

TRADITION AND INNOVATION THROUGH BERMUDA AVIATION ABS TRANSACTIONS

Significant structural changes to the ABS model have been implemented to enhance securitisation, provide greater liquidity and create major investment opportunities

Bermuda has been home to some of the most significant aircraft asset-backed securities (ABS) transactions of the past decade, including high-profile deals such as Elix Aviation Capital's Prop 2017-1 Ltd in 2017, and Start Ltd in 2018, the first aircraft portfolio purchase vehicle structure to include a dedicated asset manager for equity investors.

Until 2018, ABS transactions in the aviation sector followed a largely similar structure. The market has been busy since 2011, with 2017 seeing a record 14 ABS deals close and 2018 seeing a similar number.

However, investors have continued to seek value, which has resulted in some of the most significant structural changes to the traditional ABS model for some time.

These changes include: (i) the use of tradable E-notes in order to increase liquidity; (ii) deploying a dual-issuer structure to avoid the risk of the US withholding tax for non-US investors; (iii) appointing dedicated asset managers for equity investors in order to improve the sale outcome for the equity portion of the securitisation; and (iv) listing on the Bermuda Stock Exchange (BSX).

In terms of liquidity, the sale of equity notes/E-notes in aviation ABS transactions historically involved large investments that trade under strict confidentiality agreements. In traditional structures, the ABS E-note has been a large-denomination, relatively illiquid note that requires active management. This tended to attract private equity investors, but was less appealing to institutional investor finance.

Creating investment opportunities

For securitisation structures to be more attractive, markets have wanted them to be executed quickly and enable access to more liquid institutional investment on the equity side.

To achieve this, ABS transactions needed to employ liquid/tradable E-notes. In the Start transactions, these have taken the form of Reg S/144A securities which are able to trade in smaller minimum investment sizes of \$1.4m (£1.1m) minimum, with dealers able to make two-way markets and provide monthly marks.

Put simply, tradable E-notes are intended to create investment opportunities in the aviation market comparable with the way other structured products work, such as the collateralised loan obligation market.

If an ABS is structured with aircraft deriving US-sourced income being held in common with aircraft deriving non-US-sourced income with dividends

payable to US and non-US investors, a risk exists that dividends payable to non-US people may be subject to withholding tax.

To mitigate this risk, dual-issuer structures have been deployed. US-sourced income and US investors are ring-fenced in a US issuer, separate from non-US-sourced income and non-US investors.

Start Ltd implemented structures with a dedicated asset manager for equity investors, acting under a multi-year agreement on behalf of syndicated equity investors as an adviser to the board of directors. This increases and improves the quality of investor reporting, as the asset manager provides detailed monitoring of the aircraft portfolio and its performance.

The ultimate aim is to provide greater liquidity and increased value for the equity portion of securitisation transactions.

Stock exchange growth

The past few years have seen a steady acceleration in the number of new international debt listings on the BSX (a member of the World Federation of Exchanges), both through ABS and intercompany loan note transactions. Central to this growth is that the BSX is not bound by or subject to any European Union directives or regulations, including the EU market abuse regime.

Aircraft operating lessors and other issuers have been keen to take advantage of the BSX's favourable disclosure requirements and listing fee structure.

Standardisation of the ABS product has traditionally helped with investor familiarity and, indeed, the debt side of most ABS deals typically uses a familiar structure.

However, some of the highest-profile ABS deals of the past few years have shown that, even in a mature market, there is room for innovation to attract new investors, mitigate tax risk and provide greater liquidity.

The launch earlier this year of Start Ltd's successor, Start II Ltd, another Bermuda-domiciled issuer, showed the appetite which exists in the market for a product which takes the best of the traditional and innovative.



Neil Henderson,
director

CONYERS

Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda

Tel: +1 441 295 1422 E-mail: neil.henderson@conyers.com Web: www.conyers.com