Funding UNLOCKED

SECURITISATION IS NO LONGER THE PRESERVE OF LARGE REGULATED ENTITIES. PERMJIT SINGH EXPLAINS HOW INNOVATIVE MODELS ARE BEING DEPLOYED TO THE BENEFIT OF INVESTMENT-STARVED SMEs

Securitisation – essentially the receipt of cash in exchange for assets by offering securities secured over those assets – is often seen as a complex, specialist area of corporate finance.

However, regulators are now increasingly embracing securitisation as the key to unlocking capital markets and banks, and channelling liquidity towards investment-starved companies and consumers across Europe, a trend set to prove especially beneficial to SMEs.

According to a report by the National Institute of Economic and Social Research, UK banks have historically provided around 93% of UK SMEs' external funding needs via loans, factoring, leasing and overdrafts. Just four of them provide 80% of all SME loans and 85% of SME current accounts. SMEs are therefore inextricably bound to banks, so the financial crisis that dragged many banks into financial distress, dragged many SMEs to the same fate.

The funding gap left by distressed banks is wide and deep, but new and alternative lenders are beginning to fill it. One new model, referred to variously as peer-to-peer, crowdfunding or marketplace lending, offers loans to mostly small SMEs and sole traders, from a multitude of mostly small investors through online lending platforms. And there are signs of this maturing. After several years, one UK platform (itself a fintech SME) recently refinanced £130m of its book of loans through the capital markets with a term securitisation, the first of its kind in Europe.

Another securitisation model – coordinated by the European Investment Fund – involves national aggregators in several EU countries (such as the British Business Bank) buying business loans off domestic commercial deals, and then seeking to refinance these loans through a conventional term securitisation.

Small-scale securitisation

In terms of mainstream securitisations, most deals are hundreds of millions of pounds in size each, and many are in the billions of pounds in scope. Deals of this size are impossible for relatively small non-financial companies, especially SMEs.

However, small-scale securitisation transactions have become a reality in the UK, and without compromising standards or funding outcomes, they're also a reality overseas.

One SME that is filling the lending gap left by banks recently securitised its loan book in exchange for £50m of funding to provide further loans to SMEs. Loans were provided to the SME and other underfunded SMEs by a central hub company, itself a SME.

To fund its intercompany loans, the hub issues listed and rated asset-backed securities (ABS) that are identical in many ways to ABS issued in conventional multibillion-pound securitisations. For example, they have a trustee, a calculation and paying agent and a registrar, and they're of a minimum denomination, rated and listed, so are of a standard where they are eligible for purchase by many regulated and capital-conscious institutional investors.

Using a multi-seller hub model achieves economies of scale, and each borrowing company avoids the infrastructure costs needed to issue ABS themselves. It might also attract a subgroup of institutional investors who do not demand deal sizes that many SMEs cannot achieve.

Importantly, many of the costs of securitisation are relatively low to begin with, making a multi-seller conduit model a practical and viable alternative to conventional big-sized term securitisation transactions.

Even though companies can now raise relatively small amounts of funds using the multi-seller conduit model, the minimum of around £5-10m might still be too large for some companies to deploy efficiently. For them, an alternative multi-seller model could be the solution.

Asset-backed commercial paper

In essence, these transactions involve issuing small-value securities on a revolving basis – when funds are needed, ie in amounts of a few hundreds of thousands of pounds instead of tens of millions of pounds.

> Securitisation is an adaptable mechanism capable of serving the financing needs of all SMEs

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This revolving small-scale multi-seller model illustrates that there is not just one model for securitisation. ABS investors buy short-dated small-value securities (asset-backed commercial paper) that complement longer-dated term ABS.

Some of the basic costs paid in the above models of securitisation could be excluded if they are too much for some SMEs – by issuing ABS into the unlisted and unrated securitisation market.

The pool of investors and liquidity in the unlisted and unrated ABS market will be significantly reduced as a result, but not totally. The standard of disclosure will be reduced, too, but if the ABS offer is marketed as a Financial Services and Markets Authority-compliant financial promotion, then investors will have the assurance that the information memorandum is fair, clear and not misleading.

In 2015, property developer Unihousing issued a £1m retail bond as a financial promotion (unlisted, unrated and transferable), secured over a student accommodation development site, and sold to corporate and retail investors. The apartments are now built, fully tenanted and student rent is servicing the interest on the bonds.

SMEs have the means to diversify their sources of funding

The bottom line is, securitisation is an adaptable mechanism that is capable of serving the financing needs of all SMEs.

Securitisation has almost always been discussed in the media and in academic circles from the perspective of banks and institutional investors. What is different now is regulators are discussing securitisation in a sincere effort to use it to enable SME funding.

After being misused in the run-up to the financial crisis, securitisation is undergoing a transformation with the aim of making it more accessible to SMEs and of restoring its reputation. It is an affordable, adaptable and effective mechanism for funding companies of all sizes.

SMEs, especially now, have the means to diversify their sources of funding and lower their reliance on currently unreliable bank finance. Regulatory and political frictions and tensions between the exiting UK and the EU, and within the EU regulatory and political hierarchy, must not scupper or delay this opportunity.

Permjit Singh is a former head of treasury for a company that securitised its assets through term and conduit securitisation structures