirectly through debt and listed equities and via long term private equity investments into operating platforms. ESG is fully integrated into our investment decision making processes with our responsible investment approach anchored by the three key pillars of decarbonization, resilience and building tomorrow.

AXA IM Alts employs over 840+ people located in 17 offices around the world and serves the needs of more than 600 clients from Europe[2], North America, Asia Pacific, and Middle East. We are the number one property portfolio and asset manager.

[1] Source: AXA IM Alts data (unaudited) as of 30 September 2023.
[2] Source: IPE Top 150 Real Estate Investment Managers, November/December 2022. #1 real estate investment manager in Europe based on total European real estate assets under management.

James King
Head of Structured Credit

Personal Profile

James joined M&G Investments in 2003 as a fund manager within the Alternative Credit group and is responsible for the ongoing development of our ABS business.

Prior to M&G, James worked for Citigroup, initially in the corporate bank and, latterly, in the alternative investments group as portfolio manager and credit analyst focusing on asset backed securities and industrials.

James graduated from Durham University with a degree in Business Economics.

Company Profile

M&G Investments is a global asset manager with a long history investing and innovating across both public and private markets. We're part of M&G plc, an international savings and investment business with the ambition to deliver long term value for our investors, while working together to create a more positive future.

As an active manager we build solutions around what matters most to our clients whether it be investing for growth or income, to meet future liabilities, protect capital or invest responsibly. Together, through a strong sense of partnership and collaboration, we support a culture of continued innovation to build long-term relationships as needs evolve over time.

We offer access to a broad range of capabilities that span both public and private assets including fixed income, equities, multi-asset, real estate, infrastructure and private equity.

Globally we manage over £303.2 billion (as at 30 June 2023) on behalf of individual and institutional investors including pension funds, endowments and foundations, insurers, sovereign wealth funds, banks and family offices.

Roundtable Participants

Julita Perelgritz
Senior Investment Manager

Personal Profile

Julita specialises in Credit and Real Estate coverage within MRT.

Prior to joining Cardano, she worked as a Fund of Hedge Fund Analyst at Oakley Capital, as well as Millennium Global Investments. Julita started her career as a Portfolio Manager Assistant at Margetts Wealth Management.

Julita is a CFA Charterholder and holds a degree in International Finance from Concordia International University Estonia.

Jack Edwards
Head of Credit Solutions

Personal Profile

- Joined Phoenix Asset Management in April 2021
- Senior Investment Manager with responsibility for credit enhanced, asset backed and repacked transactions
- Focussed on originating and structuring private assets for the shareholder funds supporting Phoenix's BPA activity
- Additional responsibility for managing mandates that support elements of the policyholder book
- Previously worked at Lloyds Bank Corporate Markets as an interest rate derivative structurer with transactional experience of swap repacks, securitisation hedging and bespoke transactions structured for the in-house life insurer

Chandra Gopinathan
Senior Investment Manager

Personal Profile

Chandra Gopinathan leads the Climate workstream at Railpen and is responsible for climate strategy, energy transition investment, climate risk integration and management across Railpen's portfolios and investment in climate and natural capital opportunities and solutions.

Chandra has two decades of experience across investing and portfolio management, credit structuring and ESG analysis and brings a multi-asset investment perspective to Railpen's sustainability practices.

Chandra has a Master's degree from Columbia University and a CAIA designation.

Steven Hickey
Head of Credit Research, Investment Consultant

Personal Profile

Steve leads XPS's Credit research and, more generally, works with XPS's Chief Investment Officer to drive forward XPS's research efforts across the team. As such, he has vast research experience across the key public and private asset classes utilised by UK DB pension schemes. Alongside his research responsibilities, Steve is responsible for the day-to-day management of a handful of trustee clients, advising them on a full range of investment related matters.

Steve joined XPS in 2015 and is based in London. He holds a BSc (Hons), Economics degree from the University of Liverpool and also holds the UK Investment Management Certificate (IMC).

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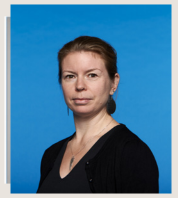

Elizabeth Pfeuti
Chief Client Officer

Personal Profile

Former Dow Jones staffer Elizabeth Pfeuti is Rhotic's Chief Client Officer and a member of the Rhotic Media executive leadership team. A highly-decorated journalist, Elizabeth has been in financial journalism for around 15 years. At Dow Jones, she covered the asset management, investment banking and investor services beats for Financial News, where she also wrote on a wide range of regulatory themes

She was previously the European Editor for CIO Magazine and boasts an exceptional contact book of buy-side and in-house institutional CIOs and asset management executives. More recently she has worked on corporate briefs for pension consultants, investment banks and asset management groups.

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