Grant Thornton
An instinct for growth™

Securitisation

September 2019

Malta

Securitisation and Beyond
- Ways Grant Thornton can assist…

23 September 2019

Contents

1 Who we are and credentials

2 The securitisation process

3 The legal and regulatory framework

4 Ways we can help

Contents

5 Credentials

6 CVs of key experts

Grant Thornton | An instinct for growth™

Who we are…

Grant Thornton International

- Operates as a network of independent assurance, tax and advisory firms
- Has 53,000+ people in 135 countries
- Reported $5.45bn of revenue in 2018

Grant Thornton Malta

- Is a member firm of Grant Thornton International
- A civil partnership constituted under the laws of Malta
- The revenue for the year ended 31 December 2018 amounted to €5.1mn

Quantitative Risk Management

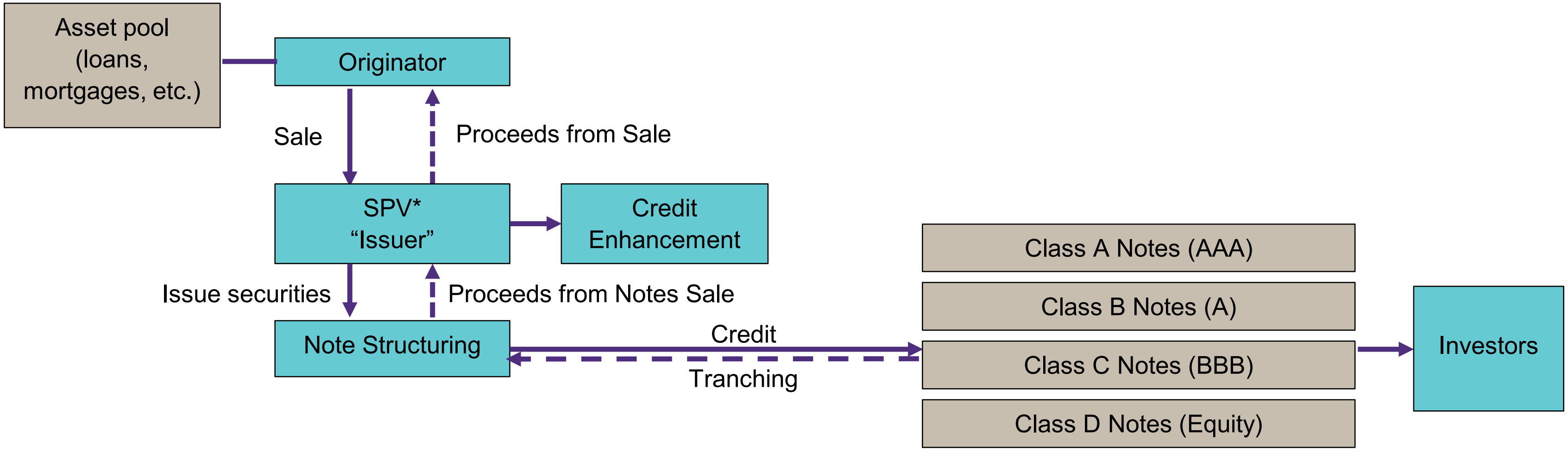
- Nowadays, financial services organisations are being significantly more under scrutiny from shareholders, executive management, regulatory bodies as well as other stakeholders
- As a result, having a sound financial engineering strategic framework provides several advantages for organisations to increase their shareholder value
- This entails having a proactive risk management strategy by using the right tool and products to quantitatively achieve such goals
- At Grant Thornton, we bring real expert advisors that enable our clients to look beyond their horizons and achieve innovative goals
- Our experts include people with mathematics, accounting, economics, decision analytics, financial engineering, transaction and investment banking experience who have taken lead roles in securitisations across Europe and the US

Grant Thornton | An instinct for growth™

The Securitisation Process

A framework in which some illiquid assets of a corporation or a financial institution are transformed into a package of securities backed by these assets, through careful packaging, credit enhancements, liquidity enhancements and structuring.

Basic Structure



*SPV stands for Special Purpose Vehicle

Grant Thornton An instinct for growth™

The Securitisation Process

Rationale for Securitisation

- ✓ Increase ROE
- ✓ Obtain cheaper funding
- ✓ Not dilute existing shareholders
- ✓ Level of capital required to support Balance Sheet is reduced
- ✓ Enhanced risk management and credit transfer

Types of Securitisation transactions

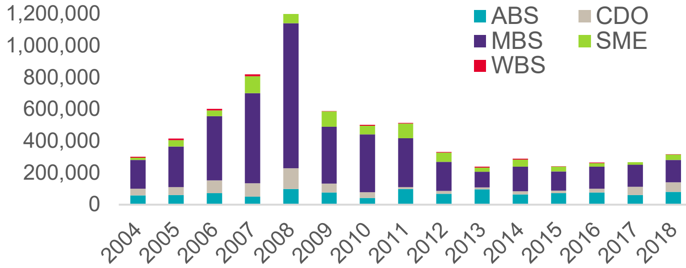
- ✓ **Sale transactions** – The originator, an entity which assigns assets or risks in a securitisation transaction, will transfer a pool of assets to the securitisation vehicle
- ✓ **Synthetic transactions** – It involves transfer of risk via use of credit derivatives or guarantees. For example, an insurance policy is taken up by banks to hedge against risk inherent in their SME loan portfolio
- ✓ **Loan transactions** – This includes granting of secured loans or other secured facilities to the originator

The Securitisation Process

SPV Structures

- **Amortization structures**
  - Pay principal and interest to investors at coupon-by-coupon basis over the life of the security
  - Pass-through structures are widely used in residential and commercial Mortgage-Backed deals (MBS) and consumer loan Asset Backed Securities (ABS)
- **Revolving Structures**
  - Revolve the principal of the assets; throughout a revolving period, principal collections are being used to purchase new receivables that meet the necessary criteria
  - The structure is being used for short-dated assets with relatively high pre-payment speed, including credit card debt and auto-loans.
- **Master Trust**
  - Frequent issuers under US and UK law are using master trust structures, which enable multiple securitisations to be issued from the same SPV
  - Under these schemes, the originator transfers assets to the master trust SPV
  - Notes are subsequently issued out of the asset pool based upon the investor demand. Master trusts are being used by MBS (Mortgage Backed Securities) and credit card ABS originators

EU Statistics on Securitisation (USD Millions)



Source: SIFMA European Securitisation

- Securitisation vehicles established **in Malta** under the Securitisation Act can be a **company, partnership, trust or any other legal structure that the MFSA may expressly permit.** Securitisation vehicles are typically established as **limited liability companies**.
- As per Subsidiary Legislation 386.16, there's a provision for the institution of **Securitisation Cell corporations (SCCs)** that may perform securitisation transactions through separate cells among that single legal entity (with every cell playing a part of the SPV within the explicit transaction that it's been established).

Grant Thornton An instinct for growth™

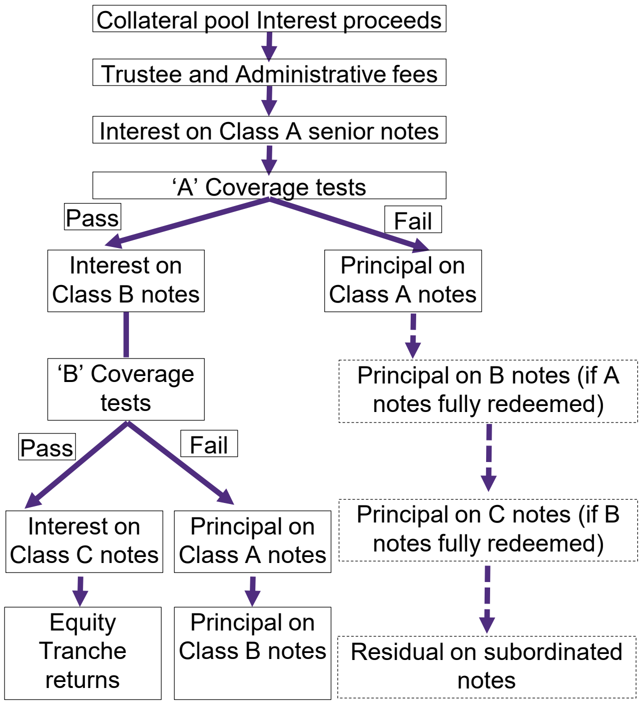
The Securitisation Process

Structure – Malta

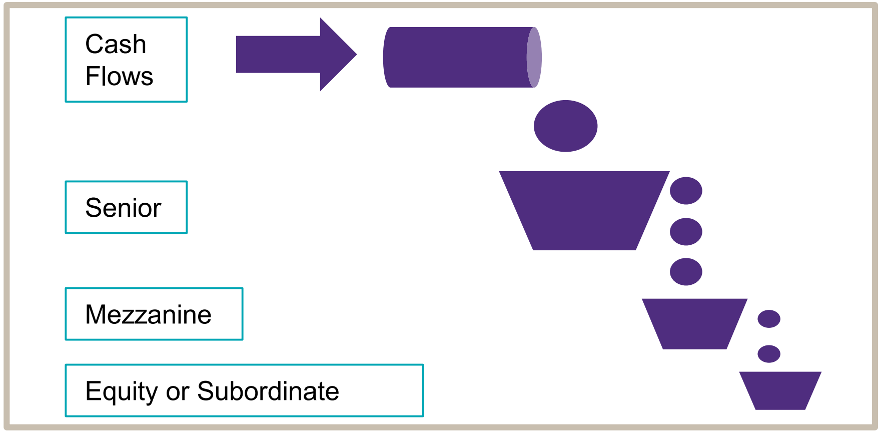
- **Master Trust**
  - Special Purpose Vehicle (SPV) is bankruptcy remote from the originator.
  - Bankruptcy remoteness requires a clear separation of the SPV from the originator. A key result of this is that the credit risk of the SPV rests on the quality of the SPV's assets, as the creditors of the SPV won't have access to assets of the originator.
  - Bankruptcy Remoteness is an entity (a single purpose entity, a SPV or a Special Purpose Entity (SPE)), which is formed to develop, own and operate a special project in order to divide financial risk and minimize bankruptcy risk.
  - From investor's point of view, the securitisation vehicle is bankruptcy remote. It means that as per bankruptcy remote structure, the securities issued are collateralised by a pool of assets that have been legally isolated from the transferor in all possible circumstances, including insolvency, so that no choice can be made by the transferor's creditors or liquidator to the securitisation vehicle's assets.
  - A mechanism commonly used in order to achieve an SPV's bankruptcy remoteness is to transfer the SPV's shares to a trust which has, as sole purpose, the holding of such shares.
  - The Regulations define a Reinsurance Special Purpose Vehicle (RSPV) as *"an undertaking, other than an existing insurance undertaking or reinsurance undertaking, which assumes risks from a ceding undertaking and which fully funds its exposure to such risks through the proceeds of a debt issuance or any other financing mechanism where the repayment right of the providers of such debt or financing mechanism are subordinated to the reinsurance obligations of such a vehicle".*
  - The Regulations nevertheless only allow limited liability companies formed in Malta to apply for authorisation as RSPVs, because the corporate structure is a well-established structure in Malta, and for that reason provides legal certainty.
  - This is a variation from the framework of the Securitisation Act, which enables the securitisation vehicles to take various forms, including trusts and partnerships.

The Securitisation Process

Cash Flow Waterfall



- All securitisation structures incorporate a cash waterfall process, whereby all the cash that is generated by the asset pool is paid in order of payment priority. Only when senior obligations are met, more junior obligations can be paid.
- An independent third-party agent is typically employed to run "tests" on the vehicle to check that there is enough cash available in order to pay all the obligations.
- If a test is failed, then the vehicle will start to pay off the notes, beginning from the senior notes.



The Securitisation Process

- **Due Diligence** – Before holding a securitisation position an institutional investor is required to perform a due-diligence assessment which allows the investor to evaluate the risks associated with both the securitisation position and the underlying exposures.
- **Marketing Approach** – Securitisation provides a useful mechanism whereby financial institutions may transfer concentrated (credit, interest rate and market) risks linked to their portfolio activities to the more broadly distributed capital markets, thereby minimising risks to individual institutions.
- **Deal Structure** – The process includes selling of future flow ticket receivables by Originator to an Issuer (SPV), the SPV issues notes in order to fund its purchase of the receivables and pledges its right to the receivables to a fiduciary agent and the Trustee accumulates funds as they are received by the SPV and the bondholders receive interest and principal payments, in the order of priority of the notes, on a quarterly basis.
- **Financial guarantors** – The investment bank will take into consideration if an insurance company, known as the monoline insurer, would need to be approached to “wrap” the deal by offering a guarantee of backing for the SPV in case of default. This insurance is given in return for a fee.
- **Financial Modelling** – An Arranger will construct a cashflow model to assess size of the issued notes. Such models are useful to track performance and provide updated valuation of the securities.
- **Credit Rating** – A formal credit rating facilitates Arranger to place the notes with investors. The methodology used by ratings agencies considers both qualitative and quantitative factors and will vary depending on the asset class being securitized. Based on the results of the ratings agency, the arranger will be able to re-design certain aspects of the deal structure so that the issued notes are rated at the requisite level.

The Securitisation Process

ABS Structures: Performance Metrics and Test Measures

- Collateral Types
  - The variety of mortgage pools offered to investors can either be Retail or Commercial
- Portfolios can offer Fixed or Floating rates
- Most common structure for agency MBS is “Pass-through”, where investors are simply purchasing a share in the cash flow of underlying loans.
- Conversely, non-agency MBS has a senior and a tranched subordinated class with principal losses absorbed in reverse order.
- Performance Metrics in the case of MBS are as follows:
  - Debt service coverage ratio (DSCR)
  - Weighted Average Coupon (WAC)
  - Weighted Average Maturity (WAM)
  - Weighted Average Life (WAL)

Debt Service Coverage Ratio (DSCR), that is the Net operating income/Debt payments, indicates a borrower’s capacity to repay a loan

Weighted Average Coupon (WAC) is weighted coupon of the pool that is obtained by multiplying the mortgage rate on each loan by its balance. It is the pool’s weighted coupon

Weighted Average Maturity (WAM) is the average weighted of the remaining terms to maturity of the underlying pool of loans in the MBS

Weighted Average Life (WAL) of the notes at any point in time is:

$$s = \sum t.\,\mathrm{PF}(s)$$

Where PF(s) = Pool factor as s; and t = actual/365

Grant Thornton | An instinct for growth™

The Legal and Regulatory Framework - The EU

"The originator and sponsor have a joint obligation to notify The European Securities and Markets Authority (ESMA) where a transaction meets the STS requirements. In the case of an Asset-Backed Commercial Paper (ABCP) programme, the obligation to notify, both with respect to the programme and the transactions within it, falls upon the sponsor."

Article 8 of the Securitisation Regulation covers a ban on resecuritisation, stating that "the underlying exposures used in a securitisation shall not include any securitisation positions". "There are exclusions from the ban on resecuritisation for certain specified purposes in relation to the winding up of a credit institution, investment firm or financial institution, ensuring the viability of any such entity to avoid its winding up, or the preservation of investors' interests where underlying exposures are non-performing, and this list may be supplemented by certain Regulatory Technical Standards (RTS)."

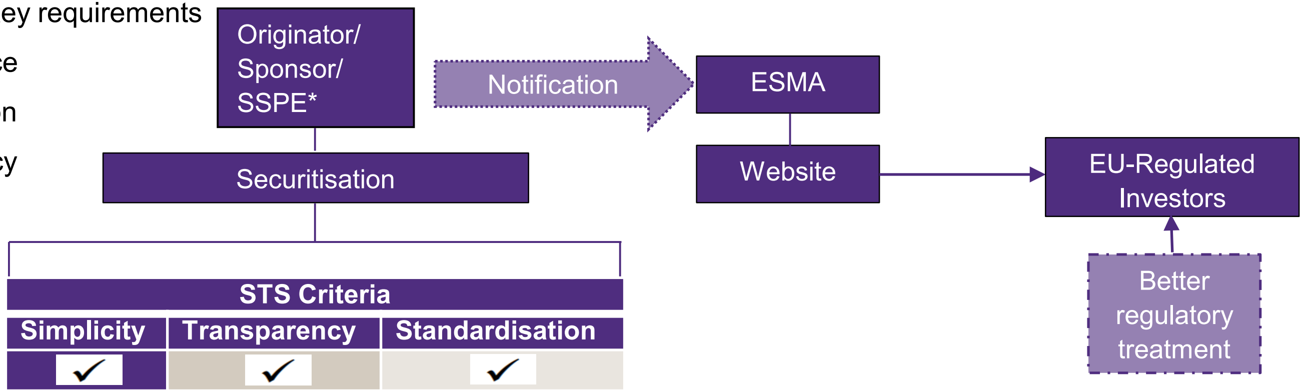
"ESMA published Final Reports containing technical standards relating to:

- The information and format that the originators and sponsors of securitisation products must adhere to when notifying ESMA that a securitisation transaction meets the STS criteria ('STS notification')
- The information to be provided to the competent authorities in the application for the authorisation of a third party assessing the compliance of securitisations with the STS criteria."

The Legal and Regulatory Framework

The EU

- **The 28 December 2017 Securitisation Regulation 2017/2402**
- This Regulation defines Securitisation and establishes, among others, due diligence, risk-retention and transparency in Securitisation, be it banks or other financial market participants.
- It also creates the Simple, Transparent And Standardised ("STS") securitisation.
- Under this regulation, the term Securitisation is to be understood as a transaction or scheme, whereby credit risk is tranched.
- The European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) consultation papers have been published in order to give further guidance.
- General framework: key requirements
  - Due-diligence
  - Risk retention
  - Transparency



Source: [Lexis Webinars]

*SSPE stands for Securitisation Special Purpose Entity

The Legal and Regulatory Framework

STS Criteria (Effective 1st January 2019)

Simplicity	Transparency	Standardisation
Portfolio and cash flows • **True sale only** • **No active management (eligibility criteria)** • **Homogeneous asset type** • **No re-securitisation** • **No defaulted exposures** • **Cashflows not substantially dependent on sale of asset** • **At least one payment made**	Investor data availability • Historical (≥5yrs) default and loss performance data • Sample of exposure independently verified • Liability cash flow model linked to exposure • Originator and sponsor responsible for transparency (Including STS notification and quarterly investor reporting)	Structural elements • Risk retention satisfied by originator, sponsor original lender • Interest and currency risk mitigated • Roles and responsibilities of transaction parties, esp. servicer, clearly described • Remedies and actions in case of delinquency/default of debtors or conflicts of investors predefined

Additional requirements

- Originator, Sponsor and SSPE must be established in EU
- All STS must be published on the official website of the ESMA
- Originators and Sponsors shall notify ESMA of new STS securitisation and verify compliance with STS criteria

The Legal and Regulatory Framework - Malta

The Securitisation Act is supported by the:

- Securitisation Transactions (Deductions) Rules, Subsidiary Legislation 123.128 of the Laws of Malta
- Securitisation Cell Companies Regulations, Subsidiary Legislation 386.16 of the Laws of Malta (SCC Regulations)
- Reinsurance Special Purpose Vehicle Regulations, Subsidiary Legislation 403.19 of the Laws of Malta (RSPV Regulations)

"The securitisation market in Malta has experienced strong growth over the past few years, founded on a robust and innovative legal framework, which is clearly indicative of Malta's potential. Central Bank programmes do not appear to have had any effect on the securitisation market in Malta."

According to Practical Law Thomson Reuters, "Trusts and trustees are recognised under Maltese law, and are regulated by the Trusts and Trustees Act (Chapter 331 Laws of Malta) (Trusts Act), subsidiary legislation passed under the Trusts Act and rules issued by the MFSA. In international market standard transactions the securities are typically constituted by trust deed, in the manner set out in the Guide to a standard securitisation."

The Legal and Regulatory Framework

Malta

Impact of STS on Maltese Securitisation

- The new STS legislative package had been agreed after lengthy negotiations by the Maltese EU Council presidency team over the first half of 2017. The European Commission had embraced this agreement as an important step towards a fully functioning Capital Markets Union until the end of 2019.
- This legislative package is anticipated to restore market activity in EU securitisation transactions in order to generate new investment possibilities and provide additional source of finance, especially for SMEs and start-ups.
- Following the recommendation by the European Banking Authority and the European Commission, agreement includes an obligation for originators of securitised assets to retain a minimum of 5% of the risk of the securitised portfolio.
- At a local level, the introduction of the Securitisation Cell corporations (SCC) Regulations opened the securitisation market to smaller transactions.
- The SCC structure, which provides lower costs and quicker set-up time for every transaction, makes it perfect for ABS offering programmes or asset-based financing (or other) platform structures.
- SCCs and securitisation cells have indeed been widely used over recent years with many local platform arrangers/sponsors currently offering originators plug-and-play solutions.
- The securitisation vehicle may choose to eliminate all its chargeable income by the use of those deductions, which leads to no income tax payable in Malta. If the securitisation vehicle has any remaining income after deducting all allowable expenses, it may request a further deduction of an amount equal to the remaining income. The securitisation vehicle concludes with no chargeable income.

How we can help…

The Securitisation key players are many and we can run this process in an efficient and seamless manner. Our team has not only the project management skill but has performed some of these major roles in European and US Securitisations. The expertise that our team brings is unique to the Maltese Market.

How we can help…

Specifically, we can partner with you to perform the following:

Due Diligence – Provide the necessary due diligence during the process

Financial Modelling – Combine specialist excel modelling skills with deep commercial insight and understanding on Securitisation. We can also assist with data analysis, model reviews and financial modelling training

Valuation – Provide independent valuation advice in relation to securities, credit derivatives and synthetic structures by using a variety of methodologies and techniques. We also apply our judgement in order to provide our clients with the quality of valuation advice they demand

Provide accounting and tax advice – Offer auditing services and tax solutions to help you achieve your targets in relation to portfolio of securities

Structuring advice – Provide securitisation related advice for the SPV structures including Amortisation, Revolving and Master trust

Be your Calculation and Reporting Agent – Act as a calculation and reporting agent for securitisation vehicles for underlying assets

Risk Management advice and Financial Engineering Services – Provides expertise using qualitative and quantitative techniques

Reporting Requirements – Provide the necessary support in order to meet the stringent reporting requirements on an ongoing basis

Selected Securitisation Credentials

Our experts have provided the following services:

- Calculation and verification agent for a number of securitisation vehicles in the UK for a Global Investment Bank. Underlying assets including RMBS and CMBS
- Due diligence and valuation of a portfolio of asset backed securities (CDOs, CLOs, RMBS and CMBS)* for an acquisition by a Japanese Securities House. Transaction was valued at USD400 Million
- Structuring transaction advice around the securitisation of a number of retail and commercial mortgage portfolios for Cypriot banks
- Acted as valuation agent for a number of European Banks owning Asset Backed Securities post the Lehman demise. Valuations were performed on a monthly basis for IFRS Reporting Purposes. Additional services were provided in relation to the disposal of some of these securities
- Provided independent valuation advice to the Board of Directors of a Swiss Hedge Fund in relation to the disposal of a portfolio of Asset Backed Securities
- Provided independent valuation services to a number of major US hedge funds regarding securities held within asset-backed structures on a quarterly basis for US GAAP Financial Reporting purposes
- Advised on the structuring of a CMBS for a US financial institution
- Appointed Expert to European Commission DG Comp to advice on the Implementation of the Asset Relief Programme in 2009 for troubled European Banks. Reviewed valuation and estimate of expected losses in portfolio of complex Asset Backed Securities owned by such bank across the EU. Advised on Balance Sheet Restructuring for such banks

*CDOs stands for Collateralised Debt Obligation, CLOs stands for Collateralised Loan Obligation, RMBS stands for Residential Mortgage-Backed Securities and CMBS stands for Commercial Mortgage-Backed Security

Selected Securitisation Credentials

Advised a European Bank on the acquisition of a number of loan portfolio including corporate, SME, commercial and retail mortgages

Model validation advice to a large Canadian Pension Fund in relation to trading in credit derivatives and synthetic CDO portfolios

Grant Thornton | An instinct for growth™

Other Credentials

Bond Issuance/Capital Markets

Main Market Bond Issues – Our role included preparing Financial Due Diligence Report for:

- IHI Plc (2015 and 2016)
- CPHCL Plc (2016)
- Mediterranean Investments Holding Plc (2017)
- Best Deal Properties Holding Plc (2018)

Prospects MTF – Included projections, financial due diligence, drafting of company admission document and corporate advisors for:

- Orion Finance Plc (2017)
- Klikk Finance Plc (2017)
- AST Group Plc (2017)
- Luxury Living Finance Plc (2018)
- D Shopping Malls Finance Plc (2018)
- Agri Bank Finance Plc (2018) – Reporting Accountants Only
- FES Finance Plc (2019)
- Best Deal Properties Holding Plc (Equity) (2019)

Grant Thornton

An instinct for growth™

grantthornton.com.mt