Growth, diversification and fragmentation

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Asset-backed securities

Asset-backed securities (ABS) are an area that is coming into the foreground for many more investors. The combination of value, yield and a degree of security is a powerful one, and more investors are looking at this area and considering adding exposure to their portfolios.

2024 has been notable for swings in interest rates and interest rate expectations. This has contributed to volatility in most parts of the fixed income universe, but public ABS has been relatively insulated thanks to the floating rate nature of the market, helping it have a pretty solid year.

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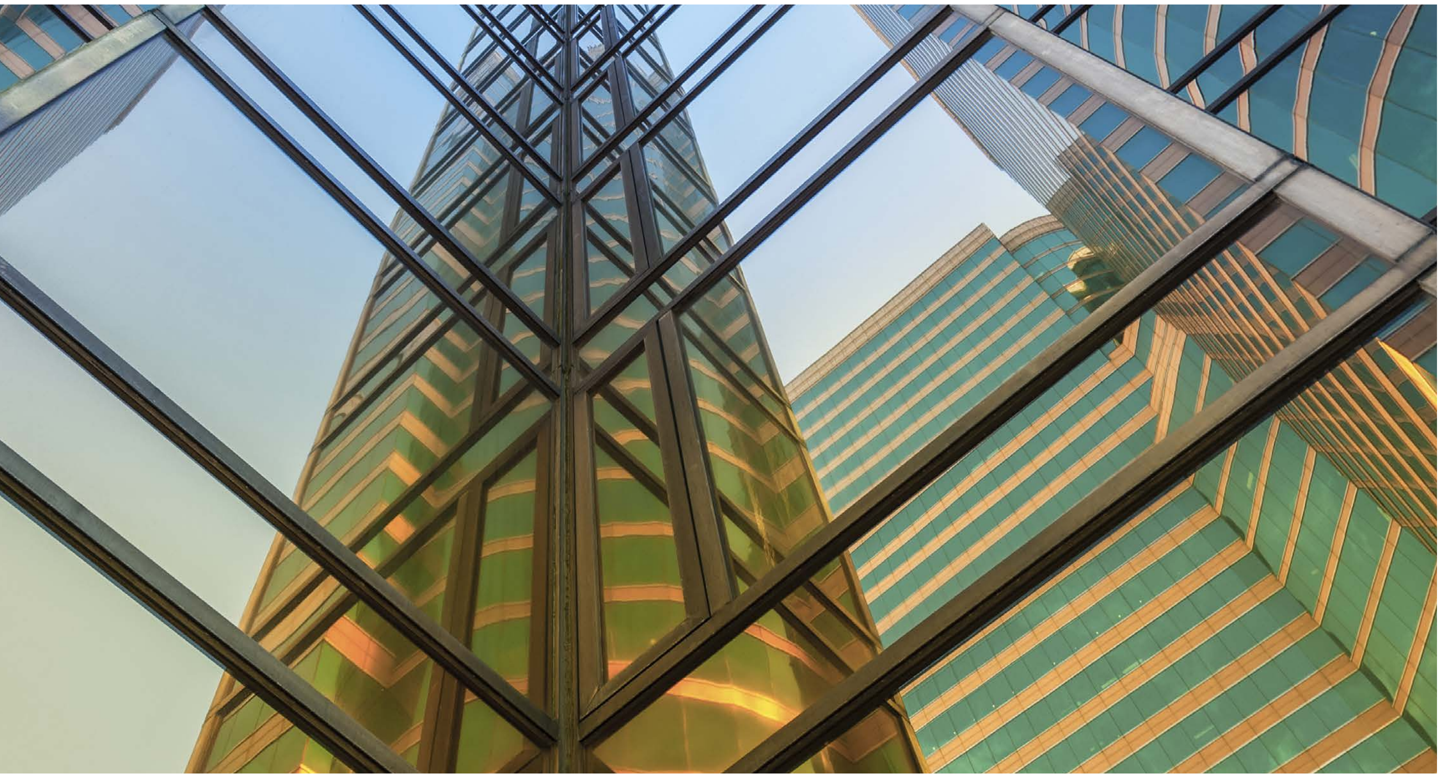
With a few weeks of 2024 still to go, it looks like European securitisation issuance will reach €100bn or higher in the full year 2024. This will certainly set a new record high for 2.0 securitisations (see box) issuance. The issuance has been met with strong demand from investors, probably partly due to the floating rate structures but also as investors look to decrease risk by moving assets from equities into fixed income. The record issuance is seen from the full gambit of the securitisation market: ABS and collateralized loan obligations, synthetic risk transfers, and regions such as Australia are set to have a record year of issuance within structured finance. Within ABS, we've seen a host of new issuers and sectors in the market, notably solar, data centres and residential mortgage-backed securities master trusts.

ABS changes over past 10 years

The global financial crisis saw all ABS under the spotlight – despite most of the problems during that period being caused by excessively-levered vehicles exposed to US sub-prime mortgages. These changes are often described as securitisation 2.0 – not a specific set of regulations, but a variety of changes. One key change is the move to Simple Transparent and Standardised (STS) securitisation, which aligns with Solvency II and allows a degree of capital relief for banks and other institutions to encourage investment in this area.



A pan-European market

The UK remains the biggest securitisation sector, by volume and with a diversity of asset classes (including commercial mortgage-backed securities). However, issuance from the periphery jurisdictions has been on the rise since the second half of 2023. Issuance from Italy, Spain, Portugal and Ireland accounted for around €24bn of 2024 issuance – compared to just €13bn in 2023 – its highest level in a decade. Much of this issuance is from banks and we believe that there is sufficient support seen to keep this momentum going in 2025. Bank issuance increased materially to €41bn in 2024 YTD, which is the highest since 2012 (due to cheaper central bank funding). As these cheaper sources of funding expire, it is expected that this trend will continue with banks being the more dominant issuer in 2025.

It should be noted that 2024 saw a steady pace of supply throughout the year, with many records taking place, notably May seeing the highest single month of issuance since the GFC and issuance still continuing through the summer when historically these have been very flat months. In comparison, in 2025, the expectation is that H1 will be stronger with a mild slowdown in H2 as rate cuts filter through and potentially, demand for bond markets fades slightly. One difference we are expecting is STS-labelled issuance. Around half of all issuance was STS-labelled in 2024, we expect that to increase to over 50% in 2025.

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Private ABS also growing rapidly

Asset-based finance is already a $5tn market that is expected to exceed $7tn in the next two to three years. For the banking sector, a mix of increased regulation, higher capital requirements and their preference for scale rather than niche opportunities means that we see less participation from incumbents, creating room for new players. This should apply equally to the middle market – which we expect to remain fragmented.

Non-bank lenders and sponsors have struggled in recent years. Low appetite and low valuations, lack of access to public market exits and slower fintech investment flows have all impacted this area. We believe that this creates an opportunity for asset-based finance providers to partner with asset originators to provide part or whole loan financing, particularly in the middle market space. This is an area with a broad spread of sectors and geographies, including sectors such as consumer finance, and infrastructure for automation / innovation assets such as data centres, with the UK, EU, Canada, Australia and the Nordics expected to be more active areas.

We believe that ABS remains cheap relative to other asset classes and that there is a lot of money still to be put to work in the sector. Many expect the momentum from this year to lead into 2025, with a strong level of issuance relative to recent history, although our expectation is that this is probably slightly lower in 2025.

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