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Securitisation yet to recover from Lehman fall

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By Tom Freke

LONDON (Reuters) - Europe's securitisation market is unlikely to recover until billions worth of assets tangled in the bankruptcy of Lehman Brothers are fixed, and any new deals are likely to have a much simpler structure.

The market at its peak sold hundreds of billions of dollars of complex debt packages secured against anything from commercial property to ticket sales at football stadiums, but was shattered by the credit crunch.

The collapse of Lehman -- one of the market's largest players -- further hurt the market, leaving financiers eager to find ways to restart the flow of the profitable deals.

Recent weeks have seen tentative signs of recovery, with a small number of low-risk deals sold to investors.

"Securitisation will come back -- it's too good a technique to be abandoned," said Conor Downey, a finance expert at law firm Paul Hastings.

Before the credit crisis, banks made massive use of complex debt instruments to offload credit risk to financial markets, enabling them to lend more money and boost profits because they needed less regulatory capital.

But instruments such as asset-backed securities (ABS) and collateralised debt obligations (CDOs) were blamed for helping cause the credit crisis, because they obscured who ultimately held the risk and had to pay in case of trouble.

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Unpicking securitisations created by Lehman, which totalled about 40 billion euros when the bank collapsed in September last year, has shown how ill-prepared the market was for such unexpected events.

"It is incredibly complex because of the large number of different elements to coordinate, and due to the many ambiguities and discrepancies in the documents," said Elizabeth Goodall, a former Lehman employee who now works for advisory firm JC Rathbone, and who specialises in fixing securitisation transactions.

Many of Lehman's property-related securitisations had the bank originate the transactions and also take counterparty roles, such as providing interest rate swaps, necessary to make the deals work, Goodall said.

The speed of Lehman's demise meant there was no time for new counterparties to be brought in, she said, leaving many deals in limbo, triggering rating downgrades and losses for investors.

Previous criteria for counterparties assumed bond issuers would have time for remedies to be pursued, for example an orderly replacement of a weakening counterparty.

Lehman's demise accelerated a review of counterparties by rating agency Fitch, which expects to launch new draft criteria by October.

Investors in new securitisation deals are likely to eschew the complex transaction structures seen during the credit boom, and instead focus on simpler deals where risk is more transparent, said Stuart Jennings at Fitch Ratings.

When investor demand for securitisation does return "it may essentially be back to square one structure-wise," he added. Straightforward ABS, where risk is easy to analyse will come back first. A recent structured finance deal backed by Tesco assets is an example, Jennings said.

But there is little demand for more complex investment vehicles such as CDOs, which are very hard to analyse because of their layered structure and because they often cross-invest in similar structures that are hard to understand.

Many investors are heavily exposed to deals stemming from the boom years, whose value is now in doubt.

"One reason there is no demand is investors don't know what's happened to their current holdings," said Rathbone's Goodall.

"I expect they won't start ploughing money into new deals until they get more certainty on what they have lost or not lost," Goodall said.

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The complexity of many securitisation deals from the boom years makes it more likely the courts will be forced to adjudicate between different interested parties.

Participants in Dante, a Lehman-designed securitisation deal, have been to the London and New York courts after a disagreement over who should be repaid first.

Billions of dollars of other so-called synthetic CDOs -- layered structures whose underlying assets often are credit default swaps -- could be affected by the case, which could also have a wider impact on the whole of the securitisation market, rating agency Fitch said.

Other banks also put together complex securitisation deals that have proved difficult to unwind. Last week an investor in an RBS-designed securitisation, Epic Industrious, went to the High Court seeking to block the sale of a portfolio of commercial property assets.

(Editing by Jon Loades-Carter)