COMMERZBANK

Product Group

Asset-Backed Securities (ABS and similar securities)

In this information sheet, Commerzbank provides information on the underlying characteristics as well as the opportunities and risks of the asset-backed securities (ABS) and similar securities product group.

General characteristics and investment opportunities

This type of bonds is part of the category of interest-bearing securities, which are often also referred to as fixed income securities, bonds, debt obligations or debentures. The investor lends a certain amount of money to the issuer, e.g. a non-financial or a financial company, and in return receives a bond denominated in euro or a foreign currency. Bonds represent a claim to capital repayment and, typically, to fixed or variable interest payments as compensation for the provision of capital. Their yield is determined by the nominal interest rate, the issue or purchase price, the redemption price and the term of the security. The individual characteristics, such as interest rate, maturity or collateralisation are specified in the terms and conditions of the securities issue. Asset-backed securities are securities backed by credit claims or other claims of the issuer on third parties. By collateralising tradable securities with bank loans, such loans become tradable and can be sold. This process is called loan securitisation. The technical term asset-backed securities (ABS) is often used for these securities. Owing to the nature of their collateralisation, asset-backed securities are classified as structured credit-related financial products and are used for transferring credit risks (counterparty default risks) to the capital market. As a result of the associated risk premium, asset-backed securities usually carry a higher interest rate. Usually, these securities are traded on securities exchanges.

Typical product characteristics

The issuer of a typical asset-backed security (true sale) is usually a special purpose vehicle that acquires assets from one or more asset sellers (asset pool). Selling an asset pool to the special purpose entity allows commercial banks or companies, for example, to refinance themselves for liquidity provision and/or portfolio optimisation. The special purpose vehicle (SPV), in turn, refinances itself by issuing various tranches of securities that are collateralised by the asset pool. The SPV usually has these tranches rated by a rating agency and offers them for sale to investors on the capital markets.

Many asset-backed securities are collateralised by bank loans; however, in principle, credit card receivables, trade receivables from companies, receivables from leasing contracts and other income-generating assets can also serve as collateral. Interest and principal payments to the securities holder are financed from the cash flows generated by the underlying assets (such as interest and principal payments on loans). Typically, a SPV will therefore pool receivables, in particular through tranching and binding payment sequences (“cascade”) for each tranche. In addition, collateralisation of the asset portfolio by third parties, especially credit insurers, can also be built into the securitisation structure to hedge the asset default risk. In addition, the special purpose vehicle is usually structured as a ring-fenced company that is neither legally, economically nor personally connected to the asset seller, arranger, or investor. The structural elements described can thus structurally reduce, but not eliminate, the risk that the securities may become worthless due to non-payment of interest and principal.

This product group also includes securities backed by residential mortgages (retail mortgage-backed securities (RMBS)), securities backed by commercial mortgages (commercial mortgage-backed securities (CMBS)) and all variants of so-called collateralised debt obligations (CDO). This product group does not include German Pfandbriefe and other so-called covered bonds, which are classified in the product group fixed income, fixed income funds and fixed income ETFs due to their specific collateralisation.

Material risks of the product group

By investing in these securities, investors benefit from return opportunities, but are also exposed to additional material risks. These include the following:

Credit risk - investors are exposed to the risk of default on the securitised assets in a securities issue and that any overcollateralization may not be sufficient to compensate for redemption shortfalls. In this case, investors receive a redemption amount below the nominal amount. The worst case is a total loss of the capital invested. Furthermore, redemption may be delayed beyond the maturity date.

Issuer risk - also referred to as default risk - when the issuer fails to meet its obligations or can only meet them in part, for example as a result of insolvency. Asset-backed securities issued by banks are subject to special regulations. If the issuing bank runs into financial difficulties, a regulatory intervention may result in a bailout of the bank, partial or total loss of the investment, or a compulsory conversion into equity, such as shares. As a general rule: The worse the credit rating of an issuer, the higher the default risk, but also the risk premium and the resulting yield. Bonds are generally not covered by deposit protection. Sustainability-related decisions relating to the environment, social aspects and corporate governance also impact on the issuer.

Interest rate and price risk - when interest rates rise, fixed income securities prices generally fall. A downgrade in the issuer's credit rating reduces the value of a bond during its term.

Liquidity risk - during the term, investors may not be able to sell the security or may only be able to sell it at a possibly much lower price.

Foreign currency risk - Investors are exposed to currency risk when investing in a foreign currency denominated security as performance could be adversely affected by exchange rate movements.

Early redemption and reinvestment risk - investors are exposed to the risk that the issuer may exercise an ordinary or extraordinary option to call the fixed income security at a time or in a financial market environment that is unfavourable for the investor, as the investor can reinvest the redemption amount only on less favourable terms.

Some bonds of foreign issuers have features not typically applied in Germany, which are specified in the terms and conditions of the security. This may result in additional risks.

The specific design of an asset-backed security varies and is documented in the respective issuing prospectus. We strongly recommend investors to read the relevant issuing prospectus to assess the specific opportunities and risks of this particular investment instrument.

Further information and costs

For further details on these aspects and the product, please refer to the relevant sales prospectus and/or basic information sheet, if available. In principle, inflation trends impact your investment performance. A resulting loss of purchasing power affects both the income generated and your capital invested. When acquiring, holding and eventually selling securities and derivatives, costs will impact returns. For further details, please refer to the respective cost information before entering into a securities transaction.

For further details on the characteristics and risks of the products, please refer to the brochure “Basic Information on Securities and Other Investments”.