Capital boost

Risk transfer technology is proving useful in the Greek banking sector. Lenders are expected to embrace synthetic securitisations to generate capital to offload their non-performing loans, as **Stelios Papadopoulos** reports.

Greek capital relief trade issuance is set to pick up, following the announcement of Piraeus Bank's transaction in 3Q20. The technology is being utilised to generate enough capital that will enable originators to offload their remaining non-performing loan stock. However, asset quality and other issues have constrained activity in the past and it remains to be seen how this will be resolved going forward.

Piraeus Bank's synthetic securitisation references a €2bn portfolio and forms part of a broader range of actions to strengthen the bank's capital ratios this year, mainly through non-dilutive actions, such as reducing its RWAs and selling certain assets and businesses. The measures are expected to enhance the bank's capital position by around €1bn. According to the lender's 3Q20 presentation, such actions could facilitate approximately €5bn of NPE derecognition by the end of 2021.

Piraeus is not the first Greek bank to have ventured into CRTs, however. Eurobank and the National Bank of Greece tried to tap the market in 2014-2015, but never managed to get trades off the ground, since NPL deleveraging has been the main priority for both banks and regulators.

The third and last recapitalisation of the Greek banking system back in December 2015 was meant to provide the capital buffer necessary to offload a large stock of non-performing loans and then proceed with advanced forbearance for the rest, through internal workouts – with the potential of sharing any upside in an improving economy – and naturally NPL outright sales and securitisations.

The efforts of lenders have paid off. Greek banks' NPL ratios peaked at 50% in 2017 and have been declining since then, but the country still struggles with close to €60bn of volumes.

Greek banks have already finalised NPL securitisations through the Hercules Asset Protection Scheme and more are expected, despite the disruption caused by the coronavirus pandemic. The scheme was approved by the Greek parliament and the European Commission last year and it effectively provides a government guarantee on the senior tranche of NPL ABS deals.

Yet, as the economic impact of the coronavirus pandemic emerges with new inflows of NPLs, existing approaches will be necessary but are unlikely to be sufficient. This is where risk transfer technology will prove extremely useful, since lenders can effectively use synthetic securitisations to generate capital for the coming offloading of NPLs.

Evangelos Venizelos, partner at PwC, explains: "The profitability of Greek banks will come under pressure because of the pandemic, leading to a new inflow of NPEs, higher provisions and therefore an inability to build capital buffers. Considering the existing capital position of Greek banks, current profitability levels and NPE volumes, it is going to be challenging to adequately resolve the NPEs at a fast-enough pace. Synthetics can allow the banks to generate enough capital to offload remaining NPEs faster through securitisations and/or outright disposals." ▶

Hence, the timing is important in understanding the attention that the asset class is now getting in the Greek market. However, "the securitisation regulation was also far more cumbersome for banks which have only recently completed synthetic securitisations with 10% senior risk weights," says Francesco Dissera, md and head of securitisation at Alantra.

Furthermore, the purpose of synthetic ABS is to maintain relationships with clients, release regulatory capital through a significant reduction in RWAs and redeploy capital to higher yielding business. However, finding quality lending opportunities with a yield that is higher than premiums paid is not easy.

Nevertheless, none of this would be possible without the country's return to the capital markets over the last three years. George Kofinakos, md at StormHarbour, remarks: "In the case of Greece, risk transfer transactions were not previously feasible post-financial crisis, due to the wider market sentiment around the country. Now, with the country and sentiment continuing to improve – despite the effects of the Covid-19 pandemic – such transactions are possible again for the first time, thanks to the support of both market and supranational investors."

Similarly, Nondas Nicolaides, vp and senior credit officer at Moody's, notes: "Unsecured capital markets have opened up for Greek banks in the last couple of years by raising Tier 2 bonds to meet capital management objectives and eventually build a yield curve. Banks can access a larger universe of investors through Tier 2, although there is a high funding cost. The pick-up in synthetic securitisations has followed this trend, along with the upgrade of Greek government debt to investment grade."

Structural complexity has historically been another impediment. Although AT1 bonds and

Francesco Dissera, Alantra

CRTs are close to each other in the regulatory capital structure, AT1 instruments are more liquid and less complex.

Yet this is where third-party arrangers, such as Alantra and StormHarbour, can help fill in the gaps. Additionally, despite their complexity, capital relief trades expose investors to a customised portfolio as opposed to the entire bank.

"UNSECURED CAPITAL MARKETS HAVE OPENED UP FOR GREEK BANKS IN THE LAST COUPLE OF YEARS"

Still, one of the biggest obstacles for arrangers is convincing senior management on the value of CRTs versus AT1 bonds, since they usually benchmark the two in the same way – while AT1 represents one of the only readily visible sources of capital pricing. However, with AT1 bonds, banks price a notional amount – meaning that whatever is priced is whatever they get – while CRTs have a leverage effect, given that only a tranche is sold. The latter effectively means that banks must size up.

Robert Bradbury, head of structuring and advisory at StormHarbour, comments: "For new issuers, discussing with senior management the value of risk transfer transactions requires a quantitative demonstration of how the deal will perform in various scenarios and over time, including from a cost of capital perspective. Qualitatively, you also need to highlight the benefits of the structure, such as the fact that they are designed to pay out when the portfolio deteriorates. Risk transfer transactions offer a 'corridor' of potential performance and costs, given the range of scenarios."

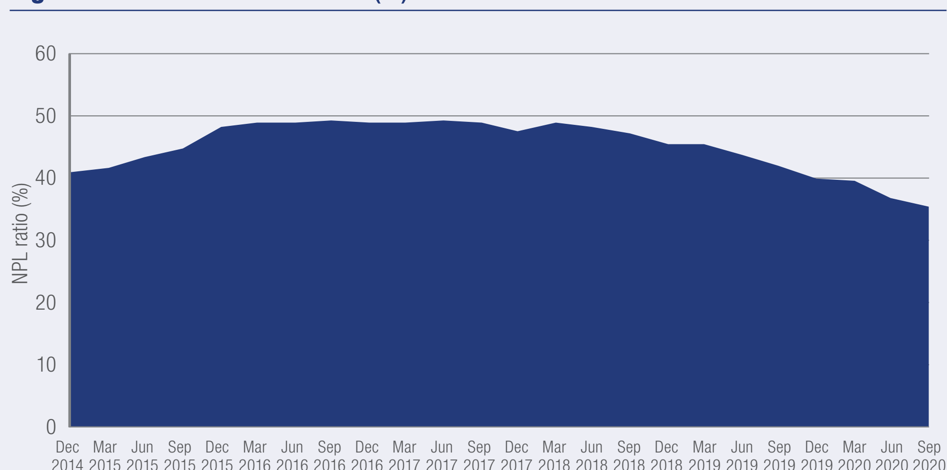
However, it remains to be seen whether Greek CRTs can work from a cost of capital perspective, given legacy issues and the small size of portfolios. Bradbury states: "Greek banks generally have portfolios with relatively high historical losses and relatively high existing rates of UTP/NPLs. In the context of a risk transfer transaction, the situation is further complicated by the small relative size of the portfolios and hence universe of available and potentially eligible assets. These factors generally increase the cost of protection and may result in transactions that are economically unattractive from the bank's perspective."

Most investors look at targeted IRRs on their investment, with such returns ranging from 8% to 15%, but in Greece it might be higher.

Meanwhile, asset quality issues will be further compounded by payment holidays. The Greek government introduced a debt moratorium for creditors with specific characteristics as part of its response to the coronavirus pandemic. The four large Greek banks reported an aggregate amount of €18bn in loans that had been granted monthly instalment deferrals as part of this response.

According to Moody's, the loan deferrals – which involve the postponement of principal repayments for up to six months and require borrowers to continue to pay interest – comprise around 12% of total gross loans in the system on average, or around 18% of performing loans as of June 2020. The Greek government has further introduced a bridge subsidy programme between the moratorium and the return to full payment patterns, under which the state will provide a

Figure 1: Greek banks' NPL ratio (%) 2014-2020



Source: Bank of Greece

Figure 2: Greek banks' return on equity (%) 2008-2020

Source: ECB

nine-month instalment subsidy for primary residence mortgages affected by the pandemic.

Additionally, the EBA's final SRT report can add to existing problems, thanks to the treatment of synthetic excess spread as a first loss tranche. Bradbury comments: "Adding in more capital requirements to the bottom of the capital stack is likely to make transactions less efficient. If you end up realising a very high cost of capital in a transaction in order to transfer significant risk, the transactions become less attractive relative to other capital alternatives, including equity."

you have to spend time with investors to explain the data."

He continues: "If you are an investor who uses a seven- to 10-year cycle and you end up with transitions that make up 50% of the 2009-2010 originated loans, then one will struggle to price a deal. Currently performing borrowers are the ones that survived the extreme 2010 crisis. All of this is legacy historical data and it has to be cleaned up."

Yet pricing is not the only consideration. Venizelos cautions: "For SME and corporate deals, it is likely that all or the majority of the

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Nevertheless, in principle, issues around the cost of protection could be dealt with through strict eligibility criteria, short WALs, static pools and tranche seniority, as well as excess spread. Yet, although all these features are welcome, they might not be economically effective, since banks transfer less risk and achieve less benefit.

Market practitioners agree that a crucial step going forward in terms of bringing the cost of protection down is more data transparency. Vasilis Kosmas, partner at Alantra, explains: "If you look at Greek credit performance, there's naturally the 2010 crisis, which has a negative impact since it adds volatility to the data. So,

systemic banks will have exposures to the same corporate borrowers, with multi-creditor lending arrangements and piecemeal security in place over different assets. Syndicated loans add complications because if there are credit events, full workout of losses will be challenging and time-consuming, since control and ability to work out may depend on the agreement of other parties."

Second, according to EBA rules, the underlying loans in a synthetic ABS transaction should arise from the bank's origination business. However, the consolidation in the Greek banking system during the crisis years will make it hard to understand the underwriting criteria.

The country's four largest banks dominate the market, accounting for around 92% of total assets – including those of all registered commercial, cooperative and foreign banks, and other credit institutions – as of June 2020. The four largest banks are Piraeus Bank, Eurobank, the National Bank of Greece and Alpha Bank.

A third concern, notes Venizelos, is that a large chunk of corporate and SME loans in Greece tends to be revolving, but investors will prefer to have this excluded from deals as they focus predominantly on amortising loans where cashflows are predetermined. Official data confirm that loans without a defined maturity amount to close to a fifth of loans provided to corporates and SMEs.

Additionally, banks have the option of putting their performing loans through TLTRO, given that the current funding cost supports their net interest margins and profitability. Consequently, lenders will likely be weighing the option of whether to include them in synthetic ABS deals.

TLTROs are targeted operations because the amount that banks can borrow is linked to their loans to non-financial corporations and households. The more loans participating banks issue to non-financial corporations and households, the more attractive the interest rate on their TLTRO borrowing becomes.

As part of its temporary measures, the ECB increased its targeted long-term refinancing operations under more favourable terms, as well as its financial asset purchase programme. According to Moody's, Greek banks' ECB funding increased to around €39bn as of the end of September 2020, from €8.1bn at the end of December 2019, as banks switched most of their interbank repos into ECB funding.

Nevertheless, synthetic securitisations remain a vital tool to generate the required capital for NPL derecognitions, as evidenced by Piraeus Bank's decision to move forward with its significant risk transfer trade and strong investor appetite for yield, following another round of rate cuts and quantitative easing. And other Greek systemic banks are already discussing the possibility of future issuance.

Yet until Piraeus closes its own deal, questions around the workability of Greek CRTs will remain. The transaction is expected to close in the first quarter of this year.■

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