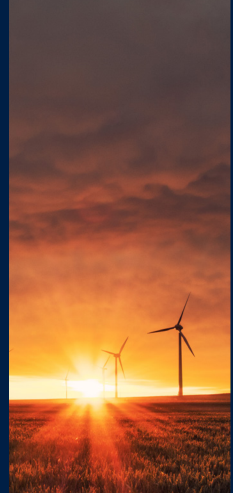
RESEARCH NOTE: SECURITISATION FOR SUSTAINABLE DEVELOPMENT



Accelerating Capital Velocity

August 2023

SUMMARY

- **G7 and G20 are calling for mobilisation of trillions of dollars of private capital to finance sustainable development, energy transition, and green infrastructure in emerging market and developing economies (EMDEs).**
- **Securitisation has a powerful role to play. It allows banks to transform illiquid EMDE assets into tradeable, interest-bearing securities. The sale of these securities enables banks to the transfer risk to institutional investors, while freeing up their balance sheets to finance new loans at a lower cost of capital. Banks can prioritise financing sustainable development when extending these new loans.**
- **Development finance actors can accelerate the use of securitisation for sustainable development in several ways: they can act as originators and transfer assets and risk from their own balance sheets; invest in the listed notes and equity of securitisation vehicles; and support policy and regulatory reform to protect issuers and investors.**
- **Securitisation can accelerate recycling of development finance to allow official institutions to focus on project preparation, origination, and seed investment to mobilise private capital.**

CONTEXT

Securitisation can mobilise private capital for EMDEs' sustainable development

G7 and G20 leaders are calling for the mobilisation of trillions of dollars of private capital to finance sustainable development, energy transition, and green infrastructure in EMDEs. The G7's Partnership for Global Infrastructure and Investment (PGII) seeks to mobilise up to US $600 billion in financing for quality, sustainable infrastructure by catalysing private investment and resources from the multilateral development banks (MDBs), development finance institutions (DFIs), and sovereign wealth funds.[1] Similarly, the G20's landmark *Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks* (the CAF Review) offers concrete recommendations to mobilise private capital. These recommendations include accelerating MDB capital velocity by transferring risk and assets from MDB balance sheets to private invetors.[2]

Private capital mobilisation through securitisation – the process of repackaging illiquid assets into tradeable, liquid, interest-bearing securities – has a significant role to play in delivering on these landmark commitments (see Box 1). The proposals on long-term investment advanced by the G20 Infrastructure Working Group and the joint G20/OECD Taskforce highlight the potential of securitisation to increase institutional investors' exposure to well-defined brownfield infrastructure assets. This potential is strengthened by securitisation's scope for scalability and replicability.[3] These proposals also include a specific opportunity to recycle MDB and Export Credit Agency capital by securitising infrastructure loans once these assets have been de-risked and reached operational status.

1 https://www.whitehouse.gov/briefing-room/statements-releases/2023/05/20/fact-sheet-partnership-for-global-infrastructure-and-investment-at-the-g7-summit/
2 https://www.dt.mef.gov.it/export/sites/sitodt/modules/documenti_it/news/news/CAF-Review-Report.pdf

3 https://www.oecd.org/daf/fin/private-pensions/Collaboration-with-Institutional-Investors-and-Asset-Managers-on-Infrastructure.pdf

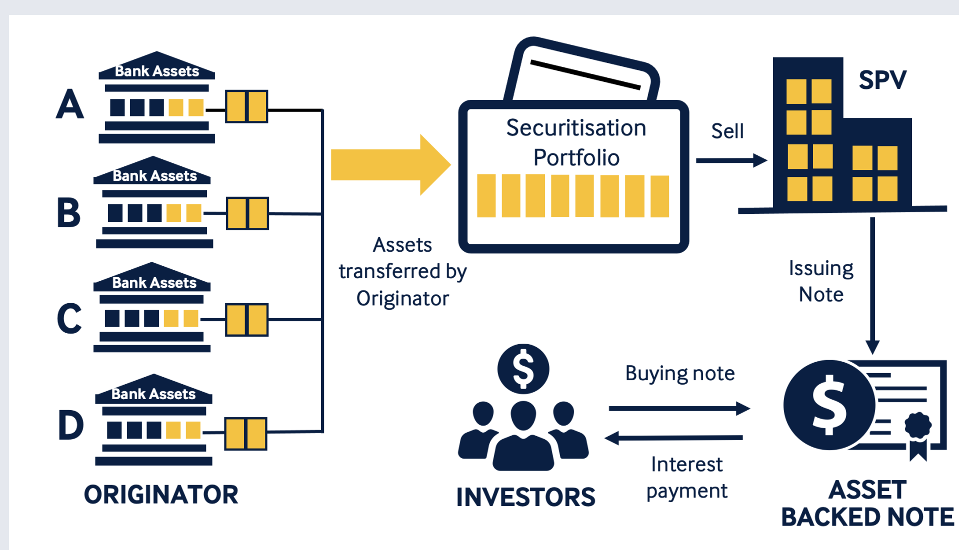
BOX 1 – UNDERSTANDING SECURITISATION

Securitisation is a financial process through which illiquid assets are pooled and repackaged into tradeable, interest-bearing securities. The investors that buy these securities receive interest and principal payments from the underlying assets and the capital freed up by the originator can be recycled into new projects and loans. A basic true sale securitisation process involves three steps:

1. A company (often a bank or a group of banks) – the 'originator' – identifies the assets it wants to remove from its balance sheet and pools them into a securitisation portfolio.
2. The securitisation portfolio is sold to the 'issuer', often a Special Purpose Vehicle (SPV) created solely for the transaction in question. The originator can recycle the capital freed-up through the sale to finance new projects, including greener projects than were sold.
3. The issuer finances the acquisition of the securitisation portfolio by issuing tradable, interest-bearing securities that are then sold to capital market investors. The holders of these asset-backed notes receive interest payments funded by the underlying portfolio. The securitisation portfolio is often divided into several slices or 'tranches'. Each tranche has a different level of associated risk and so a different set of return expectations. I

In the case of a synthetic securitisation, underlying loans stay on the books of the originating bank, giving the bank a strong incentive to originate quality projects and maintain effective oversight. Instead of selling the assets outright, as in the case of a true sale securitisation, the originating bank transfers risk associated with the underlying portfolio to third parties. This risk-transfer is typically achieved through credit derivatives, insurance, or guarantees.

Figure 1 – Capital Recycling through Securitisation[4,5]



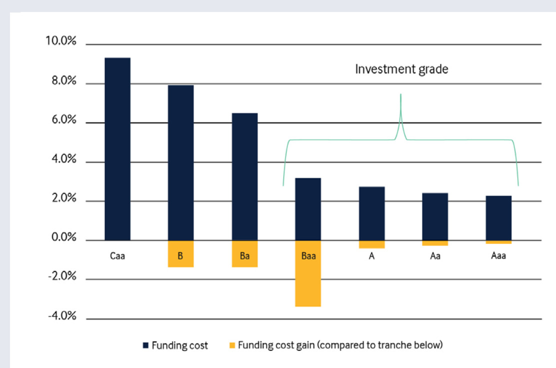
For originators, including private banks, MDBs, and DFIs:

- Securitisation reduces the cost of financing for the originating bank and so improves the terms on which it can on-lend. This is because the securitised portfolio is lower risk than underlying loans: the portfolio is diversified, credit enhanced, and remote from the originator's balance sheet, allowing it to be rated more favourably. The difference between the asset originator's credit rating and that of the securitised notes determines the extent to which capital costs are reduced for the originator and so the extent to which savings can be passed onto borrowers in the terms of new loans. Figure 2 shows the reduced borrowing costs associaed with incremental credit rating upgrades, particularly at the threshold between investment grade and high-yield bonds.
- Securitisation allows banks and their ultimate borrowers to access a broader range of investors, including institutional allocators that have investment-grade mandates.
- Securitisation frees up regulatory capital, allowing banks to extend new loans. The securitisation of official MDB and DFI assets, as recommended by the G20, could significantly accelerate their capital velocity. This would enable MBDs and DFIs to increase their annual investment volumes.

For investors:

- Securitisation provides access to highly rated assets and attractive yields without building the expertise, infrastructure, and mandate to invest in illiquid loans.
- Securitisation offers opportunities to diversify at scale into new asset classes and geographies that would otherwise be subscale or too high-risk.
- Securitisation offers multiple entry points for catalytic development finance, including investment in listed notes and providing equity capital into securitisation vehicles.

Figure 2 – The potential funding cost benefit of securitisation



Source: Montana Department of Revenue: High Yield Study (based on corporate bond yields in 2021)

To date, synthetic and true-sale securitisation have to date facilitated investment in a range of assets and markets that may not have been accessible to institutional allocators and insurers otherwise.

Recent case studies demonstrate the fit between securitisation and the predominance of illiquid, privately held assets in EMDEs, cementing securitisation

> *"at the core of international efforts to encourage private finance to invest in SDGs and other sustainability-related activities."*[6]

For example:

- The African Development Bank (AfDB) successfully recycled capital by securitising US $1 billion in non-sovereign, infrastructure, and financial institutions-related loans[7] and US $1.5 billion in Sovereign loans[8] across the African continent in a second transaction. These transactions allowed the AfDB to transfer risk in part to private investors and insurers and in part to the UK Government.
- The Asian Infrastructure Investment Bank (AIIB) seeded and has supported Bayfront Infrastructure Management, a specialised investment manager, to list securitised notes backed by private banks' infrastructure assets under four separate transactions.[9]
- The Inter-American Development Bank has identified potential to increase its lending capacity by US $10 billion over ten years through risk transfer of similar nature.[10]

The public listing of asset-backed notes has particular advantages that help to mitigate information asymmetries as well as the risk of misaligned incentives between originators and investors[11]. For example, publicly listed securitisations in the European Union – defined as those for which a prospectus is required by regulation – must submit all materially relevant data on the credit quality and performance of underlying exposures to a securitisation repository in a standardised format and on a regular basis. This reduces the cost of investor due diligence and ensures continued transparency among potential buyers and sellers. In contrast, private securitisations do not require a public prospectus or regular reporting to a central repository, which potentially limits pricing ability, risk assessment, and possibly also legal protection when less experienced investors are involved.

Moreover, listing securitised instruments creates publicly available prices for assets that are otherwise complicated to trade and difficult to value. For example, recent transactions by Bayfront Infrastructure Management include dedicated sustainability tranches, ffering institutional investors exposure to sustainable infrastructure assets in Asia Pacific through a traded, liquid security. These transactions have generated public data on the pricing, returns, and default risk of sustainable infrastructure assets in the region. This information is updated regularly and presented in a format that facilitates simple benchmarking against unlabelled tranches and other traded assets and can, therefore, help to facilitate replication in other regions and asset classes.

POLICY IMPLICATIONS

Development finance actors can do more to accelerate the use of securitisation for sustainable development

Despite the encouraging performance of the pioneering securitisations discussed above, EMDEs are still vastly underrepresented in the global markets. The global securitisation market is dominated by developed countries, especially the United States. Sustainability-themed securitisation in emerging markets – with the notable exception of China – is even more negligible. Figure 3 shows the predominance of the G7 countries in the global green asset-backed securities (ABS) market until 2020, the latest year for which comparable data are available. The absence of ABSs offering EMDE exposure leads to an inefficient allocation of EMDE risk, which remains concentrated among originating banks in EMDE regions.

Expanding the role of securitisation in financing sustainable development in EMDEs requires innovations related to demand, supply, and policy and regulation. On the supply-side, the opportunity for official development finance actors to serve as originators has been well-documented. For example, the landmark G20 CAF Review identifies opportunities for true-sale or synthetic risk transfer through securitisation.[12] MOBILIST-supported research identified similar opportunities as early as 2021.[13]

However, several hurdles still prevent the expanded use of exit mobilisation through securitisation of MDB and DFI assets:

- MDBs and DFIs generally hold assets to maturity, meaning assets are not revalued ('marked-to-market') on a frequent basis. Securitisation transactions force such a revaluation, meaning that losses on underperforming assets will crystalise in the MDB or DFI's annual profit and loss statement.
- Net income may also be reduced if there is a lag between risk transfer and capital redeployment.
- The potential that origination will be biased toward those investments that would be easier to securitise over more complex or higher-risk assets.
- A lack of standardised legal documentation and overall opacity among official portfolios.
- Preferred Creditor Treatment (PCT) of MDB Sovereign loans may complicate the true-sale transfer of these assets through securitisation.

MDBs and DFIs are pursuing purpose-built origination structures and transparency enhancements to accelerate risk transfer and capital recycling. One such institution is exploring a warehousing initiative whereby newly originated loans would be held in an independent credit-enhanced portfolio until the underlying assets can be securitised. Each loan would follow standardised legal documentation specifically designed to ease subsequent risk transfer. This standardisation could be mainstreamed across MDB/DFIs' portfolios. Similarly, momentum around G20 recommendations to share the MDB/DFI Global Emerging Markets Risk Database with investors could significantly enhance the market's understanding of underlying risk and so the prospects for pricing of securitisations backed by MDB/DFI loans.[14] For Sovereign assets, MDBs should partner with credit rating agencies to define a harmonised framework regarding the implications of PCT for securitised instruments.[15]

On the demand side, MOBILIST's recent equity investment in a securitisation SPV demonstrates the catalytic potential of development finance institutions as *investors*. MOBILIST invested to catalyse a listed securitisation of privately held sustainable infrastructure assets in the Asia Pacific region. This transaction is the latest in the series by Bayfront Infrastructure Management and frees up private banks' lending capacity to finance new green projects in the region. This is the first in transaction in the series to focus predominantly on financing developing Asia's energy transition.

MOBILIST's equity contribution plays a catalytic role by taking a higher-risk, higher-return position in the capital structure. Rather than investing in highly rated notes, MOBILIST has pioneered direct external equity provision on a commercial basis into a private sector securitisation vehicle, enhancing the listed notes' rating to attract institutional investors. The underlying assets are Asia Pacific infrastructure debt, with approximately 75% of exposure in developing countries and 34% accredited as sustainable. The total securitisation transaction was sized at US$410.3m with a 10% equity tranche. MOBILIST committed an anchor investment of up to US$20.4m in the Preference Shares in BIC IV and received a final allocation of US$5.0m (equivalent to 5.0 million Preference Shares), given investors' robust demand, which resulted in strong oversubscription for

6 Daniela Gabor: Securitization for Sustainability: Does it help achieve the Sustainable Development Goals? (Oct 2019)
7 https://www.newmarketcapital.com/wp-content/uploads/2021/11/Room-to-Run_Risk-Control.pdf
8 https://odi.org/en/insights/afdbs-new-room2run-highlights-opportunities-and-questions-about-mdb-risk-transfer/
9 In June 2021 Bayfront issued the world's first public securitisation sustainability tranche under a US$401.2m securitisation transaction which was followed by a US $402.7m securitisation transaction in September 2022. Source: https://www.aiib.org/en/projects/details/2022/_download/singapore/Infrastructure-Asset-Backed-Securities-Outperformance-in-a-Tumultuous-Year_20230414.pdf
10 https://www.g20.org/content/dam/gtwenty/gtwenty_new/document/G20_Roadmap_for_MDBCAF.pdf
11 See Andreas Jobst: Back to Basics: What is Securitisation? (IMF, Sep 2008

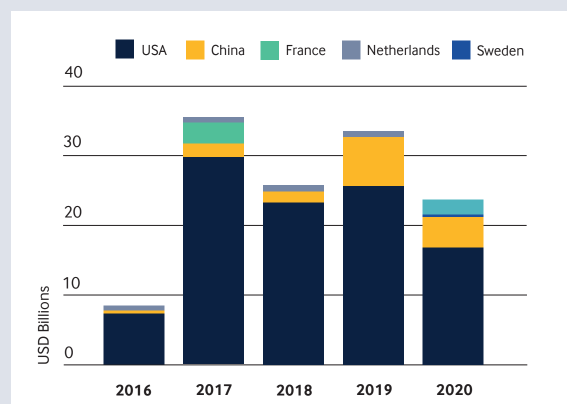
the Notes. MOBILIST's equity participation implies a ca. 80-times mobilisation rate, achieved by enhancing the credit rating of more senior parts of the capital struture.

Moreover, regulators require investors and intermediaries to hold less capital in reserve for higher-rated assets. Securitisation could therefore free up significant extra capital for new investments by transforming lower-rated individual assets into higher-rated notes backed by a securitisation pool For example, under Basel III rules[16] the risk weight for financial instruments rated between AAA and AA- is 20%, compared to the risk weight of 100% for investments rated between BB+ and B-. This means that if a securitisation transaction manages to deliver an upgrade from BB+ to AA- the amount of reserve capital that a financial institution needs to hold against the asset in question falls five times.

MOBILIST's participation has impact beyond its direct capital contribution. MOBILIST's equity participation was sized in part to cover the sustainability tranche of this transaction, facilitating the listing of an instrument backed by accredited sustainable assets. MOBILIST requires and monitors alignment of the transaction with the SDGs (specifically SDGs 7, 11, and 13) and its own ESG framework. MOBILIST's participation also creates a precedent for applying third-party equity to such deals. Information about the pricing and performance at listing and then in the market is an important public good for other issuers and investors considering comparable transactions, including those led by official sector originators holding similar underlying assets.

Regarding policy and regulation, further technical support may be required to enable listing of securitised notes in EMDE jurisdictions. For example, the

Figure 3 – Global Green ABS Issuance by country



Source: Climate Bonds Initiative

securitisation vehicle described above is registered in Singapore, and the notes issued by the SPV will be listed on the Singapore Exchange (SGX). This choice was informed by the "*balanced and thoughtful approach*" taken by the Monetary Authority of Singapore in regulating securitisation, including by implementing the Basel securitisation framework.1 Bringing future transactions to market on EMDE exchanges may require technical support to ensure alignment with the Basel standards and regulatory best practices.

Across demand, supply, and policy and regulation, MOBILIST's participation in this transaction is designed to generate learning to inform mobilisation efforts by the development finance community. This securitisation structure offers the first example of a direct equity provision into a securitisation vehicle by a development finance actor on commercial terms. Few sources of catalytic yet pari passu equity investment exist for securitisation sponsors, offering a strategic entry point for development finance. Similarly, the underlying assets in this transaction are comparable to MDB infrastructure loan portfolios, meaning that development finance actors could capture learning to inform the recycling of their own capital through similar securitisations. The listing of these securitised notes ensures that pricing and risk information is widely and frequently distributed.

MOBILIST hopes that this data and operational learnings from this transaction will inform the community's efforts to accelerate capital recycling and mobilise private capital to finance EMDE sustainable development.

12 https://www.dt.mef.gov.it/export/sites/sitodt/modules/documenti_it/news/news/CAF-Review-Report.pdf
13 https://www.mobilistglobal.com/research-data/mobilist-the-exit-mobilisation-opportunity-in-africa/
14 https://cgdev.org/blog/mining-gems
15 https://www.g20.org/content/dam/gtwenty/gtwenty_new/document/G20_Roadmap_for_MDBCAF.pd
16 Basel Committee on Banking Supervision: High-level summary of Basel III reforms (Dec 2017)
17 ASIFMA: Securitisation in Asia (2018) f