

## **SME Asset-Backed Financing Instruments**

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Securitization market: causes and impacts of the crisis, outlook

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## AGENDA

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- I. SMEs in Europe: A brief description!
  - II. SME Securitization in Europe: A diverse picture!
  - III. SME Securitization in Europe: Positive for lenders, borrowers and investors!
  - IV. Cause of the crisis: Ailing U.S. subprime sector plus linkage of worldwide structured finance markets - liquidity meltdown!
  - V. Direct impact: European ABS issuance – from Boom to Bust! The CLO primary market remains closed!
  - VI. European ABS: The current state of the crisis requires different standpoints!
  - VII. Further impact: SME financing possibilities are worsening! Impact on real economy possible!
  - VIII. SME Securitization in Europe: Challenging times ahead...
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## SMEs in Europe: A brief description!

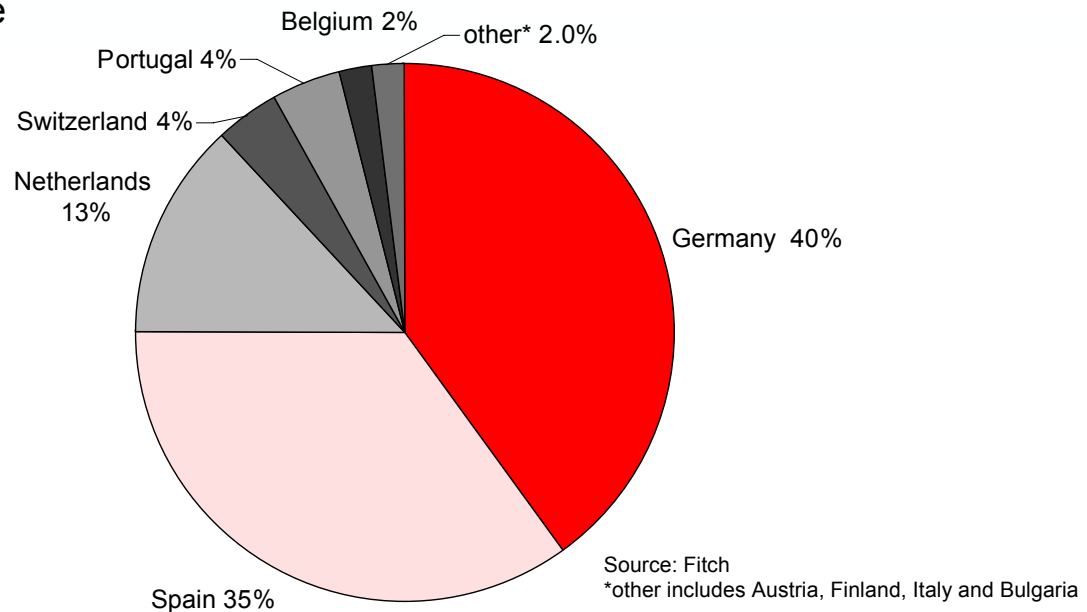
- SMEs are Small and Medium-sized Enterprises, often family-owned businesses. The European Commission defines SMEs according to size and business volume:

Enterprise category	Number of employees	Turnover	OR	Balance sheet total
Medium-sized	< 250	≤ € 50 million		≤ € 43 million
Small	< 50	≤ € 10 million		≤ € 10 million
Micro	< 10	≤ € 2 million		≤ € 2 million

- SMEs whose loans are securitized in SME CLO transactions may fall outside these parameters. However, since their operations are similar to those of the broad majority, their loans are included in many transactions.
- SMEs are an important business sector – prosperous SME business is an indicator of economic stability!  
In Germany, 99.7% of all companies are classified as SMEs and account for 39% of turnover and 71% of employment!
- In Eastern Europe, SMEs contribute significantly to fast growing economies!

## SME Securitization in Europe: A diverse picture!

### ■ European SME CLO Issuance Share by Country 1999-2007



- Established European SME CLO issuance is dominated by German and Spanish transactions! Transactions can be split into synthetic and cash deals. Moreover, there are specific deal types, e.g. SME mezzanine CLOs.
- Expansion is observed towards new jurisdictions: Nordic countries like Denmark and Finland... but also to Eastern Europe (e.g. Microfinance).
- In Emerging Markets, SME CLOs are not similar to established large transactions as featured, for example, in Spain or Germany. Transactions have been mainly private -often bespoke- deals. In 2007, the first public ruble denominated CDO backed by SME loans closed in Russia, Transalp 2.

# SME Securitization in Europe: Positive for lenders, borrowers and investors!

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## Benefits for the originator:

- Risk transfer
- Funding
- Profit realization, RoE increase

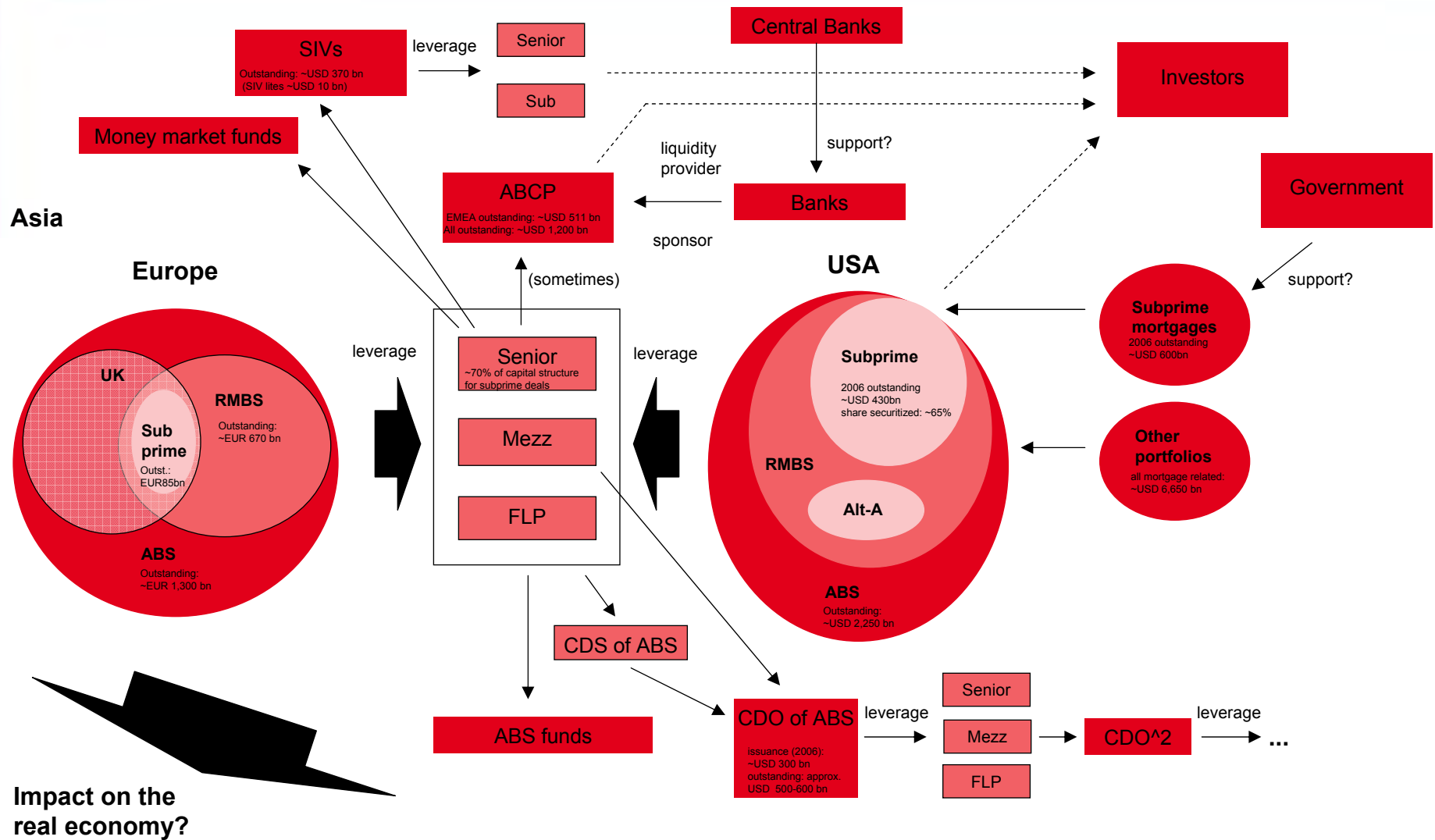
## Benefits for the borrower:

- Capital market access
- Loan accessibility
- Public lending support

## Benefits for the investor:

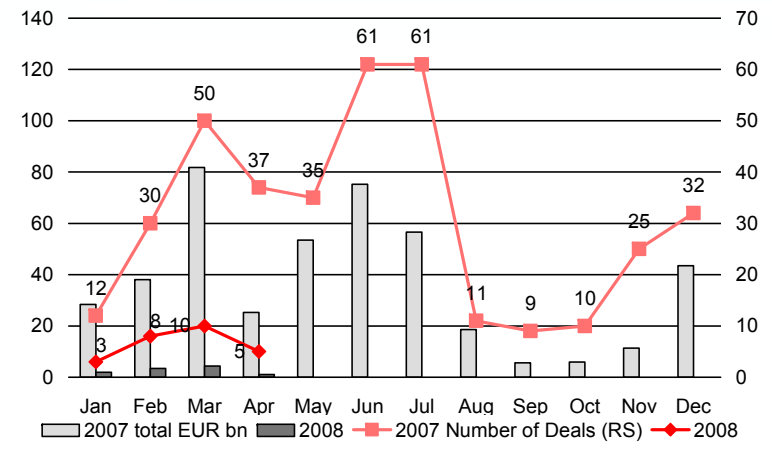
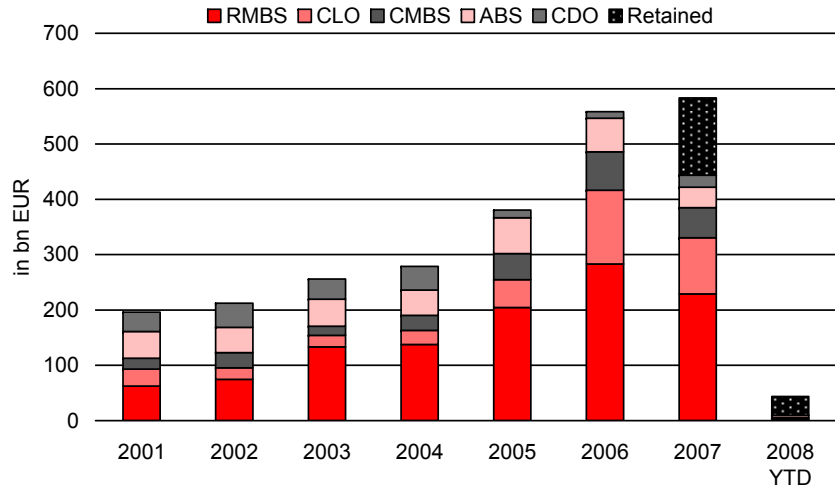
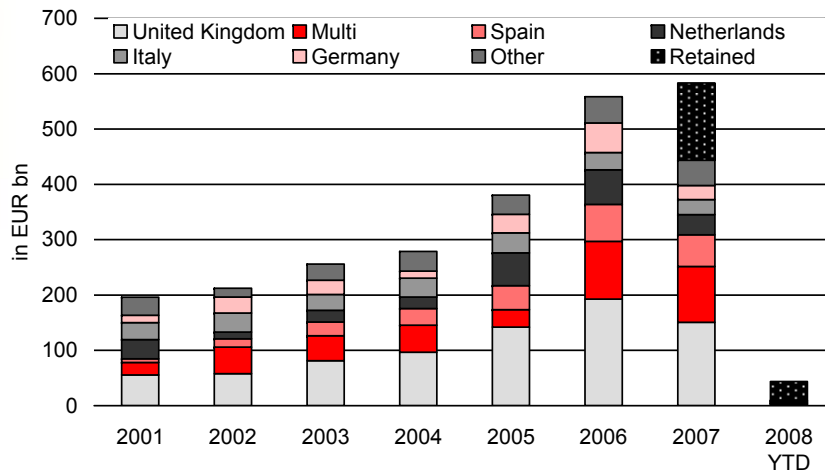
- Asset diversification
  - Participation in specific credit markets
  - Choice of level of risk to be taken
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# Cause of the crisis: Ailing U.S. subprime sector plus linkage of worldwide structured finance markets - liquidity meltdown!



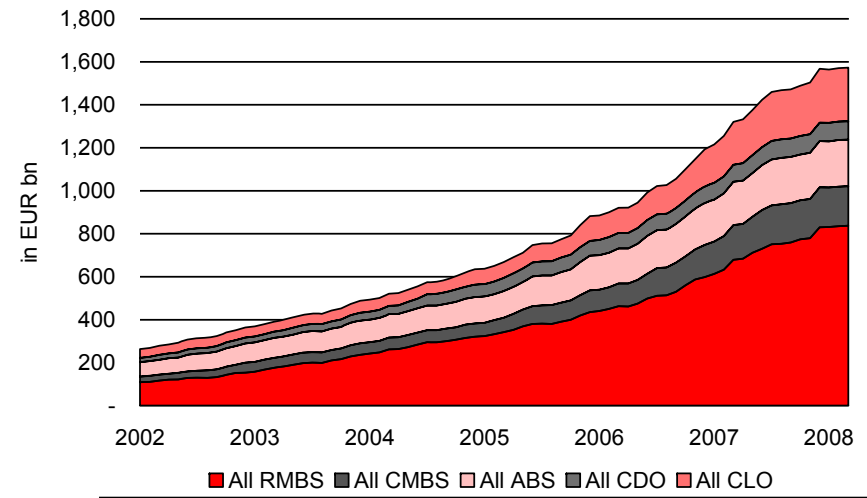
# Direct impact: European ABS issuance - from Boom to Bust! The CLO primary market remains closed!

**European Issuance Volumes:**

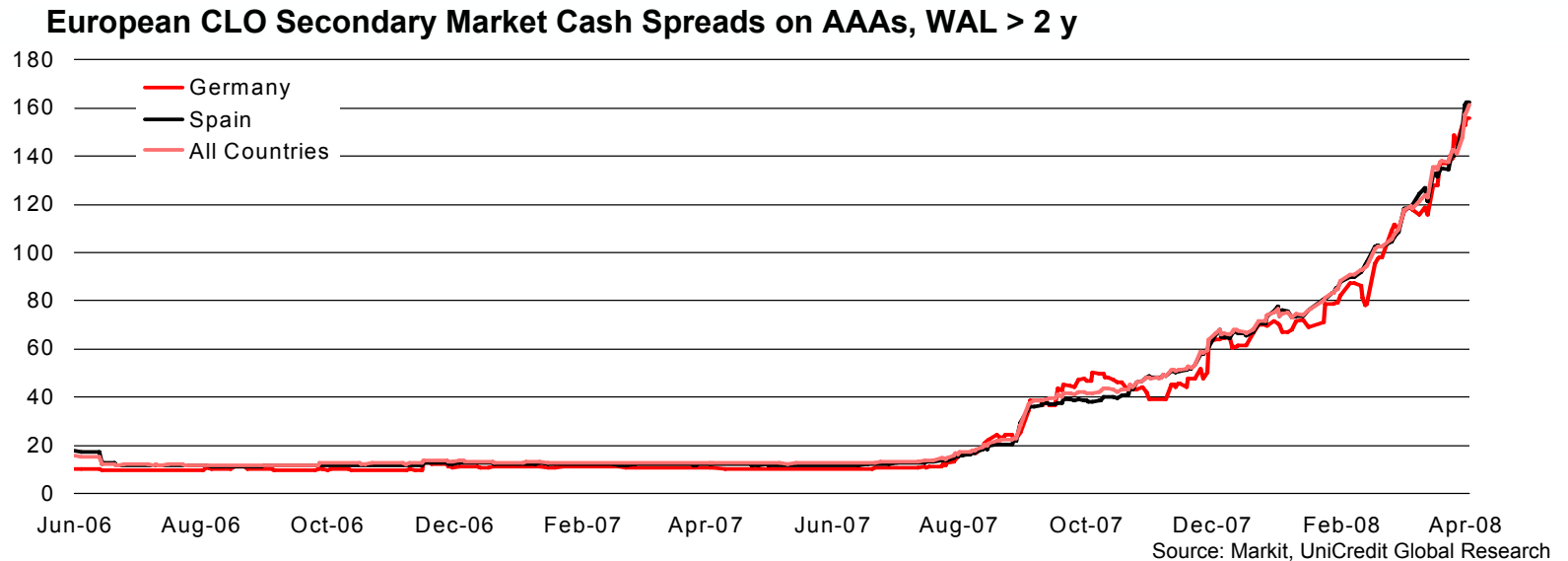


Source: Bloomberg, Reuters, UniCredit Global Research

**European Outstanding Volumes stagnate for the first time ever:**



# European ABS: The current state of the crisis requires different standpoints!



In order to determine future ABS and CLO spread movements, we need to analyze European securitization markets from different standpoints:

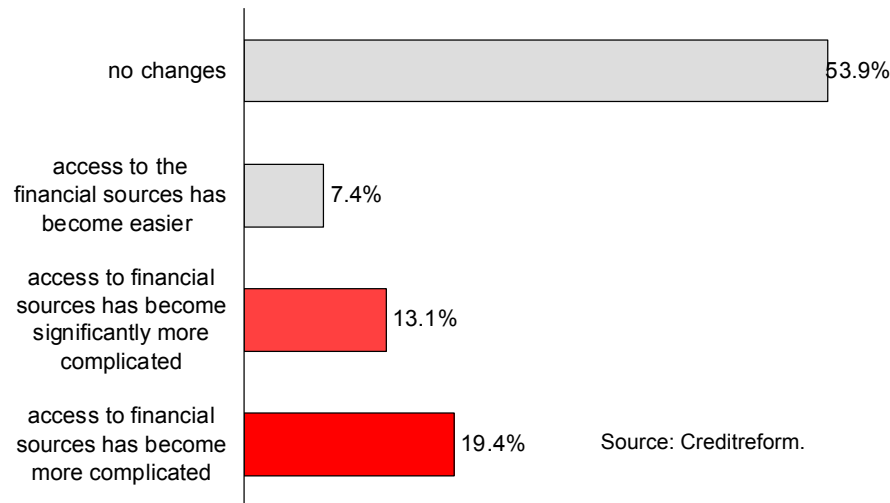
- **a) The cash side:** Still little changes on the cash side. Bids are simply missing, hence liquidity is non-existent. Appetite for secondary paper is mainly limited to AAA-AA rated assets and well-seasoned paper without any link to risky sectors or tricky structures. Hence, correlation with recent spread tightening is very limited for these assets.
- **b) Exotic structures:** Less seasoned paper or notes with exotic structures or a risky asset mix remain illiquid. We believe that many investors in these assets remain latent sellers in the current environment. As soon as spreads tighten to more reasonable levels, investors will offer this paper, hence ABS spreads will remain volatile!
- **c) Synthetics:** The European synthetic side – CDS on ABS- is (naturally) more actively traded in the current environment than the cash side. CDS on ABS contracts are correlated with spread tightening on the broader credit market at least to some extent. Moreover, we realize that the CDS basis is becoming less positive, hence synthetic spreads are converging with cash levels.
- **d) The primary market:** The primary market remains closed and the ECB is crucial to refinance

# Further impact: SME financing possibilities worsen! Impact on real economy possible!

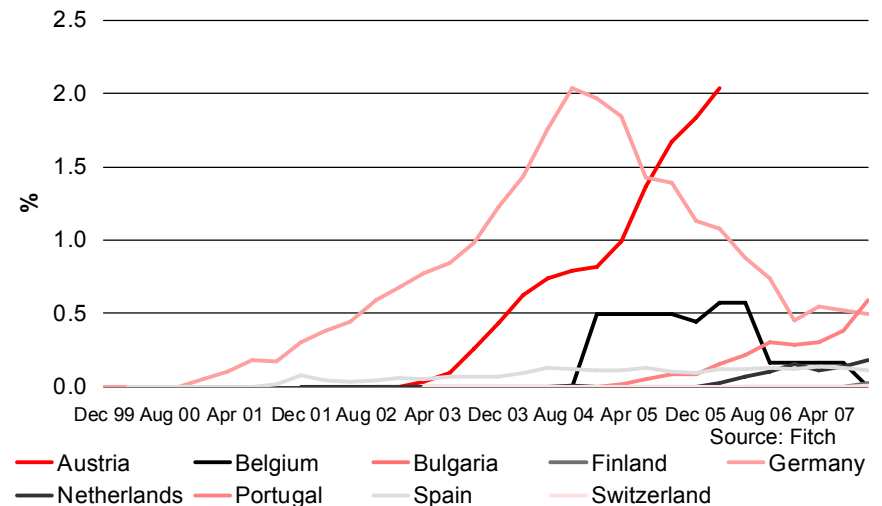
- **Lending criteria tightening across Europe!**
  - Financing possibilities for SMEs - especially for start-ups and risky entities are restricted.
  - Lending costs increase!
  - Example Germany: Financing has become more restricted for 32.5% of all corporates.

- **The delinquency cycle in Europe is not yet on an upward path as is the case in the US. However, the situation can easily turn and also affect European SMEs!**
- **Default rates are expected to rise, however, a severe and sudden deterioration is unlikely.**

**Worsening SME Financing Conditions since autumn 2007:**



**Outstanding SME Defaults as % of Outstanding Portfolio Balance**



## SME Securitization in Europe: Challenging times ahead...

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- No relaxation short to medium term.
  - Eastern European SME CLOs should be among those asset classes to return first! Financing need is high!
  - Microfinance, the trend product, also for Eastern European SME CLOs.
  - Established CLOs will suffer from second and third round effects.
  - Example: CDO rating methodologies will apply higher stress levels and become more conservative, e.g. in terms of concentrations (Fitch's approach).
  - Downside risk in established CLOs is high, especially in Spain as well as for selected mezzanine CLOs. Portfolio concentrations are key for future performance.
  - Does securitisation from originators' perspective still make sense given current spread levels?
  - The overall business model of ABS is still healthy. The rationale for ABS still applies.
  - Can we lure back investors? What level will spreads stabilize at?
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## Your contacts

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