Looking east

Polish SRT issuance boosted synthetic securitisation volumes last year. **Stelios Papadopoulos** assesses the prospects for increased activity across the CEE region.

Significant risk transfer issuance in Central and Eastern Europe received a boost in 2022, with the opening up of the Polish market. However, activity across the rest of the region will likely continue to be dominated by EIF transactions.

According to Robert Bradbury, head of structured credit execution and advisory at Alvarez & Marsal: "There were already some limitations in the securitisation market in Poland before recent SRT issuances – including having a non-euro currency and Wibor as a benchmark rate. It gives rise to more limited FX liquidity and greater volatility, as well as a narrower pool of investors able to deploy funds in the currency."

He continues: "The second obstacle was that the banks previously had limited need for SRT. However, the combination of Basel 4, the credit impact of Covid and legacy issues from Swiss franc mortgage portfolios – as well as the options afforded by the new Securitisation Regulation – have raised prospects."

The Polish securitisation market has traditionally been more constrained by supply than demand and Polish banks are well capitalised and funded. Given the concerted effort required to execute the first cash or synthetic transactions, Polish banks needed time to fully incorporate the product into their treasury and capital toolkits. By reducing RWAs, Polish banks reduce MREL requirements and improve CET1 ratios.

Poland is the most active CEE jurisdiction for, among other reasons, the size of the domestic market and the lack of a securitisation framework ▶

Robert Bradbury, Alvarez & Marsal

in other CEE countries. Hence, the EIF has been the most active counterparty in CEE jurisdictions outside Poland, since its presence in those markets doesn't require the establishment of a securitisation framework.

The dominance of Poland is evident from EIF figures. Over the last 10 years, the fund has invested over €8.5bn in tranche notional terms and more than half has been in Poland.

Nevertheless, issuance has been increasing in other CEE jurisdictions as well, but more because of the snowballing effect from Poland and initiatives from Western European banking groups with subsidiaries in those regions.

Georgi Stoev, head of northern Europe and CEE securitisation at the EIF, explains: "For all the rest of the CEE, what played a role is the snowballing effect from the Polish market, along with Western European parent banking groups – such as UniCredit and Santander – initiating efforts to render their subsidiaries more independent in terms of formulating their own capital management policies."

The first transactions with private investors in Poland were funded structures, such as mBank's debut synthetic securitisation – dubbed Project K2 – in March 2022 *(SCI 24 March 2022)*. The STS deal was structured as a direct CLN.

The aim of the capital relief trade was to deliver the objectives of the bank's strategy for 2021-2025 and support the development of its corporate and retail banking franchises, both of which are poised for future growth. Commerzbank is the lender's strategic shareholder, owning the bulk of the shares.

Wasif Kazi, structurer at UniCredit, was directly involved as arranger in the deal. He notes: "Polish banks have been active in securitisation for some time, and they were exploring SRTs for a few years. It was a matter of time before SRTs picked up, given the solid economic advance of the country and, in the case of the mBank transaction, a convincing growth story. K2 is now acting as a model for future trades in the CEE, given its size and efficiency."

"FOR ALL THE REST OF THE CEE, WHAT PLAYED A ROLE IS THE SNOWBALLING EFFECT FROM THE POLISH MARKET"

The K2 trade is not a financial guarantee, since this would involve placing the collateral in a third-party bank account under STS rules. "Until STS rules came into effect, the financial guarantee format suited many banks well. But for bilateral deals, you will see more direct CLN structures such as K2," says Kazi.

Depositing collateral in third-party accounts under STS rules can be an issue from an originator perspective, because it dilutes the capital benefit for some lenders.

The mBank trade was then followed by Getin Noble Bank's CRT in July *(SCI 4 July 2022)*. The funded first loss guarantee referenced a static portfolio of housing community loans. The transaction was one of a handful of standardised bank SRTs sold to private investors and enabled a significant reduction in risk weighted assets for the reference portfolio of more than 80%.

Yet unfunded structures maybe perhaps even more suitable for CEE jurisdictions. Bradbury explains: "Unfunded deals have much less explicit currency risk, since there's no currency mismatch to be funded. If a given insurer, for example, acting as a tranche protection counterparty, has no need to switch zlotys to euros or dollars, then there's no hedging cost for either party. But the transactions must continue to have highly efficient structures to mitigate the impact of counterparty risk."

Indeed, several arrangers have pointed to the benefits of the unfunded format – although the first point of contact for them for the foreseeable future will remain the EIF, since for the smaller standardised banks that are typically found in these regions, EIF guarantees remain the most cost-effective option. Nevertheless, insurers can help lay the groundwork for a private market in CEE jurisdictions outside Poland under certain conditions.

Harald Weiser, head of solutions at Erste Group, comments: "In CEE countries, we would look at residential mortgages first, since you would have to start with low-risk portfolios. And this would involve insurers as well, who would be

Georgi Stoev, EIF

willing to go down the capital structure if there is a retained first loss or synthetic excess spread."

He continues: "Synthetic excess spread is less cost-effective, given the EBA's proposal regarding the full capitalisation of synthetic excess spread. But the excess spread structure can work from an efficiency standpoint, if it's smaller in size and if the pool is backed by low-risk mortgage pools."

Diversified corporate portfolios are another option. But for investors, Western Europe will remain the preferable option in the foreseeable future. Tranching is also expected to be more conservative in the broader CEE, due to the higher risk that investors can expect.

The risk that investors would be focusing on though wouldn't just concern the underlying portfolio. Getin Noble Bank's bankruptcy in late September is a case in point *(SCI 3 November 2022)*, in terms of the risks that investors have to consider when dealing with smaller and less experienced banks in a relatively uncharted territory and the implications of this for the credit protection.

Getin Noble Bank had been encountering difficulties since 2016, due to low profitability which depleted its capital. The bank then experienced a bank run in 2018 when around €2.25bn of funds were withdrawn in less than three weeks. The legal and credit risks associated with the Swiss franc mortgage loans further decreased the value of the bank's assets, while the recovery measures taken by the bank since 2016 to address its difficulties proved to be inadequate.

Consequently, on 30 September, Polish supervisors declared the bank "failing or likely to fail". The lender was then put into resolution in line with the EU Bank Recovery and Resolution Directive (BRRD).

The resolution plan stipulated that the bank's main assets and liabilities – except the equity and subordinated debt that will be fully written down to absorb losses – will be transferred to a newly created bridge bank following the resolution. The purpose of this transfer is to ensure the continuation of normal banking operations and provide sufficient time to organise an orderly sales process for the bridge bank.

SCI has confirmed the continuation of the credit protection, which vindicates the resilience of synthetic securitisations. Synthetic securitisations differ in this respect from CDS contracts – where bankruptcies can trigger a close-out – because if the bank keeps paying protection premiums, the hedge remains in place.

However, the resiliency of each transaction depends on the structure of the deal and that structure wasn't disclosed in the case of Getin Noble Bank's trade.

Getin Noble Bank proved to be the second SRT issuer to fall under the EU's BRRD, along with Banco Popular. However, the cases aren't exactly similar, since Popular was acquired by Santander, which then decided to keep a synthetic ABS called STAR that was executed in January 2016. Getin's resolution plan, on the other hand, stipulates the transfer of the assets and liabilities to the bridge bank.

Nevertheless, this isn't deterring investors and arrangers from looking forward. Kazi states:

"GOOD CANDIDATES IN TERMS OF ASSET CLASSES FOR POLISH SYNTHETIC TRADES ARE CORPORATE AND SME LOANS"

"Good candidates in terms of asset classes for Polish synthetic trades are corporate and SME loans, given the substantial capital efficiency that banks can benefit from and the benchmarking that they allow."

He concludes: "Project finance is another one, but a substantial pick-up is unlikely, given the small size of most portfolios. Retail via the full-stack option could also gain a foothold, especially given the track record for cash deals that already exists in Poland."

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