

# European Structured Finance Outlook

## H2 2020: **Weathering The Storm**

July 28, 2020

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**S&P Global**  
Ratings

# Key Takeaways



**Issuance:** European securitization issuance now looks set to end the year substantially lower than in 2019, at about €60 billion-€70 billion, while benchmark covered bond volumes also look set to decline.



**Central banks:** Across Europe, central bank responses to the public health emergency have included renewed large-scale provision of cheap term funding for credit institutions, which is likely to stifle bank-originated structured finance supply.



**Macro:** With social distancing likely to constrain economic activity for several more months, we expect both the U.K. and Eurozone economies to contract by about 8% this year, before rebounding in 2021.

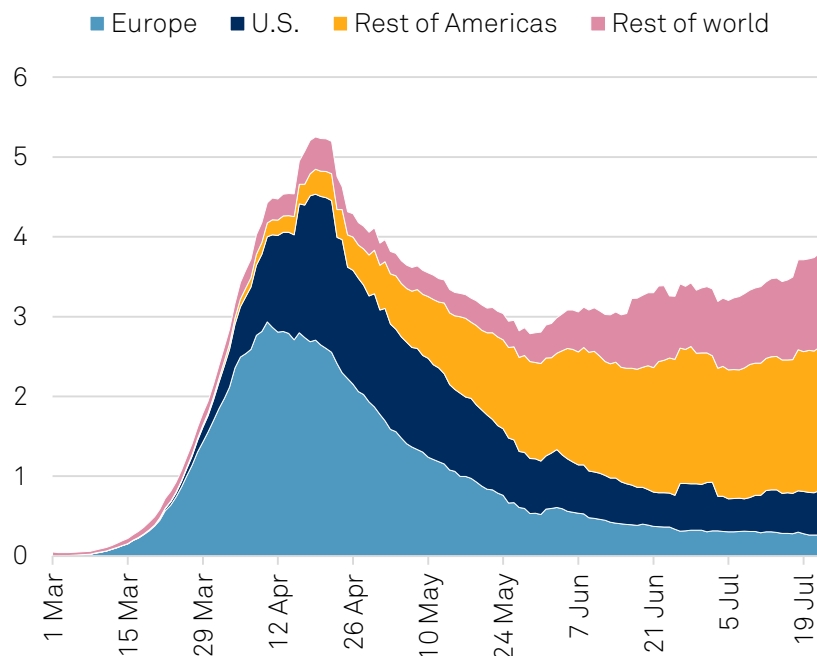


**Credit performance:** Given the macro backdrop, fundamentals will continue to be under pressure across structured finance sectors. However, structural protections mean most asset classes appear robust, and we have only taken negative rating actions on 4% of our outstanding ratings.

# COVID-19 Has Triggered Disruption For Structured Finance Issuance And Credit Performance

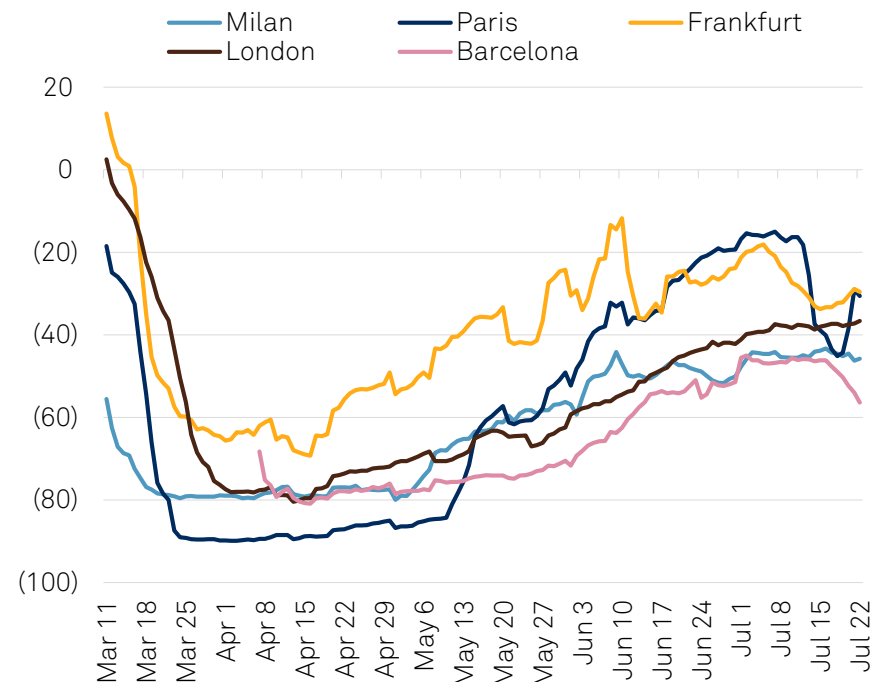
- While the disease has abated in Europe for now, day-to-day activity remains far from pre-crisis norms.
- Financial market volatility, a sharp recession, and robust monetary and fiscal policy responses have disrupted structured finance issuance and performance.

**Daily COVID-19 Deaths, 7-Day Avg. (000s)**



Source: European Centre for Disease Prevention and Control.

**Traffic Congestion Vs. 2019 Level, 7-Day Avg. (%)**



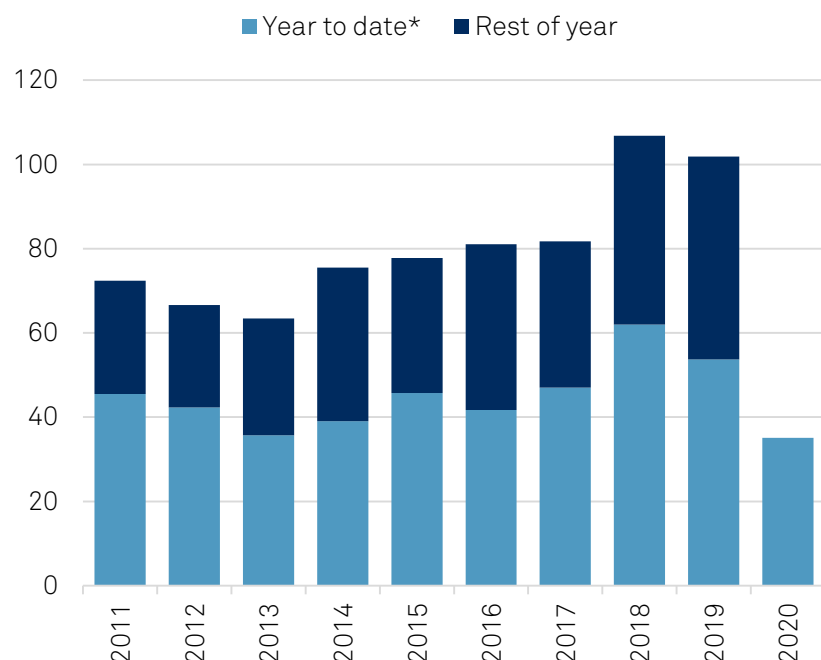
Source: TomTom, S&P Global Ratings.

# Issuance Prospects Diminish

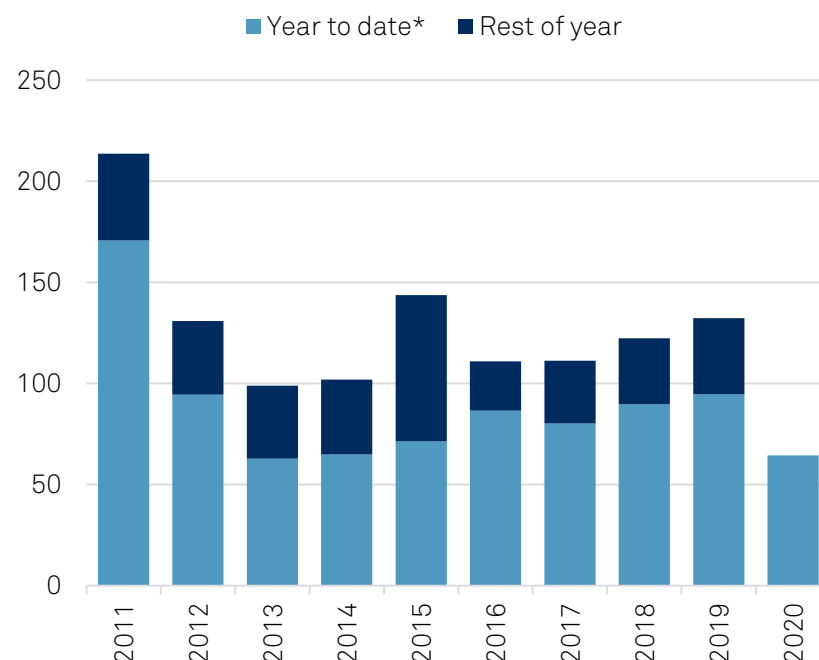
# Volumes Have Stalled Significantly Across Sectors

- Year-to-date investor-placed European securitization and benchmark covered bond volumes are both down by more than 30%, at around decade lows. Securitizations are mostly being pre-placed for now.
- Full-year figures could now be €60 billion-€70 billion and €90 billion-€100 billion for the two sectors respectively.

## Securitization Issuance (Bil. €)



## Benchmark Covered Bond Issuance (Bil. €)

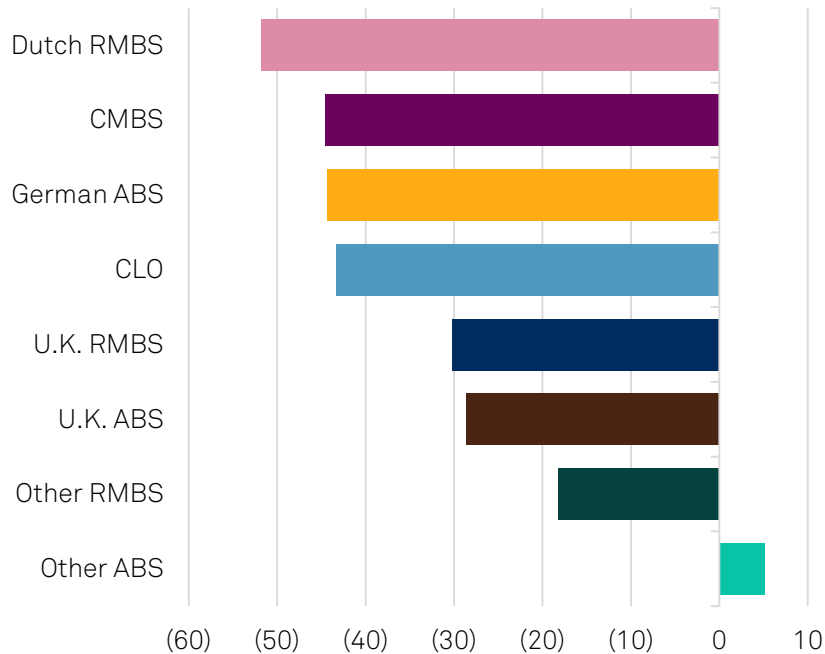


\* Year-to-date figures as of July 20 each year. European investor-placed issuance only. Securitization issuance includes structured credit, e.g., leveraged loan CLOs, but excludes CLO refis and resets. Source: S&P Global Ratings.

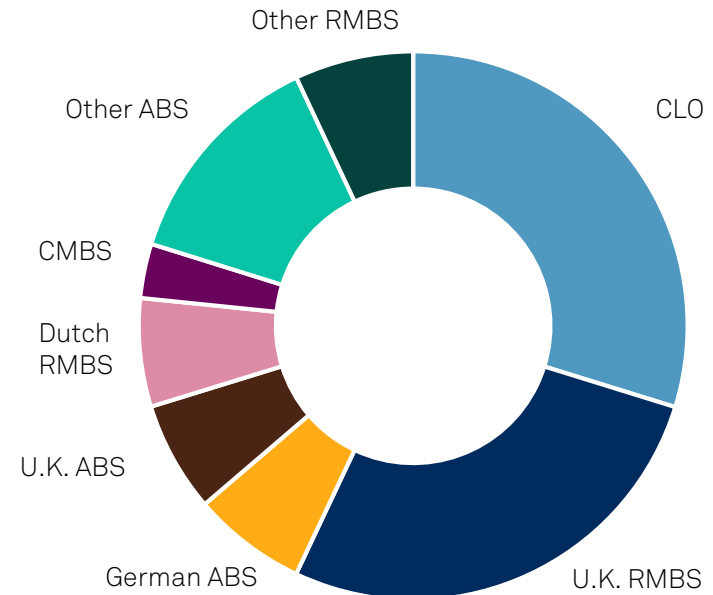
# Securitization Issuance Is Increasingly Diverse

- While securitization volumes have declined, the share of issuance from niche subsectors has risen.
- Recent examples include transactions backed by Spanish trade receivables and Dutch auto leases.

Issuance Increase/(Decrease), 2019-2020 (%)



Breakdown Of 2020 YTD Issuance By Sector

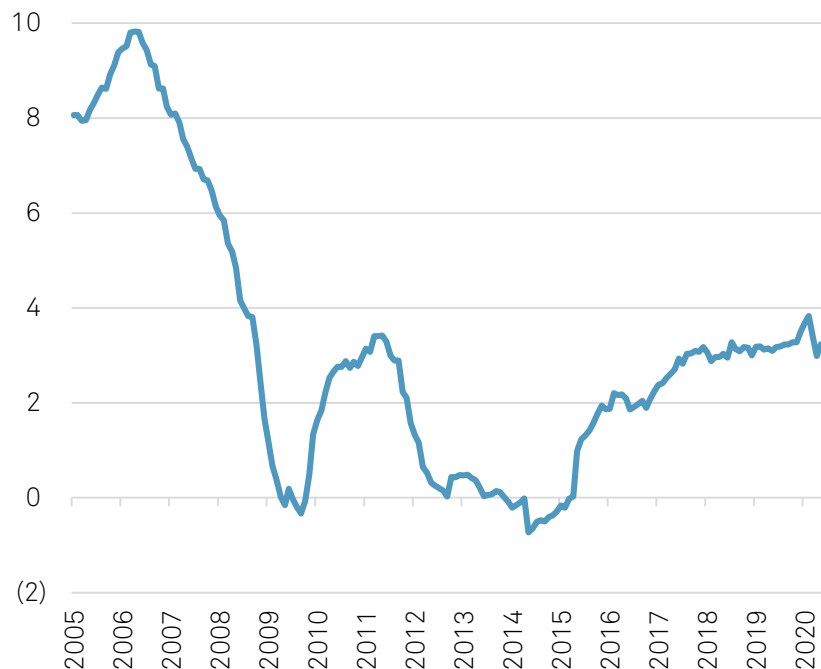


Based on year to date volumes as of July 20 each year. Investor-placed issuance only. Excludes CLO refis and resets. Source: S&P Global Ratings.

# Growth In Banks' Loan Books Supports Issuance, Although Lending Standards Have Tightened

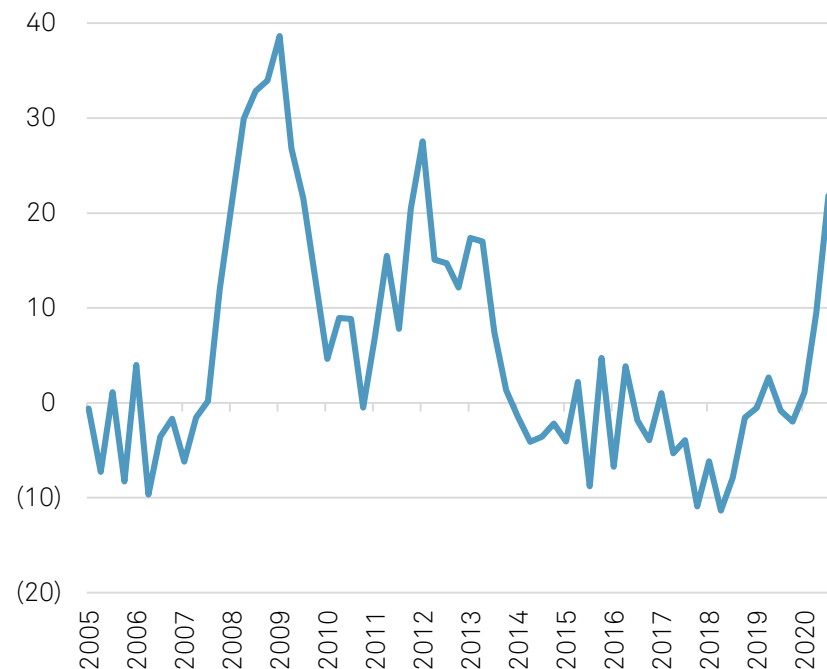
- Credit conditions have tightened, but only moderately, given governments' support for households.
- Conditions should gradually improve again, in line with the economic recovery, and we expect monetary policy to remain extremely loose across Europe for several years.

**Growth In Lending To Households, Eurozone (%)**



Year-over-year change in balance of lending. Source: European Central Bank.

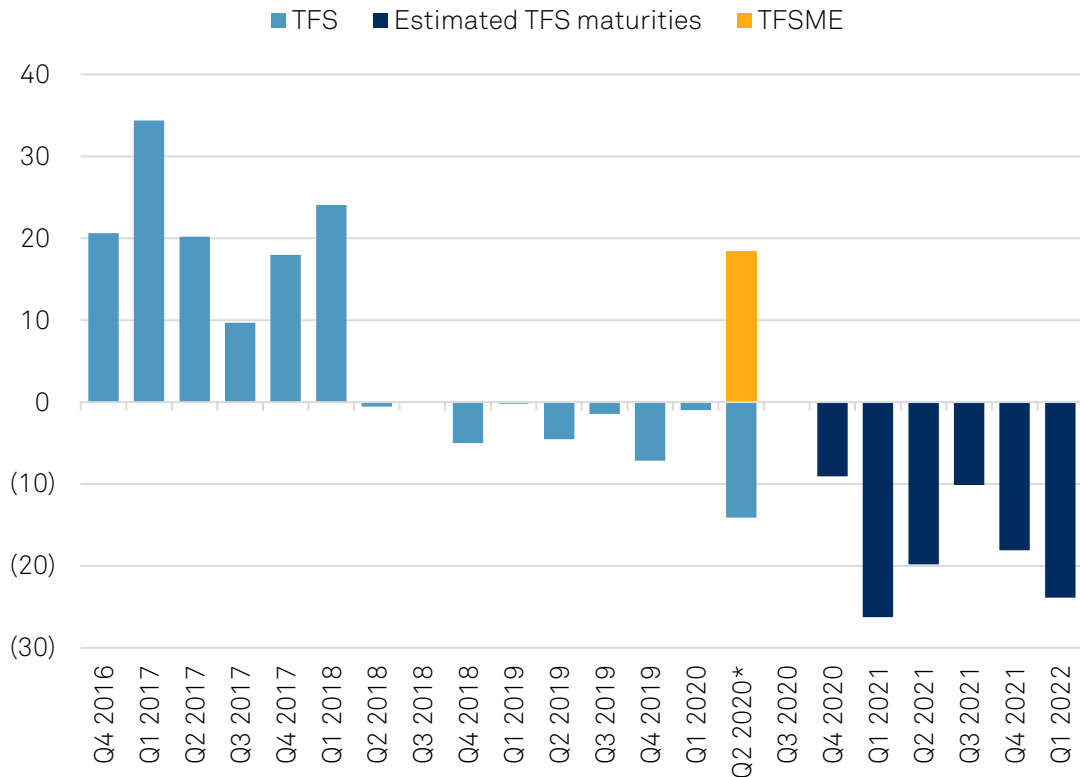
**Lending Standards, Loans For House Purchase (%)**



Net proportion of respondents tightening standards minus those easing. Source: Bank Lending Survey, European Central Bank.

# New Official Sector Funding Provision Will Stifle Bank-Originated Structured Finance Supply

Bank Of England Scheme Net Drawdowns/(Redemptions) (Bil. £)



- The approaching maturity of some originators' borrowings from official sector funding schemes had promised to spur growth in bank-originated structured finance in the U.K.
- However, the Bank of England's subsequent response to the COVID-19 emergency has included renewed provision of cheap term funding for credit institutions, which is likely to stifle bank-originated securitization supply again.
- Since its launch in March, the new TFSME has provided nearly £20 billion in funding.

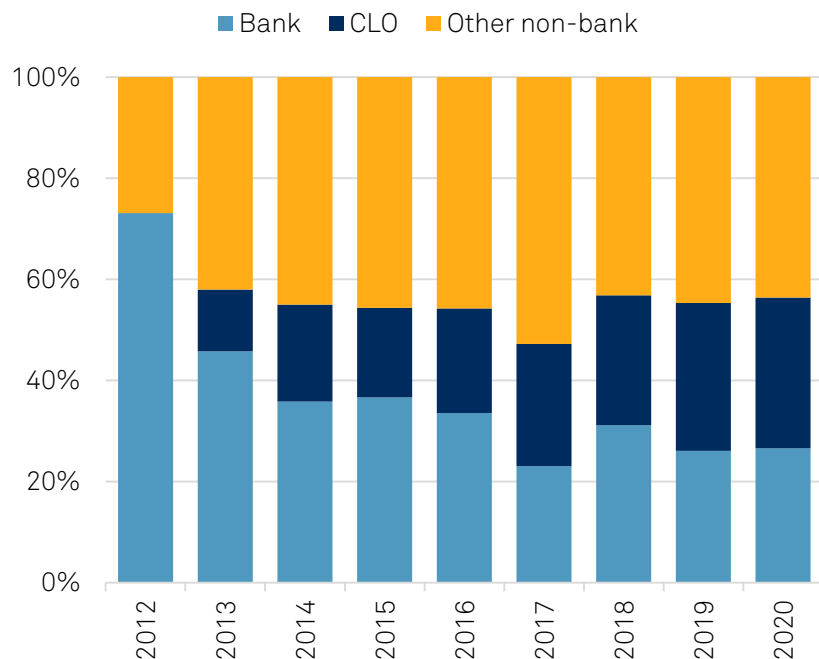
TFS(ME)--Term Funding Scheme (with additional incentives for small- and mid-sized enterprises). \* Approximate, based on data for period between March 31 and July 15, 2020. Source: Bank of England, S&P Global Ratings calculations.



# Securitization Issuance Set To Remain Dominated By Non-Banks Or Motives Other Than Funding

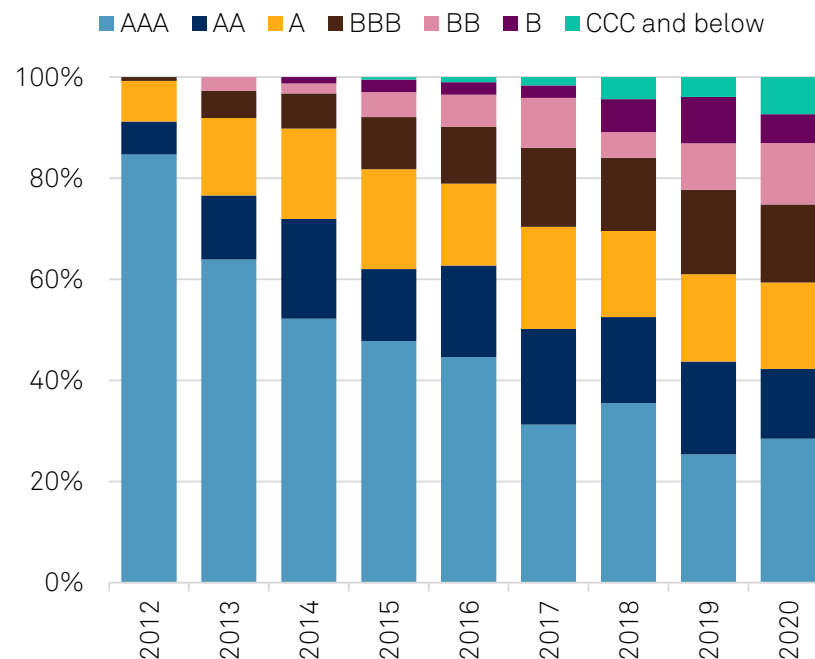
- Bank-originated issuance is less than €10 billion so far in 2020, and only a quarter of the total.
- Originators are increasingly selling the full capital structure of ABS and RMBS transactions for wider balance sheet management objectives, rather than just to raise funding.

## Securitization Issuance, By Originator Type



2020 year-to-date figures as of July 20. European, investor-placed issuance only. Excludes CLO refis and resets. Source: S&P Global Ratings.

## ABS And RMBS Mix, By Count Of Tranche Rating



2020 year-to-date figures as of July 20. European, investor-placed issuance only. Source: S&P Global Ratings.

# Pockets Of Weakness In Credit Performance

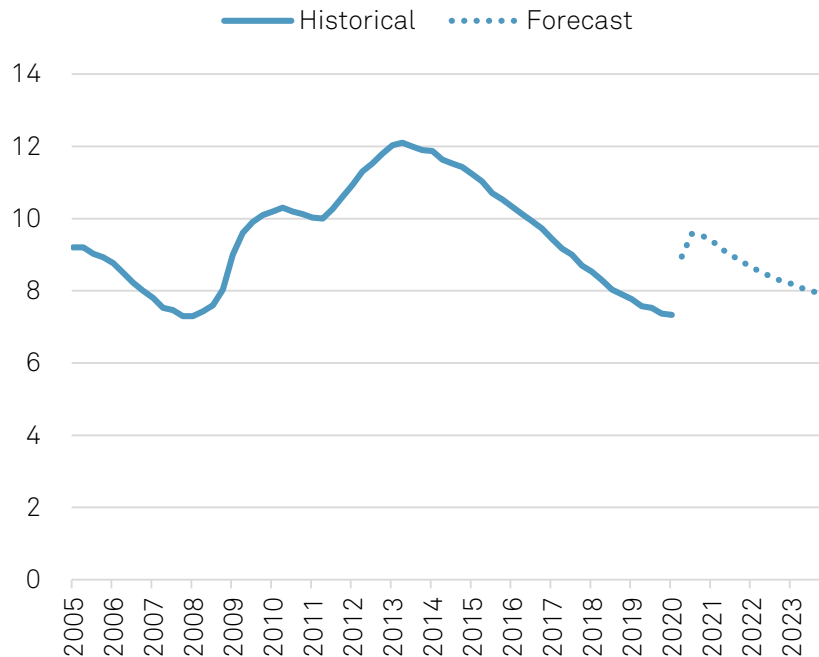
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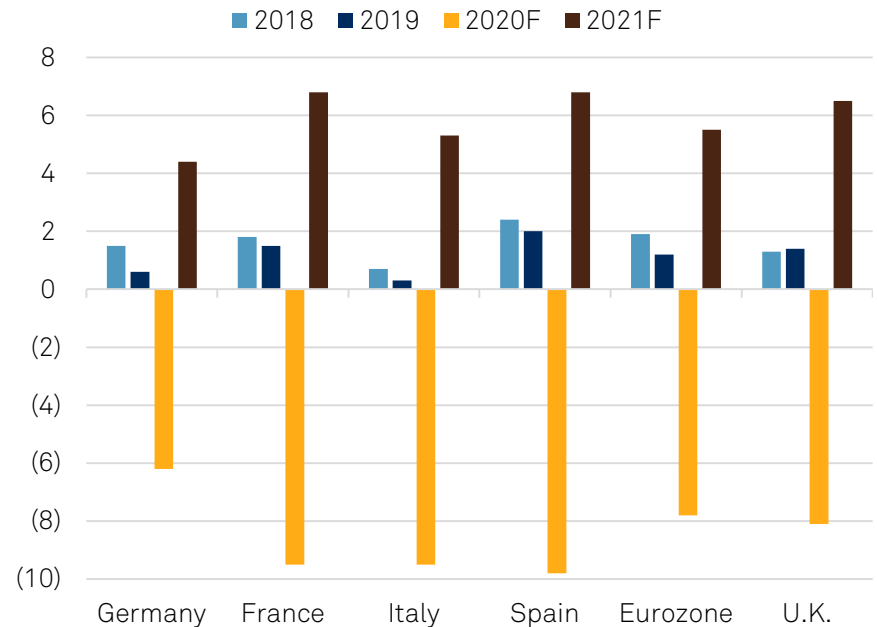
# Expect A Significant Economic Rebound In 2021

- In our view, economies will experience a bumpy transition to a post-COVID-19 "new normal", which will only take shape once a vaccine or effective treatment is widely available, likely not until H2 2021.
- The U.K. and Eurozone economies could contract by about 8% this year, before rebounding next year.

## Eurozone Unemployment Rate (%)



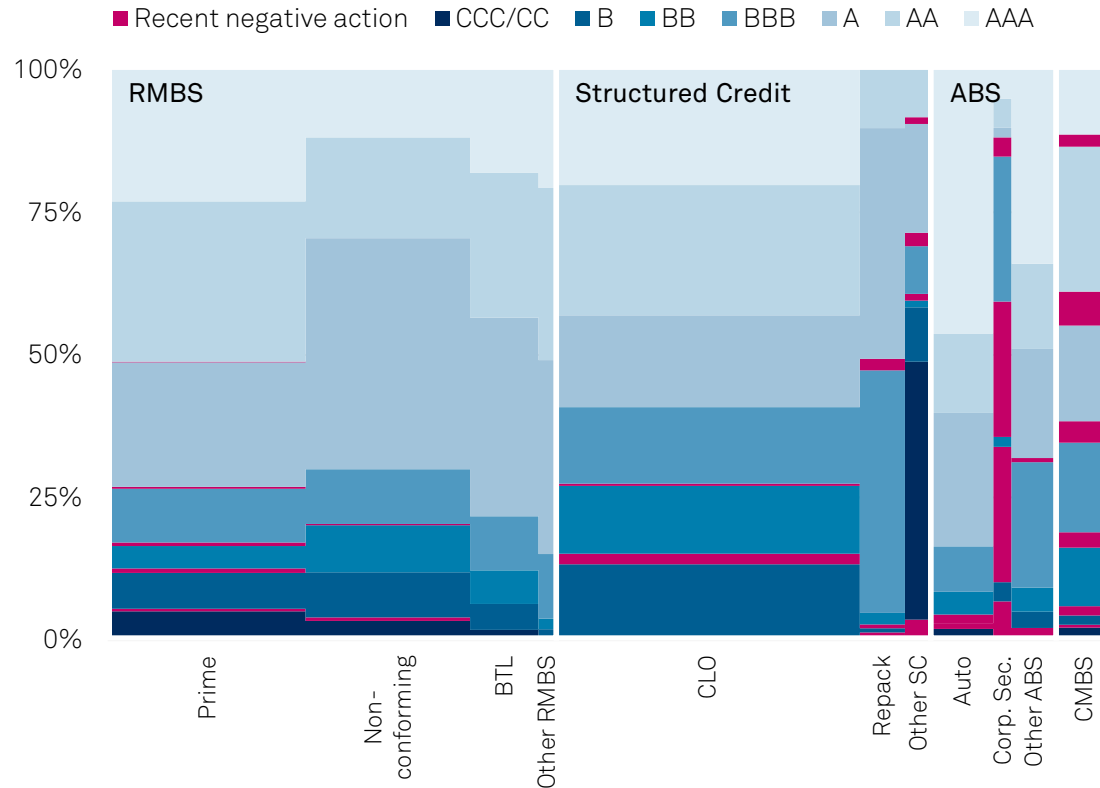
## S&P Global Ratings' GDP Growth Forecasts (%)



F--Forecast. Source: Eurostat, S&P Global Ratings.

# Most Securitization Subsectors Have Seen Very Few Negative Rating Actions

## Distribution Of Ratings And Recent Actions, By Count



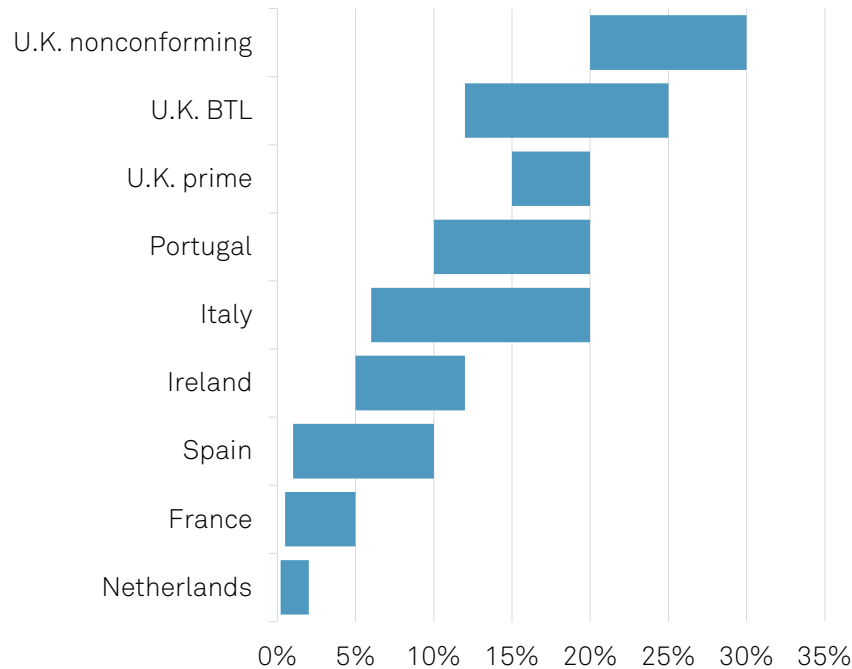
- Overall, we have lowered or placed on CreditWatch negative only 4% of our ratings on European securitizations since the beginning of March.
- The most affected asset classes have direct exposures to sectors suffering most disruption from lockdown policies, including corporate securitizations backed by leisure businesses and hotel-backed CMBS.
- By contrast, for transactions backed by lending to consumers, policy action has helped avoid much deterioration in credit performance.

BTL--Buy-to-let. SC--Structured credit. Based on cumulative actions since March 1, 2020, as of July 16, 2020. Includes actions not related to COVID-19. Excludes confidential ratings and covered bonds. Source: S&P Global Ratings.

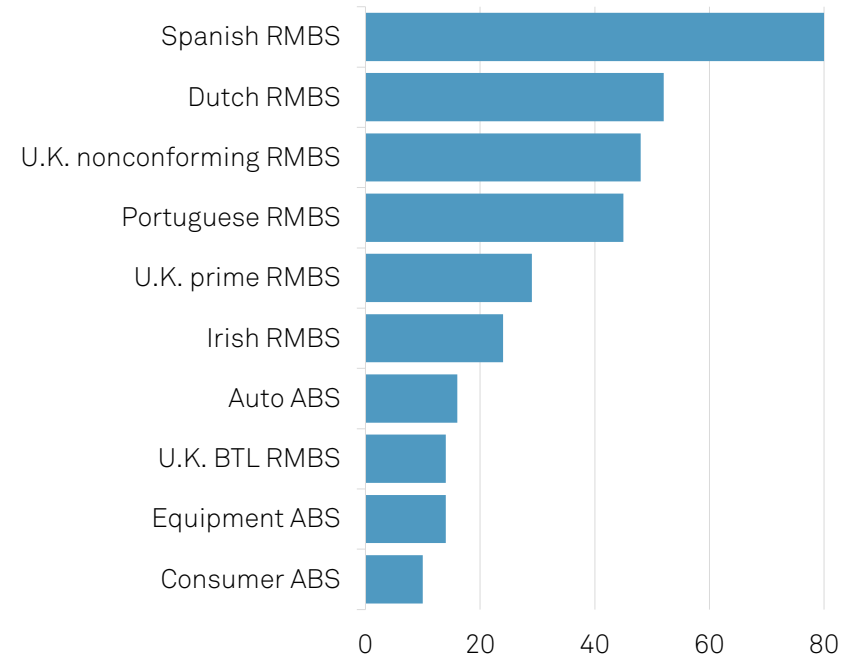
# ABS And RMBS Borrowers Have Taken Payment Holidays; Liquidity Facilities Will Cover Shortfalls

- Take up of payment holidays has varied significantly between countries and lenders, due to different eligibility criteria and application processes, but is now likely close to its peak.
- Even if receipts drop substantially, most transactions can cover several periods of bond payments.

## Take Up Of Payment Holidays In European RMBS



## Median Number Of Coupon Payments Covered\*



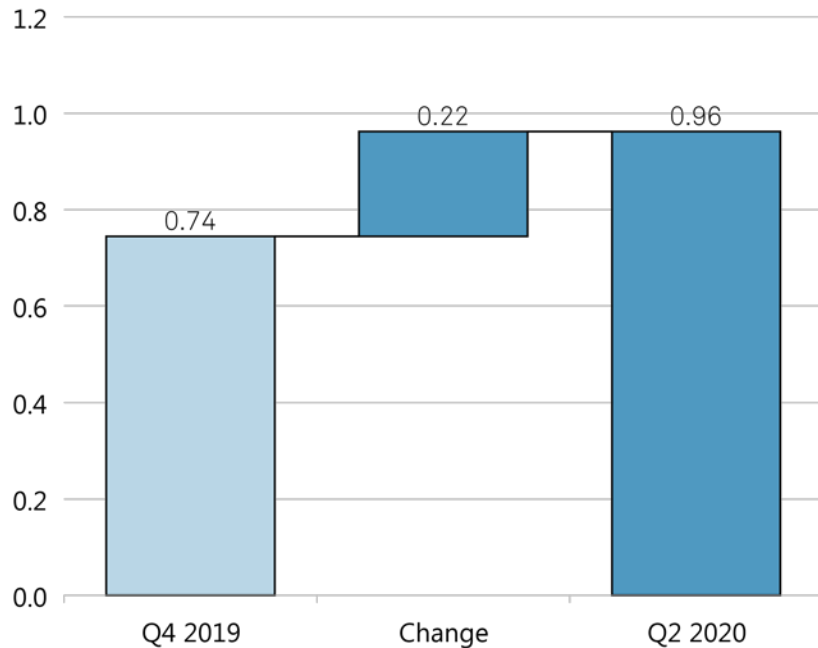
BTL--Buy-to-let. Responses may be based on assets backing transactions not rated by S&P Global Ratings. Source: RMBS servicers, S&P Global Ratings.

\* Assuming interest collections fall by 50%. BTL--Buy-to-let. Source: S&P Global Ratings.

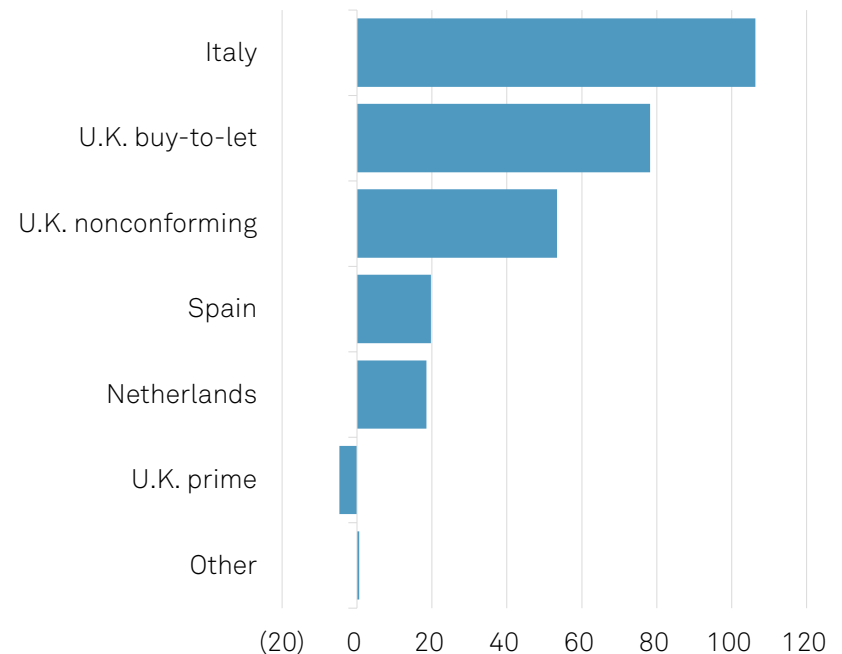
# ABS And RMBS Transaction Reports Have So Far Only Shown A Modest Rise In Short-Term Arrears

- Anecdotal evidence from some U.K. originators—where 25%-30% of borrowers initially took a payment holiday—suggests that 70%-80% of these borrowers are now back to paying monthly instalments.

**Average RMBS 30-60 Day Arrears (%)**



**Average Change In RMBS 30-60 Day Arrears (Bps)**

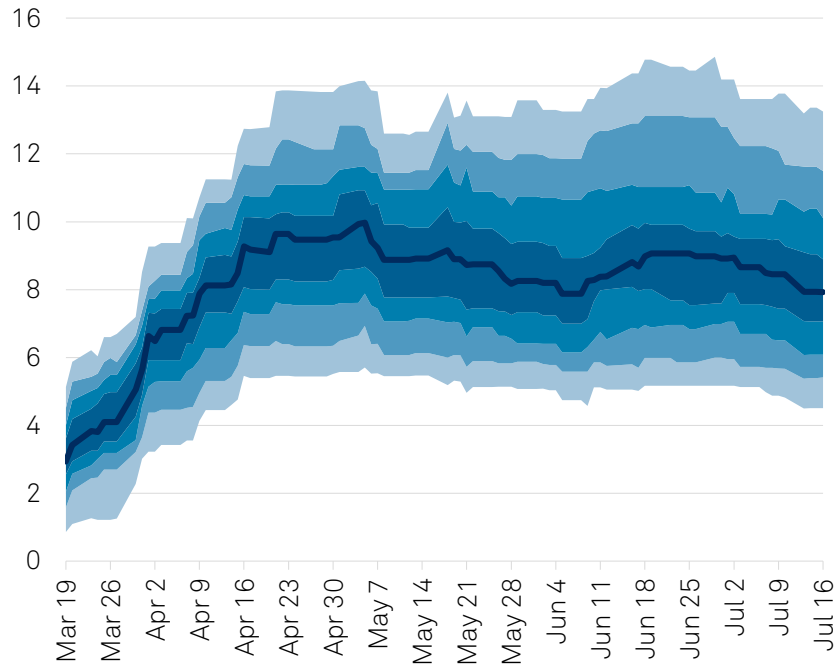


Right-hand chart shows change from Q4 2019 to Q2 2020. Bps--Basis points. Based on sample of transactions for which both Q4 2019 and Q2 2020 data is available. Source: S&P Global Ratings.

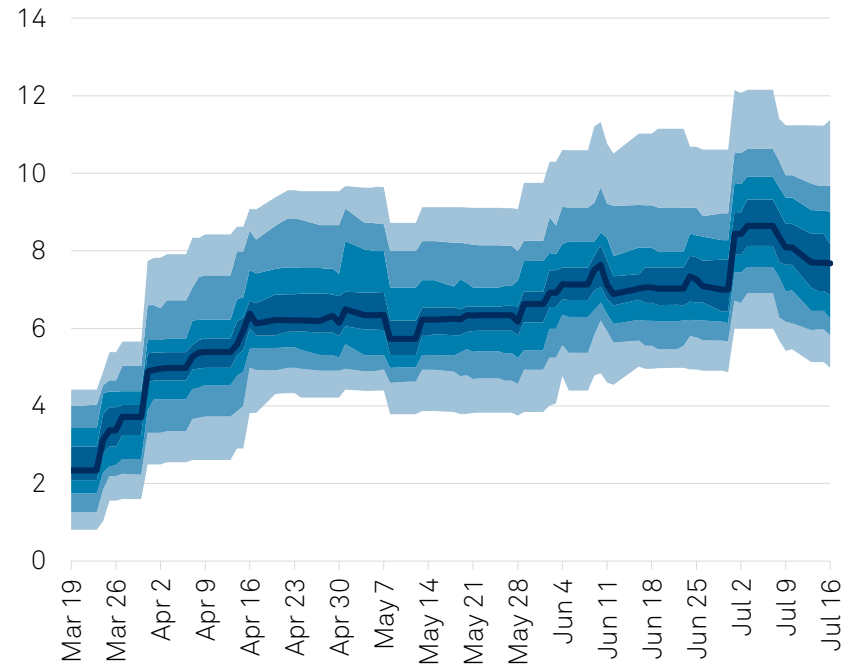
# CLO Portfolio Credit Quality Has Deteriorated Since March, But Is Now Stabilizing

- Active management of the underlying loan portfolios has helped mitigate the decline in credit quality.
- That said, trading out of distressed collateral has led to some erosion of par in CLO transactions.

**European CLO Exposure To 'CCC' Category Corporate Obligor (%)**



**European CLO Exposure To Corporate Obligor On CreditWatch Negative (%)**



Solid line is the median, with each band representing a decile, from 10<sup>th</sup> to 90<sup>th</sup> percentiles. Estimates based on portfolios from latest available trustee reports, with ratings updated. Source: S&P Global Ratings.

# Analysis Suggests That Investment-Grade CLO Ratings Are Resilient Outside Severe Scenarios

## Hypothetical Effect Of Downturn Scenarios On CLO Tranche Ratings

		Scenario number									
		1	2	3	4	5	6	7	8	9	10
		Proportion of 'CCC' category assets in the portfolio increases to:					Portfolio default rate of:		One-notch downgrade to whole portfolio	10% lower recovery rate assumptions	Higher correlation assumptions
Class	Initial rating	5%	10%	15%	20%	25%	5%	10%			
A	AAA	AAA							AA+	AAA	AA+
B	AA	AA							AA-	AA	
C	A	A		A-					BBB+	A-	
D	BBB	BBB	BBB-						BB+	BBB-	
E	BB-	BB-	B+		B				B-	B	B+

### Effect on tranche ratings



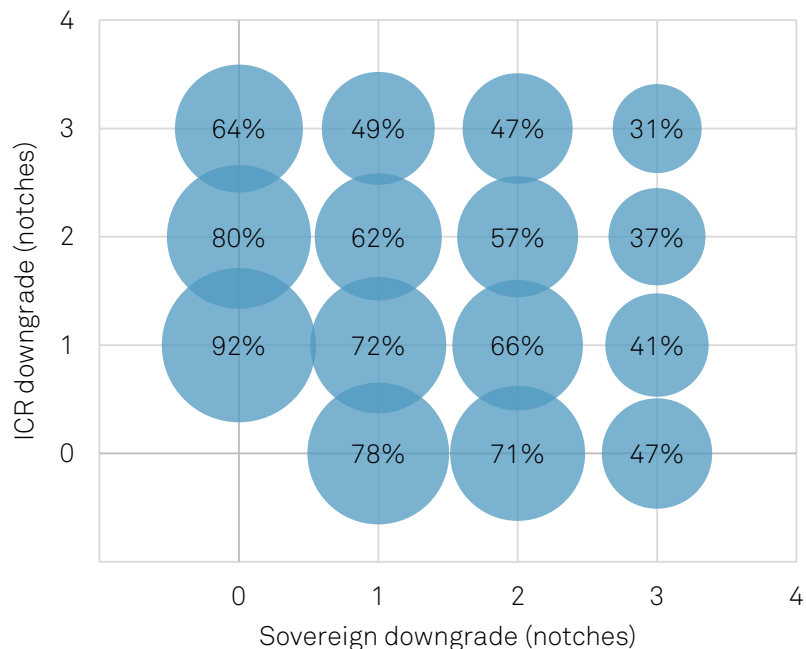
For more details, see "[Scenario Analysis: How Credit Distress Due To COVID-19 Could Affect European CLO Ratings](#)," published April 2, 2020. Source: S&P Global Ratings.



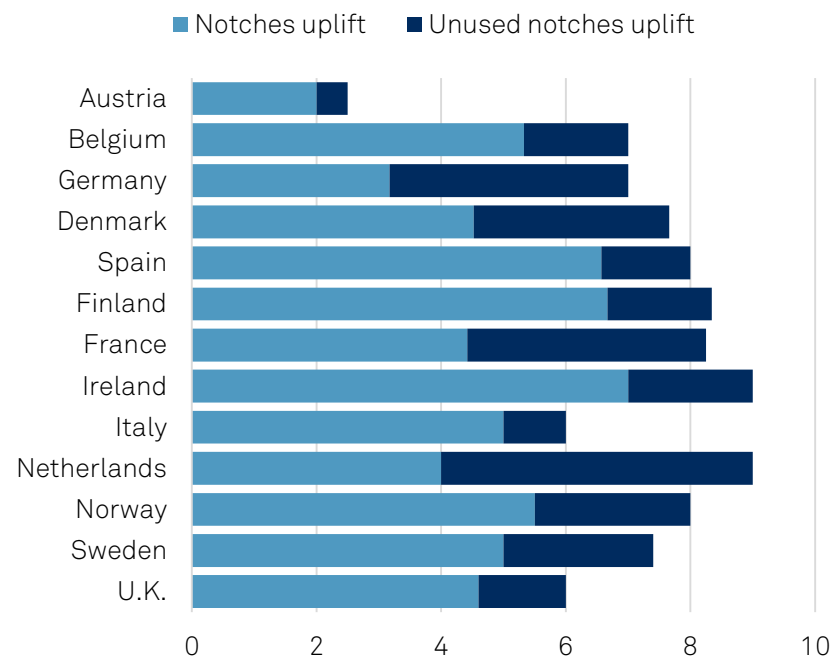
# Most Covered Bond Ratings Are Resilient To Issuer And Sovereign Downgrades

- About 80% of our covered bond program ratings would be unaffected by a two-notch downgrade of the issuer or a one-notch downgrade of the sovereign.

## Proportion Of Program Ratings Unaffected By Combinations Of ICR And Sovereign Downgrade



## Average Notches Of Uplift, Q2 2020



As of July 23, 2020. ICR—Issuer credit rating. Our rating methodology determines how many notches above the ICR a covered bond program may be rated. Some of this uplift may be “unused” if the program rating is ‘AAA’ or capped by other analytical considerations, reducing the program rating’s sensitivity to any subsequent lowering of the ICR. Source: S&P Global Ratings.

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