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# SEC-SA and the death of public securitisation

**Adam Croskery, head of debt financing and structuring at Arrow Global, calls for arrangers to create new public market offerings and help facilitate a deep and dynamic securitisation sector**

In the early 2010s, I was a mortgage structurer at the forefront of the birth of NC2.0 (the non-conforming 2.0 sector). Even before then, I rated RMBS transactions at a major rating agency. If anyone should be a cheerleader for public securitisations, it's me.

There is no doubt that public transactions are academically appealing (if somewhat exhausting) to put together and who doesn't love a roadshow? Yet, having now headed up the debt function at Arrow for a number of years, we have issued a single public securitisation in my time here.

We use securitisation technology on a near daily basis. It's the de facto form of finance from banks because of that pesky SEC-SA I reference in the title to this article. Besides that, us securitisation types get everywhere, so there is often a strong whiff of securitisation in many deals - even when they are backed by something that doesn't constitute a financial asset.

While the SEC-SA is far from perfectly calibrated, regulators should be given credit for creating something that levels the playing field for European banks and increases the depth of the banking market for asset-backed financing.

When I started out, it was a market of 'haves' and 'have nots' – those that had an IRB model and those that had to make ends meet using the standardised approach. The IRB banks were able to offer bridge and acquisition financing on financial assets without a rating that made sense from an ROE perspective. Meanwhile, the standardised banks – absent a public rating – carried the risk-weighting of the underlying assets irrespective of how much overcollateralisation they had. Terms offered by standardised banks would have to be meaningfully better to incentivise a client to work with them because they then would have to take on the cost, time and execution risk of getting the deal rated, only to then refinance out a few months or a year later.

Looking back, the IRB banks were a relative handful at the time and they all had a very similar business model – to deploy their balance sheets to subsequently generate lead manager fees. The goal was to churn the balance sheet as fast as possible.

In general terms, the banks would set margins on their financing by reference to the public markets plus a spread. In that way, sponsors were incentivised to go down the public securitisation route because it made economic sense to do so.

With the advent of SEC-SA, there was a proliferation of truly viable bridge finance providers, with the competition resulting in the margin of warehouses over public deals tightening (and sometimes disappearing altogether). At the same time, alternative finance providers proliferated in Europe on the back of the vacuum left by banks exiting business lines following the GFC – to the extent that, in many instances, they now directly compete with banks on financing.

With all this going on, the incumbent banks – given the general pressures on bank capital – increasingly moved towards a syndication model, with secondary liquidity providers tending to be buy-and-hold. Warehouses and bridge financing terms became longer and the need to refinance into a public securitisation began to erode.

The current users of public securitisation fall into one of a handful of categories: jumbo deal buyers, where single finance providers can't absorb the size; arbitrage, where you can take your basis off the table through the security transformation process; and, to an increasingly lesser extent, franchise.

At Arrow, we deeply appreciate CLOs, specialist resi, re-performers, UTPs and NPLs. But on their own, they won't lead to a deep and dynamic securitisation capital market.

Indeed, given the competing finance sources for the same underlying, public markets will increasingly become purely a price-led alternative – one with a significant disadvantage relative to other options – the inherently higher frictional costs of a capital markets deal. Compounding this reality is the progressively shorter duration of securitisation bonds (directly and indirectly resulting from bank treasury LCR requirements) over which to amortise the establishment costs. Even the advantage of a lack of Euribor floor (which is prevalent in private financings) has fallen away for the time being.

The logical consequence of all of the aforementioned is that sector-agnostic players shall leave the market, lose the expertise to look at it, and pockets of liquidity will be permanently lost. Sector specialists will see their allocations shrink.

Yet, it doesn't need to be this way. Despite a tough couple of years on the macro front, we see from the relative abundance of non-performing loan securitisations (and yes, business plans in many instances have been detrimental to the health of that segment) that where the SEC-SA isn't well calibrated relative to the inherent risk of a proposition, the capital markets can be a value-additive instrument for all parties. NPLs are not the sole area where the calibration of the SEC-SA means banks struggle – development loans, fund NAV loans and various other 'esoterics' fall into this camp, among many others.

Just like my generation of structurers innovated with NC2.0 and arranged NPL securitisations before that was a thing, the ball is now in the court of the current crop of arrangers to create exciting new public market offerings and bring those of us who are slightly more jaded back to the table.

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