Swiss ABS market opens up – Citibank takes credit

October saw the launch of a further issue through Citibank's asset-backed security (ABS) issuing vehicle, Citibank Credit Card Master Trust. This issue, however, is an unprecedented one for the Swiss franc market – Permjit Singh reports.

Established by Citibank in 1991 for its credit-card securitisation programme, the trust issues multiple-certificate series, each representing an undivided ownership interest in the trust. This issue was the first in Swiss francs, following the trust's three earlier Deutsche mark issues (in 1996 and 1997). The issue was also unique in three other ways. It was the:

- first ABS to be listed on the Swiss Exchange;
- first fixed-rate credit card-backed issue in Swiss francs; and the
- largest ever Swiss franc bond, at SFr1.064bn.

The listing enabled the ABS to be targeted at the Swiss retail investor base (individuals, and intermediaries such as private banks) – earlier repackaged securities in Swiss francs had been mainly targeted at institutional investors.

One previous credit card-backed Swiss franc issue (the SFr700m Cool issue via the monoline credit-card company, Capital One, this year), was not listed on the Swiss Exchange and was specifically targeted at money market mutual funds.

Part of the nine-month preparatory period necessary to bring the debut issue to market was spent on developing a listing procedure; obtaining clearance from the Swiss clearing system to enable the ABS to be treated as 'regular' bonds; and amending the Swiss securities reporting system, Telekurs, to report the ABS' expected maturity date, as opposed to its legal maturity date.

In addition, considerable time was devoted to the education of investors in what was regarded as a new asset class. Lead manager Credit Suisse First Boston also undertook a substantial amount of self-education to bring its salesforce up to speed with the latest in securitisation technology.

A market foundation

The preparatory work undertaken with this issue has laid the foundations on which a future Swiss ABS market can be built – the prospect of which has resulted in the debut issue receiving extensive press coverage.

In a recent press release, the Swiss Listing Authorities stressed the increasing importance of the ABS product in the Swiss market and its substantial potential for growth. "This issue has opened up a market for true retail distribution," said Peter Schmuki, managing director at CSFB.

Citibank's debut issue was well received by investors – secondary market trading of the senior certificates was seen as low as 15bp below Libor – a sign of solid placement and investor attraction. "We were surprised at the relative breadth of the placement and the relatively small flowback," said Charles Wainhouse, treasurer at Citibank.

Even so, while the majority of CSFB's allocation had been pre-placed, in the wake of the volatility in markets across Europe, CSFB did buy a few bonds back .

A great deal

The attractiveness of the issue is attributed to a combination of its large size; the senior certificates' high credit rating (AAA ratings from Standard & Poor's, Moody's, Duff & Phelps and Fitch); and the certificates' relatively attractive yield – the senior certificates were priced to yield 7bp below, and the junior certificates 12bp over, the five-year Swiss franc swap rate.

According to CSFB, the senior certificates' yield is around 15 to 20bp higher than that of conventional AAA rated corporate Swiss bonds (foreign industrials and sovereigns) – a yield that is more commensurate with an AA rated or even strong A rated corporate bond.

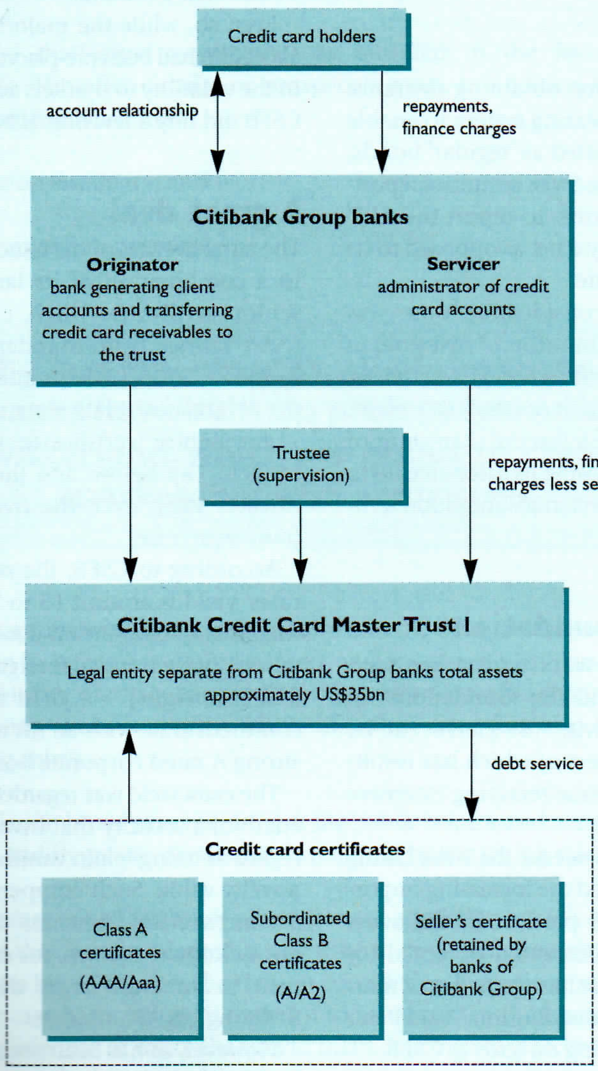
The extra yield was regarded as a 'sweetener' for a security that investors do not regard as being 'plain vanilla', ie, it has a novelty value. Such compensation for a product's relative 'newness' to a market is not unknown – it was, for example, evident to an even larger degree in the fledgling US ABS market.

However, as has been seen in the US – where ABS spreads relative to AAA rated corporates have been tightening ever since the product was first launched – in the European market, CSFB expects such differentials to narrow in line with increasing investor awareness and competition.

Notwithstanding the yield pick up to investors, Citibank still managed to achieve a lower, although immaterial, funding cost compared with an equivalent US dollar issue at the time.

According to the lead, approximately two thirds of the senior certificates were placed with retail investors, with the rest distributed among institutional investors (insurance companies, pension funds and fixed-income funds). The junior certificates were placed with institutional investors (bond funds).

Citibank credit card ABS: simplified structure



Source: Offering circulars Citibank Credit Card Master Trust I

Geographically, investors were predominately Swiss based – not surprising given the prevalence of low Swiss franc interest rates compared with other currencies, and an absence of consensus with regard to the relative strength of the Swiss currency.

The swiss franc issue

Citibank has taken a considered approach (in terms, for example, of security pricing and distribution) when it has wanted to tap an investor base. With European Monetary Union (EMU) on the horizon, the Swiss franc market is considered to be of strategic importance to Citibank.

This is because the Swiss franc will not be included in the basket of currencies comprising the euro. The Swiss franc market will therefore remain independent and accessible post-EMU.

From a cashflow perspective, the Swiss franc issue does not differ greatly from a fixed-rate bond; interest on the certificates is payable annually and principal will be paid on the maturity date – expected to be November 2002. The certificates are divided into two classes – a senior Class A and a junior (subordinated) Class B. The former pays a fixed rate coupon of 3.25%, and the latter a fixed rate of 3.50%.

Tranche enhancement

Credit enhancement for the certificates comes through a combination of subordination by the Class B certificates – representing 6% of the face value of the two classes; cash collateral accounts – the initial amount of which is equivalent to approximately 7% of the face value of the two classes; and excess income spread.

Mismatches between the trust's assets and liabilities in relation to this issue give rise to currency and interest-rate risks – both of which have been hedged through a swap between the trust and AA/Aa3 rated Credit Suisse Financial Products (CSFP).

A feature of the transaction, and one that contributed to its rating because it mitigated event risk, is the presence of a standby swap counterparty – in the form of AAA/Aaa rated General Re Financial Products (GRFP). In the event of a default by CSFP, GRFP will assume all of its rights and obligations.

Currency risk arises due to US dollar-denominated receivables servicing Swiss franc-denominated payments on the certificates. Interest-rate risk (basis risk) arises from the interest rate earned on the receivables being a variable rate (and one that is linked to the US dollar prime rate) servicing the fixed rate of interest paid on the certificates. Under the swap, the trust receives fixed rates of interest in Swiss francs and pays a floating rate (Libor) of interest in US dollars.

The underlying assets

In keeping with other credit card issues, the Swiss franc issue incorporates a revolving period, during which repayments of credit-card debt are reinvested in newly generated credit-card receivables. The revolving period is followed by a further period, called the accumulation period, during which credit-card debt repayments are not reinvested in new receivables, but are accumulated to meet the full (bullet) and timely repayment of investors' principal.

Citibank regards its credit-card business as being of great strategic importance – representing almost 25% of its core business earnings. Furthermore, its trust – into which credit card receivables originated through Citibank's Visa and MasterCard credit-card business in the US are routinely transferred – is the largest credit-card ABS issuer in the US.

As at September 1997, the trust's portfolio of credit-card receivables totalled approximately US$35bn; it comprised 34m accounts; and had a total yield of 17.82% – including an average three-month excess spread of 4.39%.

Citibank's objective

With such a large portfolio to be refinanced on a regular basis, it is not surprising that one of Citibank's objectives in the Swiss franc issue was to broaden the investor base for its securities – an objective that has been achieved as a substantial number of investors in the debut issue were first-time ABS investors.

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Citibank's debut issue is not expected to be its last in the Swiss franc market. "Our objective was also to establish a platform from which we can return to the market – possibly next year," said Wainhouse.

The trust's next issue in that market may be at a floating rate or, if it is another fixed-rate deal, it may have a different maturity date.

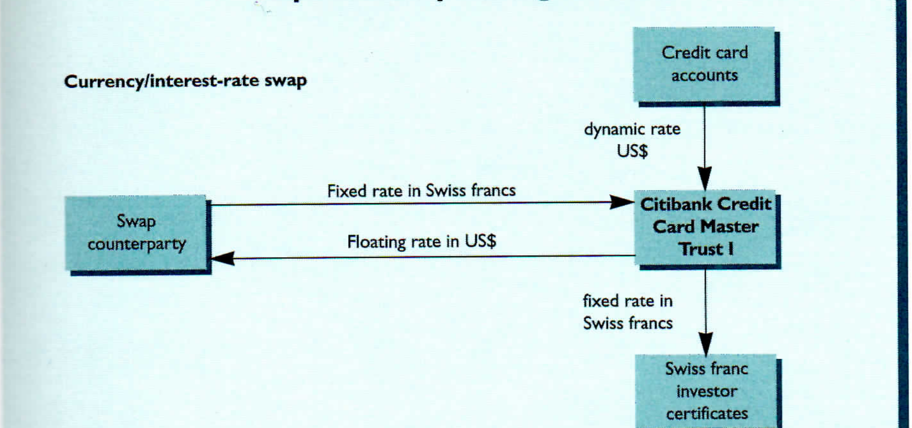
Regular issues

"Once we have established a franchise, we want to regularise issuance, to the extent there is investor appetite," Wainhouse added.

The trust has implemented this strategy already in the Deutsche mark market. It began with a three-year floater in April 1996; it followed with a five-year floater in August the same year; and in July 1997, it came with a 10-year fixed-rate issue.

1 This contrasts with Ford Credit's recent Globaldrive securitisation programme – reported elsewhere in this issue of ISR – where each series of securities is independently rated and is secured on discrete pools of Globaldrive's assets.

Credit card ABS in Swiss francs: simplified swap arrangements



Source: Credit Suisse/First Boston