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Structured Finance – Europe

2020 Outlook — Stable deal performance as the credit cycle enters late stages

Summary

In 2020, performance of residential mortgage backed securitisation (RMBS), auto loan/ lease securitisation (auto ABS), consumer loan securitisation (consumer loan ABS) and SME loan/lease securitisation (SME ABS) will remain stable, amid positive - but slowing - GDP growth, low interest rates and low unemployment. However, as the credit cycle enters its late stages, high levels of consumer indebtedness, increasing leverage of companies and future weakening of macroeconomic indicators, will start to weigh negatively on securitisation performance. Underwriting standards will generally remain prudent but are becoming looser in certain RMBS and ABS market segments, resulting in emerging pockets of credit risk. Key themes that will shape RMBS and ABS credit in 2020 are found below in the Appendix.

» **RMBS:** Underwriting standards among mainstream lenders in the main markets will not materially deteriorate. Securitisation performance will remain steady in 2020, with most of our collateral forecasts being stable (see Exhibit 2).

» **Auto ABS:** The credit quality of new origination will weaken slightly with riskier products on offer. Auto manufacturers' captive originators will continue to grow their used car footprint and enter into new markets, amid stalling new car sales. Securitisation performance will soften, due to increases in arrears and losses from historically low levels. Receivables backed by electric or plug-in hybrid electric vehicles (EV and PHEV) will have an increasing presence within underlying collateral pools.

» **Consumer Loan ABS:** Underwriting standards will diverge across the different consumer markets in Europe. The credit quality of collateral portfolios among new securitisations will vary depending on trends in product type as well as underwriting criteria.

» **SME ABS:** We expect no substantial changes to the credit quality of underlying collateral portfolios for new transactions. Deal performance will remain stable because benign liquidity conditions for SME borrowers will continue.

» **Non-performing and Re-performing Loan (NPL/RPL) securitisation:** Portfolio quality for new NPL securitisations will remain diverse, reflecting credit institutions' different strategies to reduce their NPL stock. Macroeconomic conditions, local court systems efficiency and servicers' ability to implement collection plans will be the main drivers for NPL and RPL securitisation performance.

Geographical highlights

Exhibit 1 provides an overview of credit characteristics for new deals and performance among existing transactions on a country basis.

Exhibit 1

Credit characteristics of new deals will be mixed; stable performance among existing transactions

	Credit characteristics of new deals	Credit performance of outstanding deals
	France	
	More auto leases with residual value (RV) for retail customers, higher percentage of used cars	Stable performance for all sectors; low delinquencies and defaults
	High loan-to-value (LTV) ratios but debt-to-income (DTI) levels will remain very prudent in mortgage lending	Steady house price inflation
		Decreasing unemployment supporting performance
	Germany	
	Higher share of used vehicles in captive financing programmes	Stable performance for all sectors
	Lower yielding auto loans, as companies increase interest rate subsidies	Robust house price inflation
	Stable credit quality for SME loan portfolios on the back of prudent underwriting	Unemployment will remain low
		Benign liquidity environment decreases refinancing risks for SMEs
	Ireland	
	Stable NPL/RPL credit quality with many loans that will have high LTVs	Long-term arrears will continue to decrease but remain at high levels
	Increasing take-up by private equity in mortgage portfolio disposals	Dublin house prices falling, house price inflation to remain strong elsewhere
		Consumer confidence dropping due to Brexit uncertainty
	Italy	
	New asset types will be securitised in NPLs	Stable collateral performance
	Increasing presence of smaller originators, but with greater activity from larger issuers	Zero house price inflation
	Stricter eligibility criteria for ABS SME transactions, as a result of a more stringent default definition for NPLs	Consumer confidence will stay only slightly positive; unemployment will remain high
	More balloon auto loan origination as captives seek to expand penetration rates	Increasingly efficient foreclosure and bankruptcy court proceedings are credit positive for securitised deals with exposure to NPLs, and SME debt in particular
	The Netherlands	
	Collateral quality to remain unchanged	Stable performance across all sectors
	Greater activity in non-bank lending and more buy-to-let (BTL) deals	Strong house price inflation, albeit below recent years
	Portugal	
	Some decline in gross lending for mortgages	Stable collateral performance
	Consumer credit underwriting will remain unchanged	Strong house price inflation, albeit below recent years
		Robust consumer confidence; unemployment will decrease slightly
	Spain	
	Origination by banks to remain prudent, including for SMEs, unsecured non-bank lenders' credit standards will stay relaxed	Stable performance across all sectors
	More balloon auto loan origination as captives seek to expand penetration rates	Steady house price inflation
	Consumer loan quality from non-bank lenders to continue declining	Increasing consumer confidence; unemployment continuing gradual decline
		Benign liquidity environment decreases refinancing risks for SMEs
	United Kingdom	
	Longer fixed-rate products in RMBS, more use of automated valuation models (AVMs) in the prime space; Specialised lenders to continue origination of riskier/niche products	Weaker performance expected for all sectors
	Auto ABS pools to feature increasing share of used cars and lower yielding assets as captives increase interest rate subsidies	Low-to-steady house price inflation in the event of a deal on Brexit; price declines in the event of a no-deal
	Marketplace lending (MPL) to continue with tighter SME underwriting in response to increasing defaults and as a consequence of new regulation for MPL platforms in effect from December 2019	Brexit continues to pose downside risks. After the UK's eventual exit from the European Union (EU, Aaa stable), growth prospects are likely to weaken as a result of lower trade with the EU Single Market. Institutions have already weakened, in part due to the serious challenges raised by Brexit.

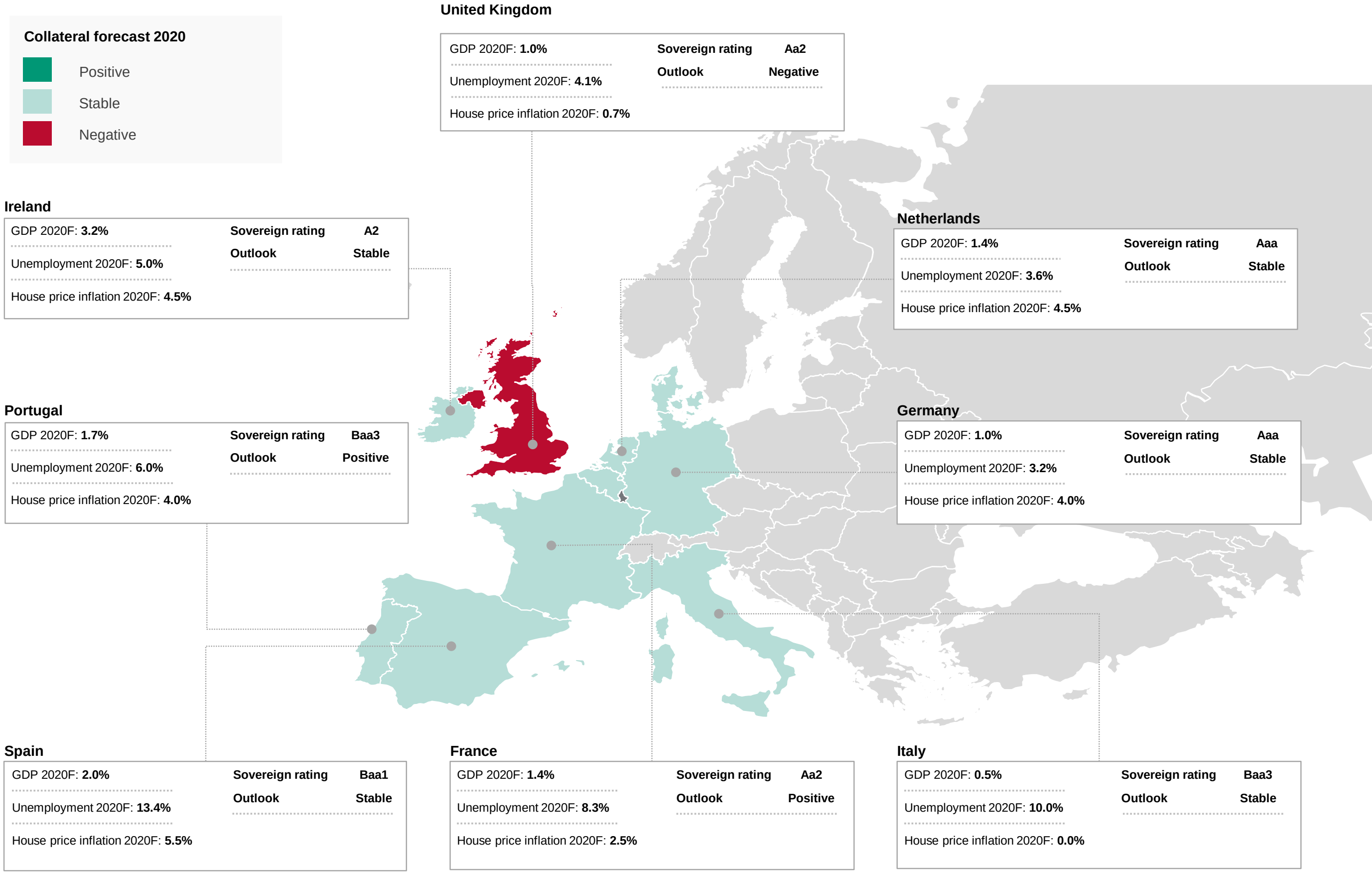
Source: Moody's Investors Service

Exhibit 2 shows our macroeconomic and collateral forecasts for the main European markets. All collateral forecasts for the UK are negative, whereas all other forecasts are stable in other countries. We have changed our collateral forecast on Dutch RMBS to stable from positive to match the rest of continental Europe because of slowing house price inflation and signs of stretched affordability in major cities. The stable collateral forecast is supported by the low unemployment rate, strong housing demand and the predominance of long-term fixed-rate loans in the mortgage market.

Exhibit 2

Most collateral forecasts are stable

Collateral forecasts for all sectors, ABS, RMBS and ABS SME



Source: Moody's Investors Service

Brexit extension removes immediate risk of no deal but prolongs uncertainty[1]

On 28 October, the European Council announced that it was willing to formally postpone the UK's (Aa2 negative) departure date from the European Union (EU, Aaa stable) until 31 January 2020. The delay removed the immediate risk of a no-deal Brexit and indicates that the likelihood of the UK leaving the EU with an exit arrangement in place is higher than it has been for some time. Nevertheless, the delay prolongs the uncertainty around the UK's final departure date and the terms of its exit. The UK will now hold a general election on 12 December. While the election outcome is highly uncertain, for now our base case is that the UK eventually leaves the EU with a negotiated deal.

Even if the UK leaves the EU under the terms of the revised Withdrawal Agreement, the two sides will still have to go through difficult and lengthy negotiations around the terms of their future relationship. Upon leaving, the UK would enter the transition period agreed with the EU. Under current plans, the transition period would last until the end of 2020, although the EU and the UK could agree to extend it. As such, the uncertainty around any new UK-EU relationship will persist for some time.

RMBS

Low interest rates driving shift towards longer fixed-rate terms

The main development in 2020 will be the continued lowering of mortgage interest rates. In some markets, like the Netherlands, UK and Spain, we will also see a continued trend to offer longer fixed-rate periods for mortgages. For instance, in the UK, 92% of mortgage origination gross advances were fixed-rate in the second quarter of 2019,[2] versus 81% five years previously.[3]

Longer fixed terms are credit positive in markets like Spain and the Netherlands, because borrowers have more certainty on debt-service affordability. However, in the UK, longer term fixes (of five years or more) permit more lenient affordability testing, hence if interest rates increase, there could be higher refinancing default risk.

Underwriting standards will generally remain stable apart from in France, where higher LTV mortgage loan products are on offer, also at low interest rates. LTV ratios in France have risen for four consecutive years, reaching 87.3% in 2018, up 30 bps year-on-year, a historical high.[4] In mitigation, affordability measures remain very prudent in France.

UK: Divergence between mainstream and specialist/challenger lenders' underwriting standards will continue; technology drives market change

Some of the UK's large ring-fenced banks have excess deposits which have been allocated to funding new mortgage origination. These institutions will compete with other mainstream market participants, offering low borrowing rates for longer introductory periods (two or more years) while maintaining robust credit standards in 2020.

Loan credit quality for specialist lenders' and challenger banks' new deals will be weaker than that of mainstream rivals, as they target market segments requiring bespoke levels of underwriting, amid limited performance history. Examples include loans to more than two borrowers, to small portfolio landlords and loans to borrowers with complex employment histories.

In the buy-to-let (BTL) market, the shift towards portfolio landlords served by specialised lenders will continue, driven by prior changes in prudential regulations and fiscal policy. [5]

The market is evolving fast to incorporate technological advances. Specialist lenders and challenger banks increasingly use innovation to enable them to compete for market share. They achieve this by improving the customer and broker experience via user-friendly interfaces, flexible underwriting, faster turnaround times and process efficiencies. Mainstream lenders are also rapidly digitalising their services to meet evolving customer and broker preferences and to defend their market share from challenger banks. The push to reduce friction in the origination process has led some mainstream lenders to incorporate a greater use of automated valuation models (AVMs), a credit negative because they are less accurate than full physical valuation methods.

The Netherlands: Lending credit quality will remain strong, while some transaction features weaken

Credit positive prime lending trends of recent years will continue, for example through decreasing loan-to-value (LTV) ratios (on average 80% among our rated deals)[6] and a decreasing proportion of interest-only (IO) loans. The Dutch National Mortgage Guarantee (NHG) limit was raised to €310,000 in 2020 from €290,000 in 2019, which will also be credit positive, enabling more Dutch mortgage borrowers to benefit from the safety net it affords.[7] However, deal structures in 2020 will show some credit negative characteristics. For example, more deals will have non-standard hedging arrangements, exposing transactions to hedging mismatches. Deals featuring loans originated by third-party platforms will include non-standard representations and warranties.

Green initiatives gain more momentum

In Europe overall, green mortgage lending volumes have yet to significantly materialise, but through political and industry initiatives there are early signs of a long term ramp-up. For instance, the European mortgage industry is launching steps necessary to create an Energy Efficient Mortgage Label — ensuring that loans comply with the Energy Efficiency Mortgage Action Plan (EeMAP) criteria — in the near future under a pilot scheme. The scheme involves around 47 lending institutions and 17 European and international authorities.[8] Likewise in the UK, the Green Home Finance Innovation Fund will provide funding to projects developing innovative green mortgages and other lending products.[9]

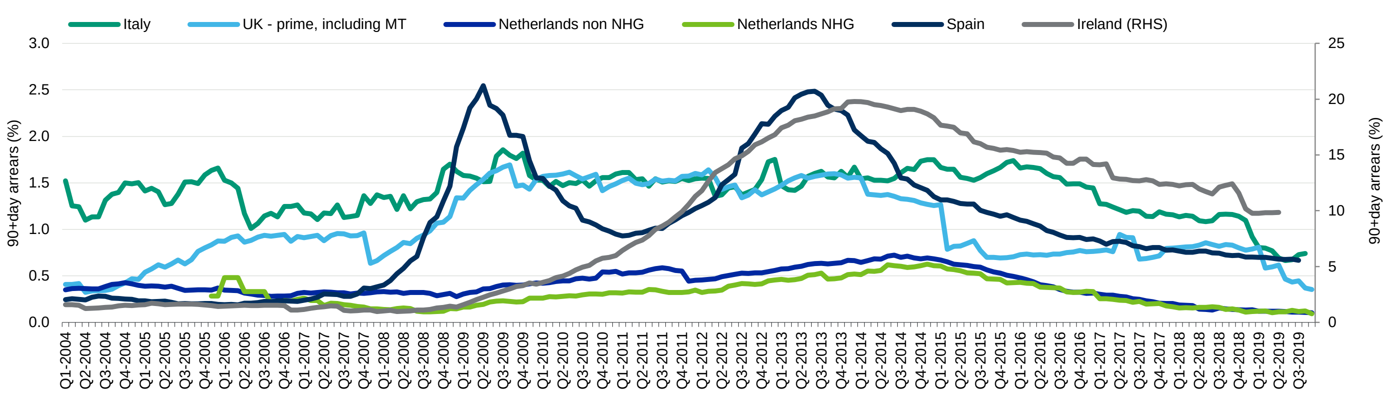
Steady securitisation performance in 2020

Most of our collateral forecasts are stable (see Exhibit 2). However, past robust performance will not continue indefinitely with the credit cycle entering its late stages. For the UK, all our collateral forecasts are negative as Brexit and political uncertainty continue to erode consumer confidence, dampening housing activity and slowing down house price inflation.

RMBS delinquencies (see Exhibit 3) and default rates [10] will remain stable because of the low European unemployment rate and low interest rate environment which helps support household debt service affordability.

Exhibit 3

90+ day RMBS delinquencies have been trending downward



Source: Moody's Investors Service

Despite moderating house price inflation, house price increases will still support potential recoveries for defaulted loans in RMBS deals. Ireland, Portugal, the Netherlands and Germany will benefit most from house price appreciation with year-on-year forecasts in 2020 of 4.5%, 4.0%, 4.5% and 4.0%, respectively.[11,12] House price inflation in the UK will be flat at around 0.7% in 2020 so UK RMBS securitisations will not benefit as much.[13]

The continuation of the current low interest rate environment will be credit positive for RMBS transactions' performance considering consumers' overall high indebtedness levels in many markets. However, the anticipation of lower rates for longer has led to weaker origination and looser underwriting in some segments. Cheap funding and higher competition will leave some niche lenders more susceptible to economic shocks.

In Spain, some pre-2008 RMBS portfolios consist of mortgage loans with very low interest rates as the main reference rate is 12 month Euribor, which is currently negative. The observed excess spread declines have been partially caused by note interest floors and/or net hedging payments. We expect the current low interest rate environment to continue, prolonging the negative effect in those transactions.

Over time, the EU's ambitious target to decarbonise its building stock by 2050 may eventually pose localised credit risks to RMBS. Non-implementation of mandatory energy efficiency improvements would impact property re-sale values, and borrowers' debt servicing abilities may be impacted in case properties need to reach those energy efficiency standards in future. However, at present those risks to RMBS are low. [14]

Issuance volumes will remain flat

Issuance volumes by UK sponsors will be flat or lower in 2020 compared with 2019, after a flurry of activity in 2019. Large bank sponsors will continue to access the securitisation market using their master trust structures. Most new issuance will use the Sterling Overnight Index Average (Sonia) benchmark rate and an increasing volume of legacy transactions will convert into Sonia-linked notes, ahead of the planned phasing out of the Libor by the end of 2021.

Issuance by Dutch sponsors will continue to be stable. Mainstream lenders will continue to be more active in covered bonds than in RMBS. The continued growth of start-ups and specialist lenders will result in additional RMBS issuance from these sponsors. The BTL RMBS sector will remain niche because the privately rented sector is small and the Dutch government intends to introduce regulations that will limit the growth of the BTL market. Green bonds issuance will continue in the Dutch market, the only RMBS market in Europe to issue so far, though issuance volumes will not be material.

We expect more synthetic and significant risk transfer (SRT) transactions as lenders choose securitisation to free up capital. The European Central Bank's (ECB) targeted longer-term refinancing operations (TLTRO) have the potential to suppress primary market activity, especially in southern Europe, where it was historically most used. After the hiatus at the start of 2019, many RMBS have and will continue to comply with Simple and Transparent Securitisation (STS) criteria due to its favourable regulatory capital treatment.

European initiatives to document energy efficiency standards, enhance building standards and encourage renovation of housing stock will spur green issuance in both covered bonds and RMBS in the long term. Beyond 2020 we expect to see growing volumes of green bond issuance, amid increasing scrutiny on environmental, social and governance (ESG) factors for new transactions and the adoption of the EU's sustainable finance taxonomy.[15]

Auto ABS

Underlying collateral quality in new deals will weaken with more residual value, balloon risk and used car exposure

Auto finance originators will expand their footprint in previously non-core markets in response to stalling new car sales across Europe (see Exhibit 4).

Exhibit 4

Car sales will remain depressed

EU27+EFTA Passenger Car Registrations K Units	Unit Sales 2015	Unit Sales 2016	Unit Sales 2017	Unit Sales 2018	YoY growth	Base case 2019	YoY growth	Base case 2020	YoY growth
Germany	3,206	3,352	3,441	3,436	-0.2%	3,430	-0.2%	3,350	-2.3%
France	1,917	2,015	2,111	2,173	3.0%	2,155	-0.9%	2,100	-2.6%
UK	2,634	2,693	2,541	2,367	-6.8%	2,295	-3.0%	2,250	-2.0%
Italy	1,575	1,825	1,971	1,910	-3.1%	1,825	-4.5%	1,770	-3.0%
Spain	1,034	1,154	1,235	1,321	7.0%	1,275	-3.5%	1,235	-3.1%
Other (EU less Eastern Europe)	2,712	2,932	3,022	3,003	-0.6%	2,860	-4.8%	2,760	-3.5%
Light commercial vehicles	1,779	1,832	1,903	1,951	2.5%	2,000	2.5%	1,900	-5.0%
Western Europe light vehicles	**14,857**	**15,804**	**16,224**	**16,162**	**-0.4%**	**15,840**	**-2.0%**	**15,365**	**-3.0%**

Source: Moody's Investors Service

In the UK and Germany, we expect captive lenders to finance more of the used car market. Used car residual values (RVs) can be harder to predict because they are more exposed to potential regulatory changes such as higher taxation and driving bans for diesel vehicles, as well as technological obsolescence.

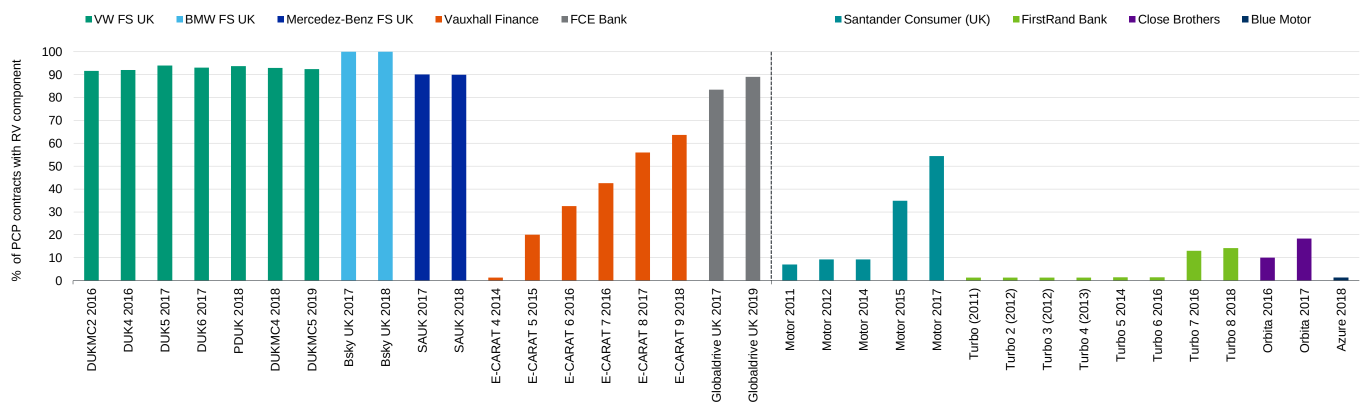
The proportion of auto finance agreements in Europe having balloon or residual value exposure is also expected to increase. Balloon loans are becoming more prevalent in Spain and Italy because captive finance companies, belonging to entities such as Volkswagen Aktiengesellschaft (A3 stable) and Daimler AG (A2 negative), have been increasing their presence in these markets and are offering these types of products.

The level of balloon and RV exposure in markets like the UK and Germany is reaching saturation point. For instance, captive lenders in the UK have increased the proportion of Personal Contract Purchase (PCP) contracts within auto ABS deals (see Exhibit 5).

Exhibit 5

Exposure to RV risk is high in the UK

PCP contracts as % of total, as of issuance or initial rating date



Source: Moody's Investors Service

Auto sector transformation will gather pace in 2020, with increased financing of electric and plug-in hybrid vehicles (EV and PHEV). This collateral is currently at small volumes but is steadily increasing. In the next 15-20 years, EVs and PHEVs will eventually dominate the vehicle market, amid changing consumer preferences and government initiatives to encourage the use of less polluting modes of transportation. Scrappage schemes, changes to taxation and outright bans on certain types of vehicles will accelerate this trend. Over time, resale value forecasts for EV/PHEVs will become more accurate as additional data on these vehicle types becomes available. At present, resale liquidity and RV forecasting accuracy is fairly poor due to the small secondhand market and high obsolescence risk.

Deal performance will remain broadly stable

The good performance we have observed over recent years will soften, but arrears and losses will remain near historical low levels[16] due to low unemployment rates across the main auto ABS markets (we forecast unemployment rates of 3.2% in Germany and 4.1% in the UK for 2020).[17] Low interest rates will continue to support securitisation performance by maintaining households' ability to meet debt service payments. Greater competition among lenders will lead to credit positive developments such as higher prepayments and deleveraging transactions, while excess spread will be impacted negatively because interest margin will be compressed.

In the UK, the recent surge in voluntary terminations of the past few years will likely ease as the lower new car sales of recent years will reduce supply to the used car market. Reduced supply supports used car values, which lessens the incentive of borrowers to voluntary terminate. We expect new car sales to decline 2.0% over the next 12 months compared to a rate of 2.9% year-to-date in 2019[18] and 6.8% in 2018. In addition, the decline in second-hand diesel car prices will gradually moderate, as cleaner diesel technology under EURO 6 standards become the benchmark.

Auto issuance volumes to increase

We expect auto ABS issuance to increase from the low levels in 2019 in both continental Europe and the UK despite lower new car sales. In 2020 we will see further Italian and Spanish auto issuance from international names via existing programmes. Most auto ABS issuances are expected to be STS-compliant, with more SRT transactions to emerge.

Consumer Loan ABS

Credit quality of underlying loans among new securitisations will vary

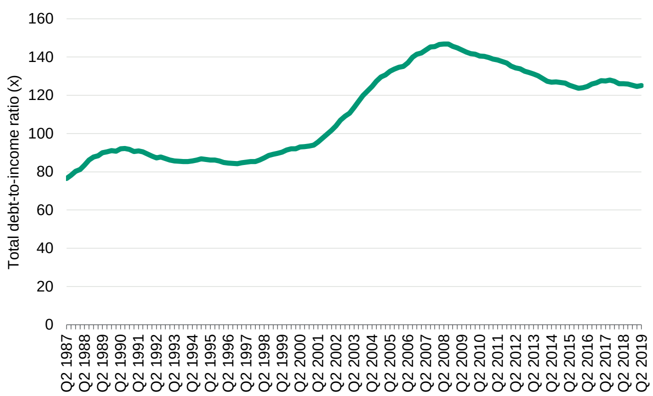
Underwriting trends in European consumer markets will diverge with looser standards in some jurisdictions. Underwriting of consumer credit remains loose in Spain, one of the biggest securitisation markets for consumer loans, following years of intense competition and improvements in the domestic economy. Whereas in Italy, unsecured loan portfolio composition will improve via a market shift towards *Cessione del Quinto* (CDQ) lending because of its lower risk profile and lower capital requirements.[19] However, non-CDQ consumer lending in Italy will also increase amid reports of local banks easing their credit standards in 2019.[20] In the UK and elsewhere market place lenders, and other lenders using technological innovation for their origination platforms, will continue to challenge the status quo.

Stable deal performance despite growing risks in some jurisdictions

The UK is especially likely to be affected by the current uncertain economic outlook because consumer credit has grown quickly in recent years. Growth in consumer credit has since declined to around 6% from double digit levels in 2017 but absolute levels of consumer indebtedness remain high (see Exhibits 6 and 7).

Exhibit 6

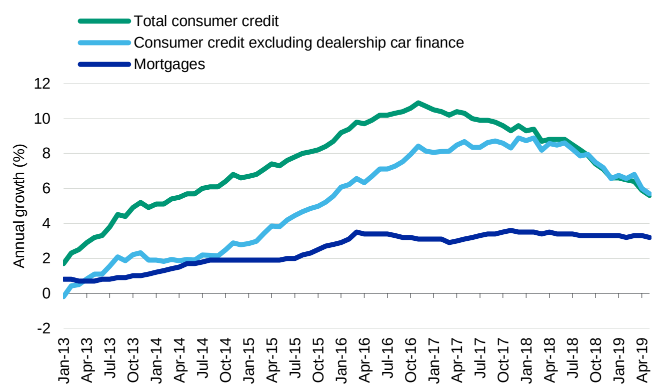
Total UK debt-to-income remains stable but at high levels



Source: Office of National Statistics (ONS), Moody's Investors Service

Exhibit 7

UK mortgage growth has been modest; consumer credit growth has slowed but remains high



Source: Bank of England, ONS and Bank calculations

UK credit card ABS performance will worsen, with arrears and credit card charge-offs increasing, albeit from a very low base. Performance deterioration will be greater under a no-deal Brexit scenario. The introduction of regulations regarding so-called "persistent debt" may help to contain performance deterioration. The Financial Conduct Authority (FCA) ordered credit card sponsors from September 2018 to enhance their servicing practices to help vulnerable/revolving customers reduce their credit card debt.[21] However, under these rules, yields within credit card master trusts will continue to decline as revolvers exit the underlying collateral pools.

Consumer loans in Italy will show better-than-average performance versus the European average, driven by good performance from the CDQ sector, as these loans benefit from payroll deduction payments and payment protection support by insurers.

In Spain, arrears levels within unsecured consumer lending have been increasing for the last three years. A gradual decline in the domestic unemployment rate alongside low interest rates will partly offset weaker underwriting. We expect unemployment to fall to 13.4% in 2020[22]from 14.1% in 2019. This sector will benefit from better refinancing conditions at lower interest rates, providing additional options to borrowers with stretched affordability.

Overall in Europe, low interest rates together with strong market competition will translate into high prepayments. The resulting strong deleveraging will offset the credit negative impact of eroded excess spread.

Issuance volumes will remain lower than other sectors but will increase versus 2019

The bulk of new consumer loan ABS issuance in 2020 will come from unsecured debt markets in France, Spain and Italy, as it has in the past. In Italy, we anticipate more CDQ transactions as originators consolidate and gain the necessary book size to enable them to securitise. In the UK, consumer loan ABS issuance will be low and the majority will be Sonia-linked.

We expect only sporadic issuance from marketplace lending platforms across Europe as this sector matures. As with other markets, more transactions will comply with the new disclosure requirements on securitisations to achieve STS compliance, and more transactions will have the aim of achieving significant risk transfer from lenders' balance sheets.

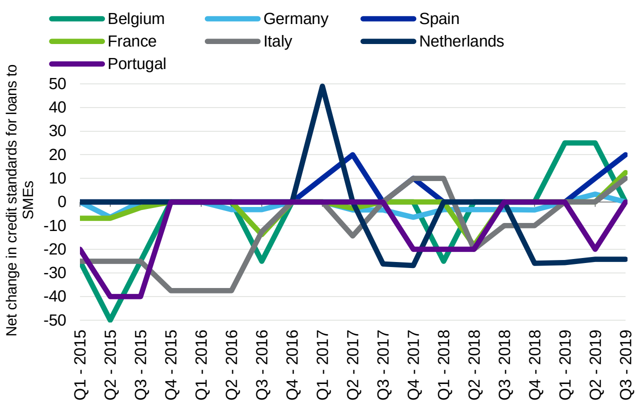
SME ABS

Credit quality among new deals will be stable

There will be no substantial changes in the credit quality of underlying collateral (loans or lease receivables granted to SMEs), amid the weaker macroeconomic environment in key markets. Banks across Europe are further tightening their credit standards in response to the weaker macroeconomic situation (see Exhibit 8). Bank loan availability is especially likely to decline in Italy and Spain into 2020, a trend that has recently gained traction (see Exhibit 9). Consequently, banks' supply of loans to SMEs will become more selective, offsetting weaker macroeconomic conditions, with newly originated portfolios possessing stable credit quality, similar to conditions in late 2019.

Exhibit 8

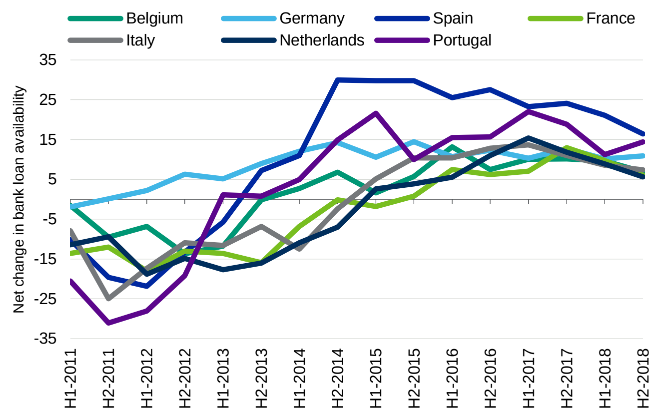
Credit standards are tightening across Europe



Positive values = tightening credit standards; negative values = easing credit standards
Source: Moody's Investors Service (calculations based on data gathered from the ECB Statistical Data Warehouse)

Exhibit 9

Bank loan availability likely to decline into 2020



Positive values = improving bank loan availability; negative values = deteriorating bank loan availability
Source: Moody's Investors Service (calculations based on data gathered from the ECB Statistical Data Warehouse)

Banks will start increasing both refinancing rates and risk premiums on their loans, amid increasing macroeconomic risks. Interest rates are currently very low so there is room for banks to increase risk premiums while keeping the loans cost-effective for borrowers.

Furthermore, stringent implementation of the default definition by banks will minimise risks among new NPL portfolios. It comes in response to amendments to banks' capital requirements regulations which require a minimum loss coverage for NPL exposures. While this is an EU wide initiative,[23] the Italian market will be most affected given the high portion of NPL exposures among local banks. For ABS SME transactions this will result in stricter eligibility criteria, improving credit quality within underlying portfolios.

More ABS SME transactions will comply with the new disclosure requirements on securitisations to achieve STS compliance, maintaining the possibility for ECB repurchase purposes. Over time, increasing disclosure requirements will contribute to stricter eligibility criteria and greater asset harmonisation; for instance, by excluding certain types of loans, which will not be in line with criteria to reach STS compliance in new transactions.

Similarly, the new regulation for UK marketplace lending (MPL) platforms (applicable from December 2019) strengthens the underlying operational environment, especially with regards to credit-risk assessments and enhanced disclosure regimes. Such regulation affects all MPL lending, a credit positive for both SME and consumer loan securitisations.

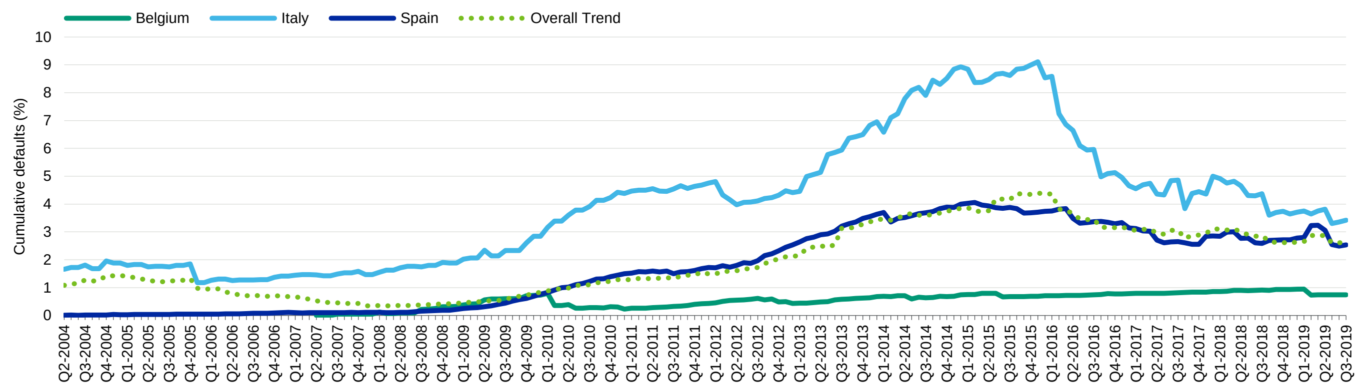
Deal performance among existing deals will be stable

Benign liquidity conditions continue to support stable SME performance. Refinancing risk is low while credit spreads on loans to SMEs remain at record low levels. European SMEs continue to deleverage. The low cumulative defaults in three key markets (those with the largest volumes) reflect robust performance that will continue into 2020 (see Exhibit 10).

Exhibit 10

Cumulative defaults are low and will remain so

% of original balance



Source: Moody's Investors Service

In Italy, increasingly efficient foreclosure and bankruptcy court proceedings are credit positive for securitised deals with exposure to NPLs and especially SME debt. However, SME borrowers are still exposed to the property market and heavily reliant on refinancing.

Issuance volumes will be similar to 2019 levels

Issuance levels for 2020 will be similar to 2019, with repeat originators dominating the landscape. Italy and Spain will remain the major markets. In Germany, there will likely be a low single-digit number of transactions. For the UK, issuance will be slightly higher, mainly from MPLs, for which securitisations will become a more prevalent funding source.

The main motivation for issuing ABS SME transactions continues to be the generation of collateral for ECB repurchase purposes for the originating bank, an established funding practice in certain markets (for example, in Italy and Spain). Issuance of ABS SMEs will also depend on originators' ability and willingness to implement STS reporting requirements, which have become part of the ECB's repurchase eligibility criteria. SRT transactions backed by SME receivables are expected to continue on a mostly private/ bilateral and unrated basis.

Overall, new issuance will be more diverse across jurisdictions since certain major European countries have not yet tapped the ABS SME market or have just done so for the first time (for example France). ABS SME will remain an important alternative funding instrument for banks.[24] Furthermore, a securitisation framework for SME receivables is under discussion in Hungary, which will expand the market.

Additionally, similar securitisations could emerge among MPLs from continental European jurisdictions because the UK based platforms are also active in Germany and the Netherlands. Such expansion comes amid an established track record among UK SME ABS deals with the backing of MPL receivables.

Finally, discussions in the market have arisen around short-dated trade-receivables backed ABS SME deals. The latter are more difficult than securitising trade receivables via ABCP conduits, an established refinancing practice used by banks.

Non-performing/Re-performing Loan (NPL/RPL) securitisations

Underlying portfolio quality of new NPL securitisations will be mixed

New NPL securitisations will have diverse collateral quality, reflecting credit institutions' different strategies to reduce their stock of NPLs. In Italy, the most active NPL market, we expect more transactions to feature homogenous asset types. Whereas previously, portfolios were a mixture of unsecured loans, residential mortgage loans and other loan types, future NPLs are likely to have only mortgage loans or only unsecured loans. In Spain, overall credit quality of underlying collateral pools will decline, with NPLs backed by repossessed real estate assets. In Greece and Cyprus, there will be new issuances with mixed collateral quality.

We expect more public RPL mortgage securitisation transactions, especially in Ireland because of the large stock of pre-crisis mortgage loans which have been restructured, and due to the strong regulatory incentive to securitise. Irish property prices have not recovered to pre-crisis levels, and among the RPL deals we rate, a significant portion of loans have LTVs above 100%. As a result, losses for such loans are expected to be material upon default.

Performance will be mixed

Future performance of NPL/RPL securitisations will depend on macroeconomic conditions, the efficiency of local courts, servicers' ability to execute collection plans (which may include out of court settlements), as well as asset sales or payment plans. Performance data on existing transactions is still in its infancy and availability of data varies between and even within markets. There is still a lack of standardisation in reporting and disclosure between deals, which is set to continue for the time being, a credit negative. Performance of RPLs will be more variable and difficult to predict as servicers require significant knowledge and resources. [25]

Issuance volumes will increase

NPL issuance will continue from Italy, the largest NPL market, because of the renewal of the Italian *Garanzia sulla Cartolarizzazione delle Sofferenze* (GACS) scheme on 20 March 2019. The scheme, in which Italy's Ministry of Finance guarantees senior securitised notes backed by NPLs for a fee, facilitates banks' securitisation of bad loans.[26] Italian banks will also begin exploring public unlikely-to-pay (UTP) securitisations, which until now were only privately issued.

We are expecting additional NPL securitisation activity from Portugal, Greece and Spain and to a lesser degree Ireland. The additional activity is partially attributable to refinancing activity among entities that have acquired NPL/RPL portfolios. Greek NPL securitisation issuance is likely since the European Commission announced[27] the approval of the Greek government's proposed asset protection scheme (APS) for the banking system.

In Ireland and other markets, banks still have significant stocks of RPL loans to manage down, which will spur additional issuance of RPL securitisation in 2020.

Appendix

Exhibit 11

Most collateral forecasts are stable for 2020

Country	Asset	Collateral forecast for 2020	Collateral forecast 2019
France	Auto ABS	Stable	Stable
	Consumer Loans ABS	Stable	Stable
	Prime RMBS	Stable	Stable
Germany	Auto ABS	Stable	Stable
	RMBS	Stable	Stable
	SME ABS	Stable	Stable
Ireland	Prime RMBS	Stable	Stable
Italy	Consumer Loan ABS	Stable	Stable
	RMBS	Stable	Stable
	NPL	Stable	N/A
	Leasing/SME ABS	Stable	Stable
Netherlands	RMBS	Stable	Positive
Portugal	RMBS	Stable	Stable
Russia	RMBS	Stable	Stable
South Africa	RMBS	Negative	Negative
Spain	Consumer Loan ABS	Stable	Stable
	RMBS	Stable	Stable
	Auto ABS	Stable	Stable
	SME ABS	Stable	Stable
UK	Auto ABS	Negative	Negative
	Credit Card ABS	Negative	Negative
	Prime RMBS	Negative	Negative
	Non-Conforming RMBS	Negative	Negative
	ABS SME	Negative	N/A
	Buy-To-Let RMBS	Negative	Negative

Source: Moody's Investors Service

Collateral forecast definition

Our collateral performance forecasts over the next 12-18 months address the direction of expected losses in the following categories:

- High (negative forecast)
- Low (positive forecast) or
- Unchanged (stable forecast)

To determine a forecast we examine:

- Whether our macroeconomic forecasts suggest an increase/decrease in (a) delinquencies (frequency) and (b) severity.
- Any unusual items affecting performance (for example, forbearance programs).

The forecasts are benchmarked against one another. Our expectations cover the market in general, not specific collateral pools among the deals we rate.

Themes that will shape RMBS and ABS credit in 2020

In the table below, we highlight ways in which four major themes will affect RMBS and ABS in 2020. The themes are among six that we expect to shape global credit in 2020. For more information on the six themes, see the graphic on the final page of the report or visit tbp.moodys.io.

RECESSION RISKS

- Expect high levels of consumer indebtedness, increasing leverage for companies and future weakening of macroeconomic indicators, to all weigh negatively on performance.
- Amid weakening macroeconomic conditions, banks across Europe are further tightening their credit standards.

LOWER-FOR-LONGER INTEREST RATES

- Low interest rates continue to support performance in the consumer markets, through borrowers' overall debt servicing capacity.
- Room for banks to increase risk premiums while keeping the loans cost-effective for borrowers.
- Expect a further move towards longer term fixed-rate mortgages.

POLITICAL RISKS

- Brexit extension removes immediate risk of no deal but prolongs uncertainty. For the UK, all collateral forecasts are negative as uncertainty continues to erode consumer confidence, dampening housing activity and slowing house price inflation.

ESG IMPACT

- Expect growing volumes of green bond issuance, amid increasing scrutiny on ESG factors for new transactions and the adoption of the EU's sustainable finance taxonomy.

Moody's related publications

Sector Comment:

» Structured Finance: Rising UK household debt is credit negative for consumer loan pools backing RMBS and ABS 11 January 2019

» Residential real estate - Germany: Credit quality to remain stable but late cycle, non-core ventures are key risks 22 January 2019

» ABS - Autos & Vehicles: Decline in UK car sales is credit negative for securitised auto transactions 18 February 2019

» RMBS — The Netherlands: Dutch buy-to-let benefits from strong credit fundamentals; more exposed than the UK sector in a downturn 19 March 2019

» Financial Institutions: EU court ruling adds certainty to Spain's mortgage foreclosure process, a credit positive for banks 1 April 2019

» Buy to Let – United Kingdom: UK ban on Section 21 evictions would be credit negative for buy-to-let securitisations 23 April 2019

» ABS - Autos & Vehicles: VW's latest securitisation is credit positive for UK auto ABS, and can serve as a model for future auto lease deals 3 June 2019

» RMBS – Ireland and Spain: Duration of re-performance is a key default indicator for restructured RPLs 17 June 2019

» Banks – France: Looser underwriting standards is credit negative for French banks 9 July 2019

» Green Bonds – Global: Annual issuance to surpass $200 billion in 2019 after record second quarter 8 August 2019

» RMBS – United Kingdom: Brexit fears reduce UK housing market activity, a credit negative for UK RMBS 23 September 2019

» Banks – Greece: European Commission's approval of Greece's asset protection scheme will help banks improve their asset quality 17 October 2019

» Brexit – United Kingdom: Brexit extension removes immediate risk of no deal but prolongs uncertainty 30 October 2019

» ABS - Autos & Vehicles – Germany: Germany's higher subsidies for electric cars is credit negative for ABS pools with combustion engines 8 November 2019

» RMBS – Ireland: Decreasing mortgage rates are credit positive for Irish RMBS 14 November 2019

Sector Profile:

» Non-performing Loans — Europe: Sector update – H1 2019: Stable or better trend in lagging of collections against servicers' initial projections 26 September 2019

» RMBS – EMEA: Sector update – Q3 2019: Brexit fears reduce UK housing market activity 15 November 2019

» Auto ABS – EMEA: Sector update – Q3 2019: Performance stable in the main markets 15 November 2019

Sector In-Depth:

» Structured Finance — United Kingdom: Strong portfolio fundamentals mitigate performance effects of a no-deal Brexit 7 March 2019

» Cross-Sector — EMEA: Innovations and challenges have mixed credit implications for consumer loans and securitisations 1 April 2019

» Cross-Sector — Europe: Lower car sales in key countries add risks for captive lenders and auto ABS 7 May 2019

» Structured finance — Global: Libor transition continues to create risks for new transactions 9 May 2019

» Banks - Europe: Iberian and Italian banks' strategies to cut problem assets vary; disposals to continue 28 May 2019

- Covered Bonds and RMBS - Spain: Rising house prices are positive, but some risks are emerging 29 May 2019
- Structured Finance – UK: Libor transition exposes swaps in some legacy deals to credit negative risks 7 June 2019
- Structured finance – Global Libor risk would loom larger for certain securitization sectors in adverse scenario 19 September 2019
- RMBS — EMEA: Post-crisis securitisations benefit from lower-risk loans and stronger structures 7 October 2019
- ESG – EMEA: Emission pricing poses low risk of losses for RMBS and covered bond mortgages 4 November 2019
- RMBS – UK: Higher portfolio landlord concentration is credit negative for buy-to-let deals 13 November 2019
- Cross-Sector – United Kingdom: UK election poses considerable credit negative uncertainties 27 November 2019
- ABS – Italy: CDQ and DP market developments are credit positive for securitisations 27 November 2019

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.


Six themes will shape global credit in 2020
RECESSION RISKS
Recession risks will rise amid a pronounced global economic slowdown.
LOWER-FOR-LONGER INTEREST RATES
An increasing share of assets globally will yield very low or negative interest rates.
POLITICAL RISKS
Domestic policy shifts and geopolitical uncertainty will threaten to undermine credit conditions in many regions.
TRADE TENSIONS
An enduring US-China trade deal will remain elusive and trade disputes will weigh on credit conditions.
DISRUPTIVE TECHNOLOGIES
Scaling up of digital technologies will accelerate the transformation of traditional businesses.
ESG IMPACT
Climate risks will constrain the availability of capital for the most-exposed sectors; demographic and social trends will create risks and opportunities.
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Endnotes

1 See "Brexit extension removes immediate risk of no deal but prolongs uncertainty", 30 October 2019

2 Typically two to five years.

3 Source: "*Mortgage Lenders and Administrators Statistics - 2019 Q2*", 10 September 2019, Bank of England.

4 Source: "*Les critères d'octroi des crédits immobiliers ont retrouvé leurs niveaux de 2007-2008*", 30 October 2019, Banque de France.

5 See "Higher portfolio landlord concentration is credit negative for buy-to-let deals", 13 November 2019.

6 Source: performance overviews, MILAN loan-by-loan data, European Data Warehouse and Sisense.

7 Source: "*Voorwaarden & Normen NHG 2020-1 - 4-11-2019*", 4 November 2019, Nationale Hypotheek Garantie.

8 Source: "*Climate Week: Energy Efficient Mortgage Initiative stakeholders meet in Venice to discuss the creation of an energy efficient mortgage label*", 26 September 2019, Energy Efficient Mortgages Initiative.

9 Source: "*Guidance: Green Home Finance Innovation Fund competition*", 3 October 2019, Department for Business, Energy & Industrial Strategy.

10 Source: Moody's Investors Service Data Reports.

11 Source: Moody's Investors Service.

12 We expect a divergence between Dublin house price appreciation (negative) and rest of Ireland (positive).

13 Source: Moody's Investors Service.

14 ESMA's proposed RMBS template includes an energy efficiency categorisation.

15 Source: "" 18 June 2019, European Commission.

16 See "Auto ABS EMEA Sector update – Q3 2019: Performance stable in the main markets", 15 November 2019.

17 Source: Moody's Investors Service.

18 Source: "*New car market continues downward trend as buyer confidence wanes*", 5 November 2019, The Society of Motor Manufacturers and Traders.

19 See "ABS Italy - CDQ and DP market developments are credit positive for securitisations", 27 November 2019.

20 Source: "*The euro area bank lending survey – Third quarter of 2019*", 22 October 2019, European Central Bank.

21 Source: "*Credit Card Market Study*", updated 22 July 2019, Financial Conduct Authority.

22 Source: Moody's Investors Service.

23 See "EU Finalises Regulation on Prudential Backstop for Bank NPEs Under CRR", 25 April 2019.

24 Either via an ECB repurchase or via placement with investors and as such other banks starting to use this instrument as well.

25 See "Non-Performing Loans - Europe: Sector profile – H1 2019: Stable or better trend in lagging of collections against servicers' initial projections", 26 September 2019.

26 The guarantee is not considered state aid under European Union rules, allowing for the full derecognition of NPLs.

27 Source: "*State aid: Commission approves market conform asset protection scheme for banks in Greece*", 10 October 2019, European Commission.

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