Asset Backed Securities as an option to improve funding

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by Groupe GTI

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Contents

I. SHORT HISTORY: FROM A FUNDING TOOL TO AN OVERWORKED TOOL

1. First development phase in the US
2. Second development phase in the US
3. Expansion: asset types and geography
4. Introducing new concepts
5. Role in the latest crisis?

1. First development phase in the US

- Housing finance industry rests with Savings and Loans (S&L)
- S&L's may not lend beyond a « narrow » geographical territory
- S&L's are the only institutions allowed to pay interest on deposits (rate is limited by regulation)
- S&L's get tax advantages for making 30 years, fixed rate (etc.) mortgage loans, ...

1. First development phase in the US

Consequently, S&L's make long term fixed rate (≈ 6%) mortgage loans funded by short term interest-earning (3%) deposits

This requires (at least) two conditions to work:

- Balance between available savings (deposits) and demand for mortgage loans
- Stable deposits

1. First development phase in the US

- Emergence of geographical imbalance:
  - excess savings on East Coast; and
  - excess needs on West Coast …

with geographical limitation.

Fannie Mae acts as intermediary (makes collateralized loans)

- Interest rate shock:
  - Rise in interest rate (up to 18%) leads to new products (money market funds)
  - Deposits flee S&L's
  - And S&L's, nearing bankruptcy are unable to borrow

1. First development phase in the US

The solution is to securitize, ie to:

- Isolate a pool of loans and issue certificates of ownership of these loans;
- Structure flow of payments from the loans to enhance quality of certificates.

BUT:

- Because S&L is “unstable”, a sale treatment is required;
- Embedded losses are booked over time (otherwise bankruptcy is unavoidable);
- Because the 30 year loan (with early paydown of principal) is not interesting to anyone, structuring of liabilities is necessary

This leads to the second development phase in the US.

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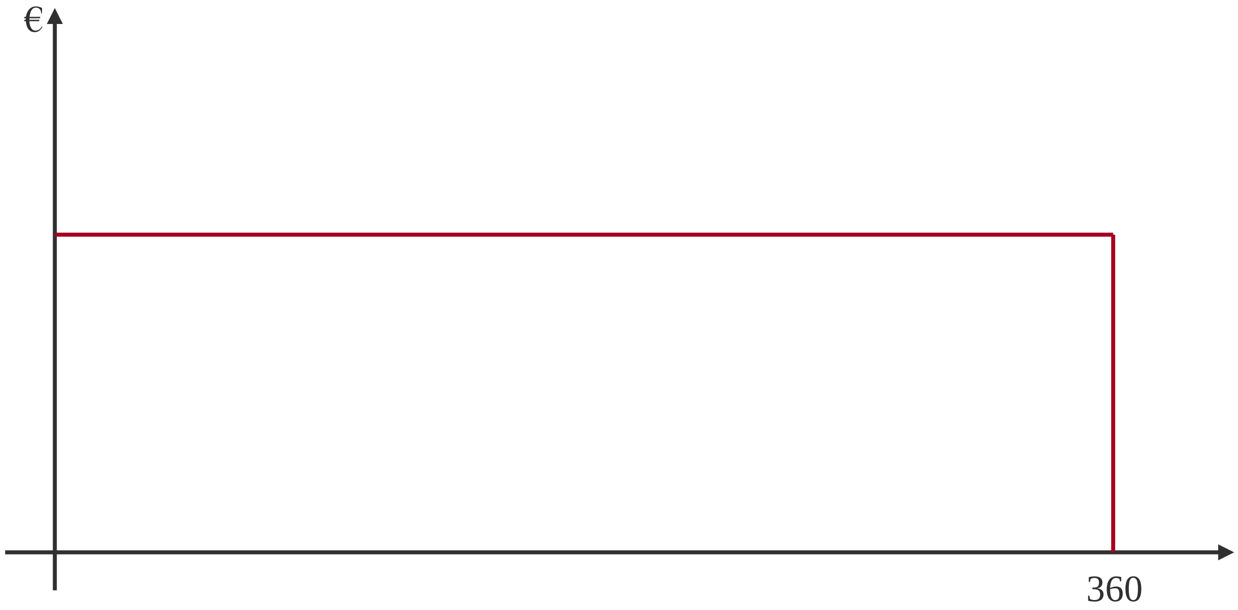
2. Second development phase in the US

Structuring becomes necessary

Flow of funds

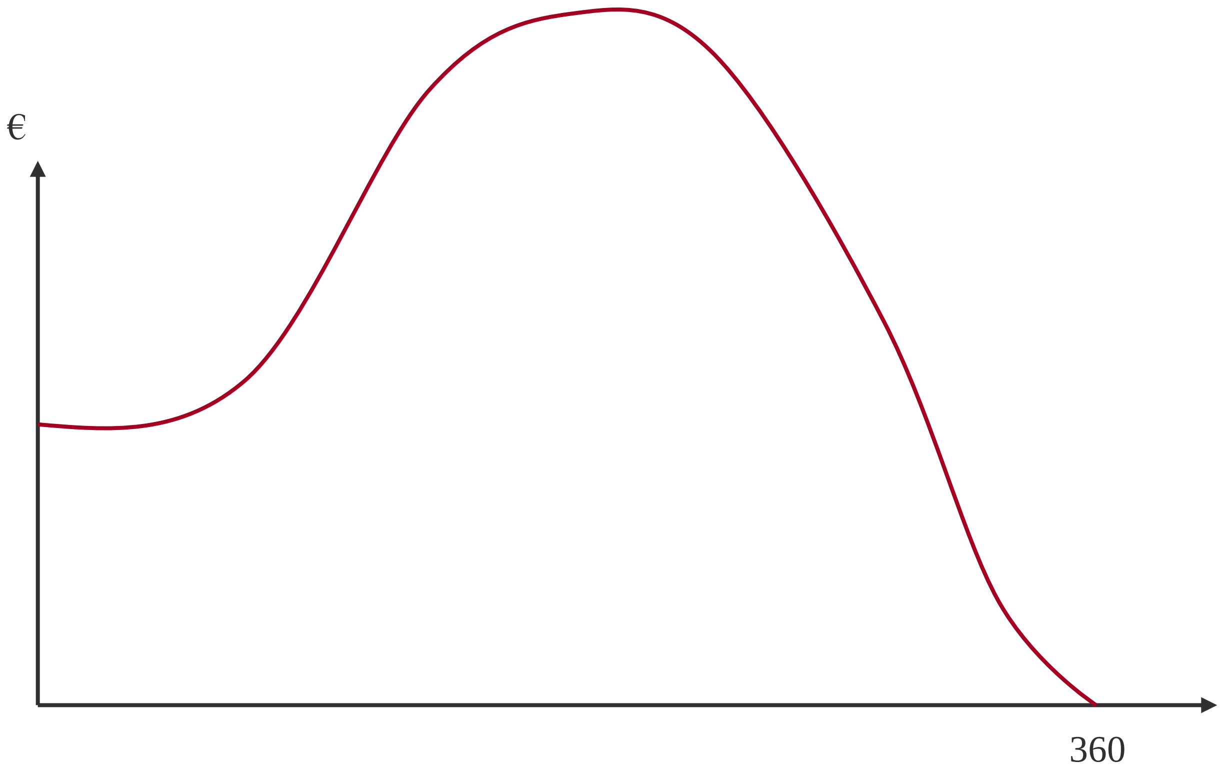


Pool of 30 years mortgage loans, fixed rate, constant monthly P&I, no prepayment, no default

2. Second development phase in the US

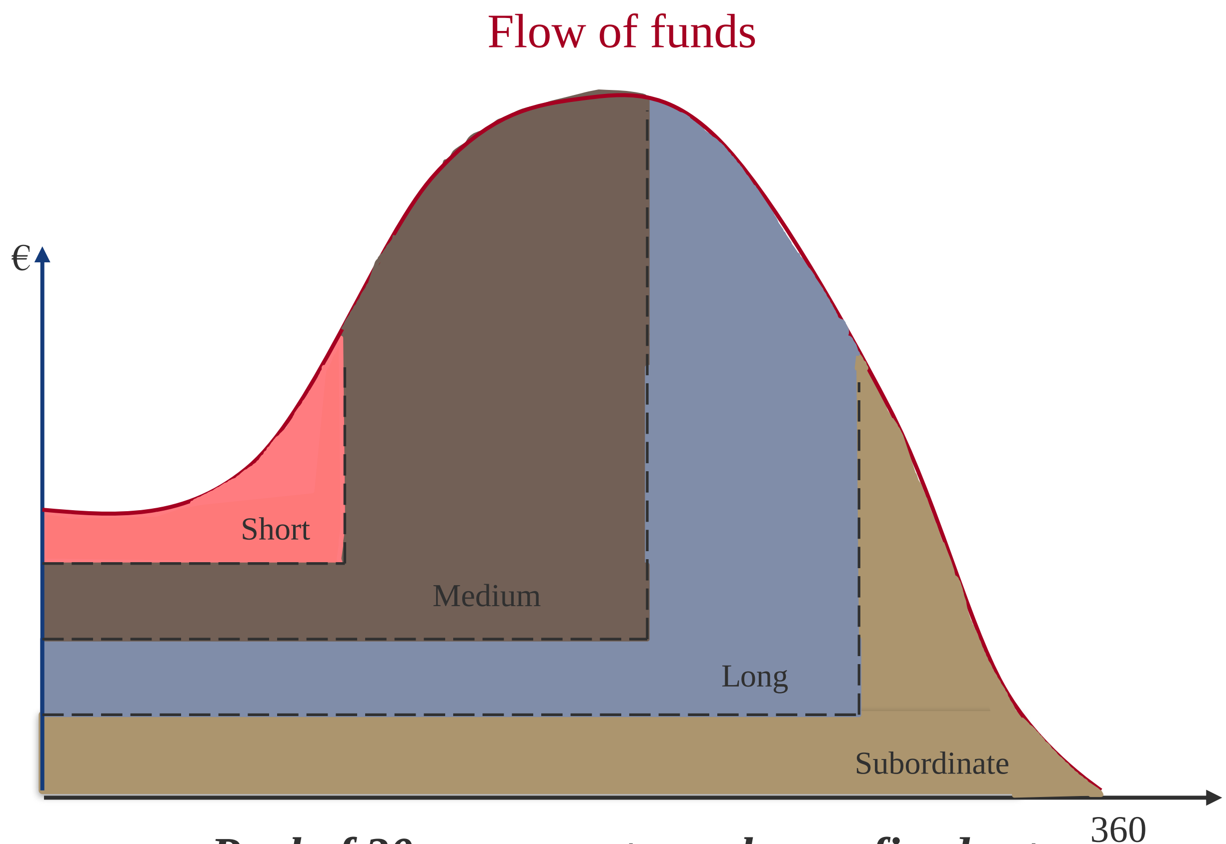
Structuring becomes necessary

Flow of funds



Pool of 30 years mortgage loans, fixed rate, constant monthly P&I, with defaults and prepayments

2. Second development phase in the US



Pool of 30 years mortgage loans, fixed rate, constant monthly P&I, with defaults and prepayments

Tranching in order to:

- Reallocate risks (to subordinated tranch)
- Create instruments with short, medium and long maturity

2. Second development phase in the US

Key concepts in the phases of development:

-Financing tool

-Sales treatment is a requirement

-Structuring adds value by segmenting liabilities market

-All models are deterministic

I. SHORT HISTORY: FROM A FUNDING TOOL TO AN OVERWORKED TOOL

1. **First development phase in the US**
2. **Second development phase in the US**
3. **Expansion: asset types and geography**
4. **Shifting objectives and concepts**
5. **Role in the latest crisis?**

3. Expansion: asset types and geography

- Diversification of asset types
- Diversification of sellers
- Diversification of actors
- Increased complexity of structure

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3. Expansion: asset types and geography

- Diversification of asset types:
  - Term loans
  - Trade receivables
  - Municipal loans
  - Auto loans
  - Securitized deal
  - CDS, CLO, CDO
  - Synthetic securities
  - Whole businesses
  - Commercial real estate loans
  - Etc…

3. Expansion: asset types and geography

- Diversification of sellers:
  - Commercial banks
  - Corporations (for trade receivables)
  - Finance companies owned by industrial corporation (to refinance sales financings)
  - Independent funds
  - Fleet rental companies
  - Etc…

3. Expansion: asset types and geography

- Diversity of actors:
  - Commercial banks
  - Investment banks
  - Arbitrage desks
  - Governments
  - Insurance companies

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3. Expansion: asset types and geography

- Increased complexity of structure:
  - Third party credit enhancement
  - Numerous tranches
  - Rating-linked triggers
  - Variable cash flow allocation

…. and questionable underwriting practices

I. SHORT HISTORY: FROM A FUNDING TOOL TO AN OVERWORKED TOOL

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5. Role in the latest crisis?

4. Shifting objectives and concepts

Shift in objectives:

Before: a financing tool, which required legal and accounting sale treatment

After: a tool which should be treated as a sale and therefore could (should?) be used to manage balance sheet and income statement (sometimes even without financing)

Introduction of two concepts:

Before: deterministic, reasonably simple models

After: models – which became excessively complicated and relying also on market values and on statistics (none being deterministic)

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5. Any role in the latest crisis?

- A tool to diversify financing hence holders are necessarily diversified
- The issue is not in the tool, but in the way it is used
- But it certainly has had a role, in the same way as gasoline can be faulted for car accidents.

With consequences on:

- Financial institutions – Basle III
- Insurance companies – Solvency II

Contents

II. CURRENT STATUS

1. Definition
2. Narrowed focus
3. Risks and how to address them
4. Key implementation steps

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II. CURRENT STATUS

1. Definition

Definition of a securitization:

use identified or identifiable assets which globally may be analyzed "statistically" to obtain financing with some degree of transformation (credit, maturity, rate type)

II. CURRENT STATUS

1. **Definition**
2. **Narrowed focus**
3. **Risks and how to address them**
4. **Key implementation steps**

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2. Narrowed focus

The rest of this presentation will narrow its focus on:

-Trade receivables ie receivables generated in the course of a company business, selling goods and/or services to numerous buyers. Very short term of approx 60 days.

-Sales financing ie medium term loans to buyers or deferral of payment by buyers. Generally calling for monthly payments

II. CURRENT STATUS

1. Definition
2. Narrowed focus
3. Risks and how to address them
4. Key implementation steps

3. Risks and how to address them (US and/or French environment)

- Claw back
- Payment delay
- Default
- Dilution
- Commingling
- Rate & maturity matching

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3. Risks and how to address them (US and/or French environment)

- Claw back: “fair trade” and usual legal environment
- Payment delay:
  - Lending commitment
  - Cash reserve
  - Overcollateralization
  - Seller’s advances

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3. Risks and how to address them (US and/or French environment)

- Default: (ie Debtors risk which ought to be defined)
  - Overcollateralization
  - Guarantee
  - Seller’s commitment to replace
- Dilution (Seller’s risk):
  - Overcollateralization
  - Guarantee
  - Commingling (risk of stay) ownership of assets)
- Rate and maturity matching

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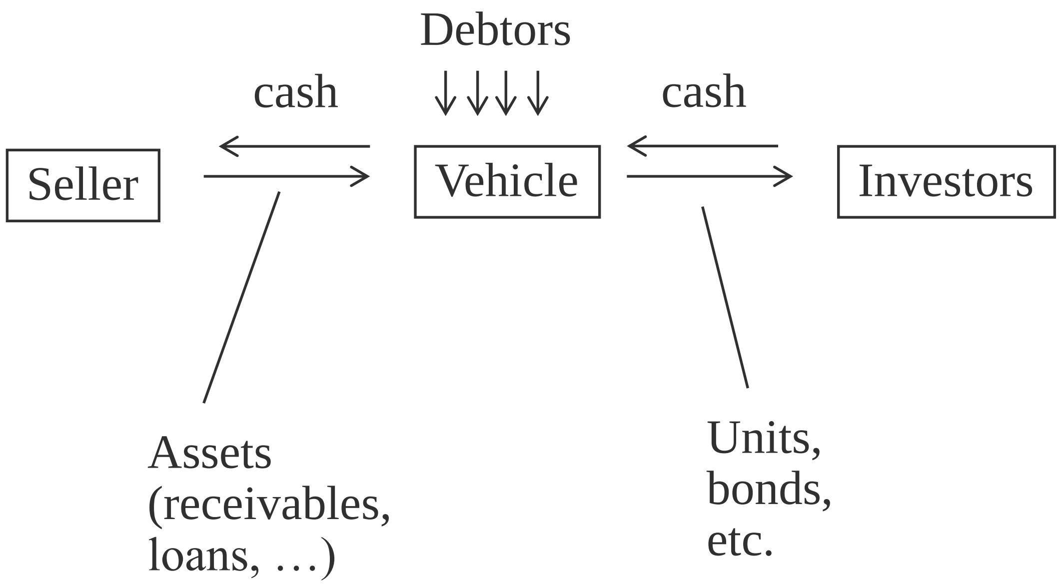
Schematic securitization



Servicing may be retained by seller or outsourced to a third party

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II. CURRENT STATUS

1. Definition
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3. Risks and how to address them
4. Key implementation steps

Key implementation steps (1/2)

Preliminary analysis	Mandate	Analysis	Structuring/ Arrangement
To obtain rapid view of the assets and determine broadly what is feasable	Determines the objectives, who does what and who pays what to whom.	Full analysis of assets: legal consideration, historical performance, etc.	Determines final structure of deal

Key implementation steps (2/2)

Negociations Documentation	**Placement**	**Implementation – Management over time**
Making sure that contracts reflect what ought to be done	Finding willing investors at the right conditions	Monitoring asset performance, taking appropriate action if necessary, collecting and paying out cash, reporting to investors …

Contents

III. Can it improve one's funding?

To securitize assets, one needs:

- A legal framework: to be expanded by GLN for China. Often the law serves a need
- Investors: the challenge is to arrange an operation saleable to existing investors, especially in environment where insurance and retirement systems are not fully developed
- A willing seller with adequate assets

III. Can it improve one's funding?

Digression on the word "improve"

- An improvement on one character often implies a deterioration on another.
- Maturity matching is an advantage, but it has a cost.
- Better rating gets cheaper funding, but less funding.
- Diversification of funding sources is safer but implies extra costs (at least at the outset)

III. Can it improve one's funding?

Key questions to define a structure:

- How is default defined?
- How to protect against delays, defaults and dilution?
- What rating level?
- How often sell/acquire assets?
- What maturities of liabilities?
- Any interest rate transformation?
- Is off balance sheet a requirement?

III. Can it improve one's funding?

How is default defined:

- Any asset unpaid for xx months (term assets) or yy days (receivables) is deemed to a 'defaulted asset".
- This is an arbitrary decision, with impact on required enhancement especially in the case of trade receivables

III. Can it improve one's funding?

How to protect against delays, defaults and dilution?

- Can be either exogenous (supplied by a third party guarantor or insurer) or endogenous (i.e. overcollateralization) or seller supplied, or a combination.
- Endogenous protection is the least expensive but reduces the funding percentage.
- So if funding amount ought to be maximized, seek enhancement by a third party, for a fee.

III. Can it improve one's funding?

What rating level?

- Sometimes the top rating may just be impossible to obtain
- Often, the top rating is financially unjustified
- Higher rating provides cheaper funding, but it comes at a cost.

III. Can it improve one's funding?

How often to sell/acquire assets?

[a factor of funding stability]

- With term assets: trade off between underwriting freedom and funding availability; successive purchases are no longer widely used with terms loans
- With trade receivables successive purchases are a requirement due to their very short maturity

<u>Example</u>: less frequent sales implies more receivables owned by buyer pay off between two purchases and the funds – generally paid to seller – accumulate and increase commingling risk. And more frequent sales may imply operational hurdles.

III. Can it improve one's funding?

What maturity of liabilities (more relevant with term assets)?

- Cost is definitively a criterion (and advantages of tranching depend on yield curve)
- Diversification of investors base is also a criterion
- Some objectives are not realistic

III. Can it improve one's funding?

Any interest rate transformation?

- With term assets: could be useful when investors dislike the type of rate used for the assets; or to rebalance seller's funding structure and sensitivity to interest rate.
- With receivables, the question is less relevant.

III. Can it improve one's funding?

Is off balance sheet a requirement?

- Increasingly difficult under GAAP and IFRS
- Comes at a cost, as it most often requires third party insurance
- Credit analysts often reconsolidate off balance sheet funding, often disregarding the facts (on/off is a binary alternative for a reality which is continuous)

III. Can it improve one’s funding?

The pro’s and con’s of funding through ABS:

- Pro’s:
  - Diversification of funding sources
  - Potential for perfect matching of liabilities to assets
  - Potential for off balance sheet treatment
  - Rigorous and extensive knowledge of the assets
- Con’s:
  - Time to come to market (especially for a first issue)
  - Cost
  - Uncertainty of success
  - FX constraints

III. Can it improve one's funding?

Quick comparison of options

	Bank Loan	Factoring	Securitization
Complexity	-	+	+ / -
Costs	+	+ +	+ / -
Cash (high volume)	-	+ / -	No volume issue
Funding diversification	-	- -	+
Durability	+ / -	May be cancelled « ad nutum »	Short & medium term

Contents

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Overview

Groupe GTI is a set of corporations including GTI Asset Management (GTI-AM), licensed by the «*Autorité des Marchés Financiers* ».

GTI-AM is a management company under EU Directive N°2004/39/CE, licensed to:

- manage third party portfolios under mandates;
- manage mutual funds (French mutual funds, european mutual funds under EU Directive 2009/65/CE, and mutual funds authorized in France).

and these funds may consist of:

- financial instruments traded on a regulated or organized market;
- mutual funds;
- loans, securities and receivables.

This charter (obtained in September 2012) allows GTI-AM to expand beyond its historical activity in asset securitization.

Overview

Groupe GTI develops a complete range of tools to structure and manage securitization operations.

Groupe GTI offers companies in search of new funding advice and implementation:

- Recognized,
- Independent,
- Not biased by any banking relationship, and
- Efficient while compliant with applicable regulations.

Groupe GTI also sponsor its own refinancing conduit.

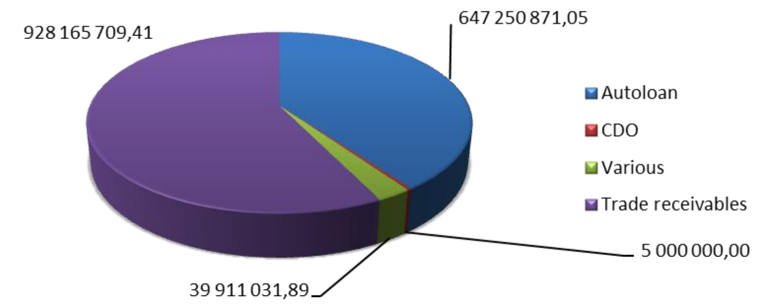
Independent and innovative

Groupe GTI, a financial engineering company:

- Established in 1989, 100% owned by the management
- A financial engineering company, specializing in asset refinancing through securitization
- Its knowledge in financial management and advice are recognized
- A susbsidiary approved by the "AMF" as a management company of "*Fonds Communs de Créances*".
- An independent refinancing Conduit (General Funding Ltd) with liquidity back-stop facilities granted by various Credit Institutions rated A-1/P-1 which issues French CP ("*billets de trésorerie*")
- 15 high-level co-workers.

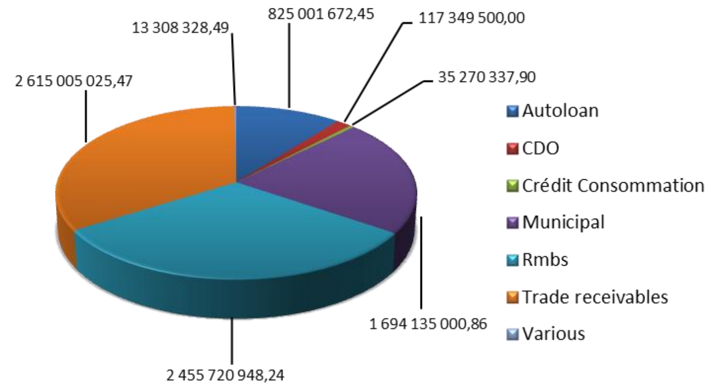
Total amount of operations under management:

€ 1. 6 billion, as of 30/09/12



Total amount of operations arranged:

€ 7.7 billion, as of 30/09/12



Groupe GTI, historic innovator:

- First French Mortgage Backed Securitization (1991)
- First French securitization of diversified portfolio of municipal (1996)
- Securitization with a first demand guarantee in France (1994)
- Issuance of floating rate notes backed by fixed rate assets without swap (1995)
- First trade receivables securitization under French legal framework(1998)
- First refinancing of French FCC Securities through an offshore conduit (General Funding Ltd) (1998)
- First refinancing of LBO with a pan-European Securitization program

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Areas of expertise

- Industrial or operational assets
- Debts
- Stocks
- Financial and immaterial assets
- Real estate
- Municipal loans
- Suppliers' debts
- Bond financing
- Outsourcing risk

Groupe GTI's businesses

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Titrisation et Finance Internationales	HORIZON PME	TFI Gestion	GTI Asset Management	Credatech
▪ **Business Development** Financial analysis Credit analysis ▪ **Structuration** Relationship with lawyers, rating agencies, financial institutions ▪ **Research** Development of new tools to improve our response	▪ **Structuration dedicated to SMEs** ▪ **Financial investment advice**	▪ **Sponsor and Manager of General Funding Ltd, independent refinancing conduit rated A-1/P-1** ▪ **Management company of GFL Ltd** ▪ **Placement**	▪ **Licensed by AMF** as "*Soci été de Gestion de Portefeuilles*" ▪ **FCC management company** Hosts most of the staff and technical resources of Group GTI: IT system, financial engineering, structures management underlying assets monitoring	▪ **Software publisher concentrating on servicing trade receivables**

Structured finance activities — *Management activities* — *IT*

Groupe GTI : A recognized objectivity

Total Independence:

- No capitalistic link with banking system or other institutions
- Confidentiality of the data thanks to a secure computer system regularly audited

Service:

- A dedicated team: 15 persons with experience in finance, credit analysis, mathematics, computing, etc.
- A complete offer:
  - Arrangement and structuring
  - FCT management (with AMF license)
  - Financing by GFL (bankruptcy remote conduit issuing BT (similar to CP) rated A1/P1)
  - A capital market expertise

Innovation:

A "track record" testifying to our capacity to be innovative

Safety:

All the investors have always collected what they expected (as of this day)

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References (samples)

Trade receivables: Arranger & Management Company

FCC Fusion	FCC Orexad	FCC GMAC
€ 300 millions	€ 100 millions	€ 230 millions
Pan-european receivables securitization programme	*Pan-european receivables securitization programme*	*French auto loans securitization programme*
Arranger & Management Company	Arranger & Management Company	Management Company

FCC Facto	FCC Seita	FCC BSN Glasspack
€ 163 millions	€ 458 millions	€ 183 millions
Trade receivables securitization programme	*Trade receivables securitization programme*	« *Cross-border* » deal
Arranger & Management Company	Arranger & Management Company	Arranger & Management Company

References (samples)

Trade receivables: Arranger & Management Company

FCC GlobalDrive	FCC Hawk	FCT Attila
€ 562 millions		€ 420 millions
French auto loans securitization programme	*Trade receivables securitization programme for TPE et PME*	*Trade receivables securitization programme*
Management Company	**Management Company**	**Arranger & Management Company**

FCC Taureau	FCC SFF
€ 75 millions	€ 229 millions
Trade receivables securitization programme	*Trade receivables securitization programme*
Arranger & Management Company	**Arranger & Management Company**

References (samples)

RMBS:

FCC Foncier 91
€ 152,5 millions
3 700 loans
Arranger & Management Company

FCC Foncier 95
€ 305 millions
8 700 loans
Arranger & Management Company

Titrimmo 05-94
€ 305 millions
9 600 loans
Arranger & Management Company

FCC Teddy
€ 1 387 millions
55 000 loans
Arranger & Management Company

Titrimmo 06-94
€ 305 millions
9 600 loans
Arranger

Municipal loans:

Tocryo 96
€ 1 067 millions
850 loans
Arranger & Management Company

Trois Lion
€ 458 millions
70 loans
Arranger & Management Company

Trois Lion B
€ 153 millions
30 loans
Arranger & Management Company

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