Understanding Securitised Credit

August 2025

SFDR Article 8

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HSBC Asset Management | Opening up a world of opportunity

Contents

Current market conditions make Securitised Credit a compelling investment

Given current market conditions, Securitised Credit is a valuable addition to a portfolio for the following reasons:

- **Yield pick-up:** Securitised Credit offers a pickup in yield to similarly rated corporate bonds. This is largely the result of a complexity premium. **Adding Securitised Credit to a fixed income portfolio can enhance portfolio yield without increasing credit risk or duration**
- **Diversification:** Securitised Credit exhibits low correlation to traditional fixed income. **Adding Securitised Credit to a portfolio can therefore provide diversification benefits**
- **Low interest rate risk: Traditional fixed income portfolios** are exposed to **higher volatility from higher duration.** Securitised Credit has **typically much lower duration** as it is **largely floating rate**
- **What does this mean for investors?** In the current market environment in which volatility is expected to rise, **Securitised Credit** offers the opportunity **to reduce portfolio duration, income generation** and potentially benefit from **spread tightening**

Compelling valuations: Securitised Credit vs Fixed Income

- The three largest Securitised Credit sectors, CLO, CMBS and RMBS (see page 5 and 6 for sector definitions), account for approximately 70% of all Securitised Credit outstanding and can illustrate how Securitised Credit is **compelling** compared to similarly rated corporate bonds on a valuation basis

Spreads above Libor (bps)

Credit Rating	US CLOs	US SFR	US CMBS	US Corporates
AAA	130	90	120	64
AA	160	110	165	75
A	180	130	200	103
BBB	275	150	250	135
Duration	<1 year	<1 year	c.5 years	c.5 years

Securitised Credit & interest rates path

- As Securitised Credit is predominantly floating rate (approximately 83% of our Investment Grade strategy is invested in floating rate securities), **rising interest rates would directly increase the yield on those assets**
- As a naturally short duration asset class, **an environment of lower interest rates would not necessarily be negative as the products performance is not driven by duration, but by credit spreads tightening**
- **Recent interest rate cuts** could in fact **be positive for the broad Securitised Credit asset class** as from a credit perspective **this will support the underlying loans/mortgages** and can therefore make them **more affordable.**

The value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested. The level of yield is not guaranteed and may rise or fall in the future. Diversification does not ensure a profit or protect against loss. The views expressed above were held at the time of preparation and are subject to change without notice. This should not be considered as an investment advice.

Source: HSBC Asset Management, Bloomberg, 31 July 2025.

What is Securitised Credit?

- **Securitised credit**, also referred to as 'Securitisations', or 'Asset Backed Securities' (ABS) are **types of bonds**
- Unlike traditional bonds, Securitised Credit cash flows are generated from a specific **pool of collateral** backing the bond. There are several types of collateral used to back securitised credit. These include **residential mortgages, commercial mortgages, credit card receivables, auto loans and leveraged loans**
- **Securitised Credit is tranched**. This means that the priority of payments received from the collateral by investors depends on how senior their note is in the capital structure: **The most senior notes receive payments first and suffer losses last**, and consequently have the highest credit rating and pay the lowest coupon as they are deemed the least risky. The most junior bonds receive payments only when all notes senior have received payment, and suffer any losses first. These **junior tranches** are consequently **riskier, receive lower credit ratings, and pay more** to compensate for this risk
- Securitised Credit **is the largest class of floating rate fixed income**. The coupon is a spread above a reference cash rate such as SOFR. This means it has **less duration risk than corporate bonds**

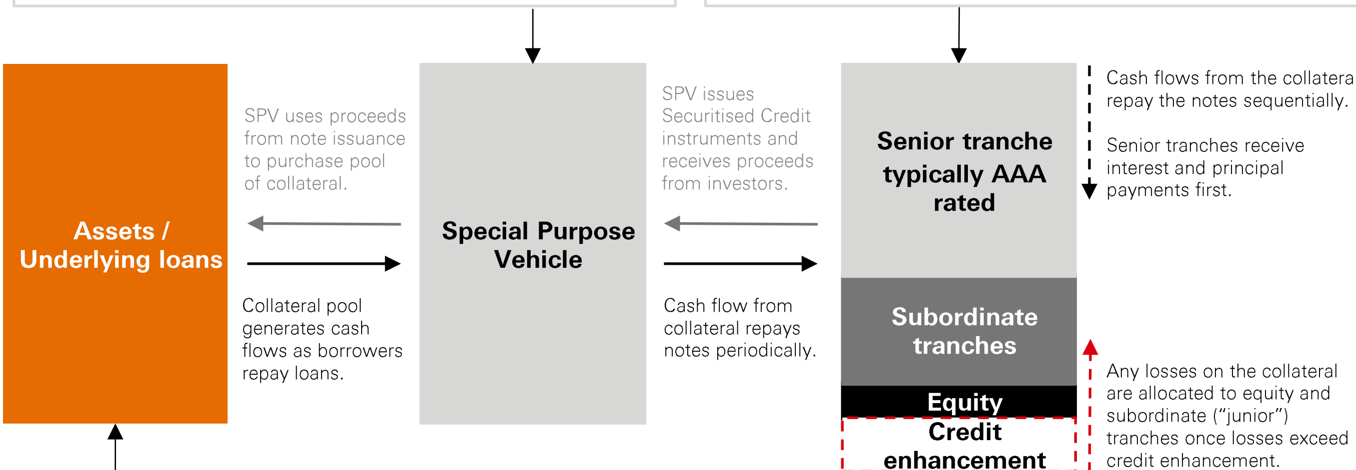
Understanding the structures

Special Purpose Vehicle (SPV)

- This is the **entity which purchases the collateral** and **issues the notes.**
- **Cash flows received** from the collateral **are used to pay the investors** periodically

Senior tranche

- This is the **most senior note** issued by the SPV
- Holders **receive interest and principal payments first**.
- This tranche is often assigned a **AAA credit rating** and **pays a lower spread** compared to the other tranches



Collateral

The assets that generate the cash flows to pay the notes are called the collateral. The main sectors types are:

- **RMBS** – backed by residential mortgages
- **CMBS** – backed by commercial mortgages
- **CLOs** – backed by leveraged loans
- **Student Loans** – backed by student loans
- **Consumer ABS** – includes ABS backed by credit card receivables, auto loans and other personal loans

Subordinate tranches, Equity and Credit enhancement

- **Subordinate tranches**: receive interest and principal payments from the collateral once the senior tranches have been paid
- **Equity tranche:** this is the **riskiest part of the capital structure** - equity holders receive all excess cash flows once all the senior and subordinate tranches have been paid. They are unrated
- **Credit enhancement: structural features which provides a cushion against collateral losses** before investors begin to suffer losses

Source: HSBC Asset Management, 31 July 2025.

What are the potential benefits of Securitised Credit structures?

Securitised Credit offers investors diversified exposure to less liquid, harder to access asset classes and allows them to choose how much risk they take on

- **Access:** Securitised Credit enables investors to gain exposure to asset classes that are difficult for investors to access directly, such as residential mortgages, which are originated by banks
- **Diversification:** Securitised Credit instruments are generally backed by large quantities of underlying loans, meaning that investors receive the systematic risk and reward profile of the illiquid assets that make up the collateral
- **Risk and reward preference:** This is the purpose of the tranched structure. Investors in Securitised Credit can select how much risk they would like exposure to through which tranche they choose to invest in. Investors in the senior tranche are exposed to relatively less risk and therefore lower returns, as they receive interest and principal payments from the collateral first, and only suffer losses once the junior tranches have defaulted. Investors in the subordinate tranches are exposed to more risk, but greater return, as the tranches effectively provide 'leveraged' exposure to the collateral – they receive a higher spread to reflect the higher risk of missed payments

What are differences between Securitised Credit and bonds?

Bonds

- Generally, **coupon payments are fixed rate** and paid periodically and principal paid at maturity
- **Cash flow** to repay bonds generated **from issuer's underlying business activity** (e.g. HSBC will pay its bonds from revenue generated)
- **Maturity dates are usually fixed**, with all the principal received on the maturity date
- Untranched – **all holders of the bond** receive payments and **suffer losses equally**
- Credit rating depends on ability of the issuer to repay the bond

Securitised credit

- **Coupons tend to be floating rate,** offering a margin above a reference rate (e.g. SOFR), paid periodically
- Cash flows to pay notes (each tranche) **generated from underlying collateral** (e.g. the repayments on mortgages)
- Life of the security depends on collateral characteristics such as principal prepayment and default rates and structural features such as call/refinancing options. **ABS are often amortising**, meaning that principal is repaid over the life of the instrument
- **Tranched** – note holders receive payments and suffer losses depending on how senior their note is
- **Credit ratings for each tranche depends on the tranche's probability of suffering losses**, which depends on underlying collateral and structure of the securities (e.g., how much credit enhancement there is to protect against losses)

Source: HSBC Asset Management, AFME, SIFMA, Australian Statistics Bureau, Reserve Bank of Australia, JPMorgan and Wells Fargo, 31 July 2025.

The difference between Agency MBS and Securitised Credit

Securitised Credit in this context means private label securities subject to credit risk. These are not the same as the much larger, well known Agency MBS market, which is sponsored by the US government and largely fixed rate. The key differences are:

- **Private vs government sponsored:** Securitised Credit are instruments that are backed by cash generating assets, such as mortgages or bank loans. MBS ("Mortgage-Backed Securities") are bonds that have explicit/implicit guarantees by the US government sponsored agencies such as Fannie Mae, Freddie Mac and Ginnie Mae
- **Fixed vs floating rate:** MBS generally pay a **fixed rate coupon**. Securitised Credit conversely, is largely **floating rate**
- **Credit risks:** MBS guaranteed by agencies such as Fannie Mae, Freddie Mac and Ginnie Mae are considered obligations of the US government regardless of defaults on the underlying collateral pool. This means that there is **almost no credit risk** when investing in agency MBS. In contrast, investors in Securitised Credit are exposed to potential losses if there are defaults in the underlying collateral that exceed credit enhancements, and are therefore rewarded for this risk
- **MBS risks:** The key risk is **interest rate risk.** MBS is particularly vulnerable to rising interest rates for two reasons: As interest rates rise, MBS prices will, all else equal, fall because they are fixed rate securities. Secondly, when interest rates rise, the **rate of repayment** in the underlying mortgage pool lengthens the maturity of the bond, which can further exacerbate the price fall
- **We do not invest in Agency MBS. We only invest in 'private label' securitised credit**

	Securitised credit	Agency MBS
Credit risk	Yes	Low
Fixed vs floating	Mostly floating	Mostly fixed
Currencies	USD, EUR, GBP, AUD and some others	USD only
Outstanding	USD 4trn	USD 11trn

Securitised Credit Sectors

Securitised Credit consists of several sectors. Sectors of Securitised Credit are differentiated by the nature of the underlying financial assets. These are defined by the collateral backing the bonds. The main sectors are:

Collateralised Loan Obligations (CLO)

- **Collateralised Loan Obligations** are Securitised Credit that are **backed by a diversified pool of corporate loans**
- Unlike other structure credit sectors, CLOs are **actively managed**. This means the CLO manager buys loans over the life of the CLO as existing loans repay. The **ability of the CLO manager in selecting loans is an important component** of the CLO's performance
- **CLOs are the largest Securitised Credit sector**, accounting for approximately 31% of all Securitised Credit outstanding globally[1]

Residential Mortgage Backed Securities (RMBS)

- The underlying **collateral is mortgage loans** issued by banks and other financial institutions to fund residential property
- Agency RMBS is backed by government agencies such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporate (Freddie Mac)
- **Prime RMBS** is backed by mortgages that are **issued by well-known high street banks**, whereas non-conforming RMBS is issued by more niche banks or to borrowers with special conditions e.g. first time borrowers
- As homeowners pay their mortgages, these cash flows are passed through as interest and principal repayments to RMBS holders
- RMBS account for approximately 25% of all Securitised Credit outstanding globally[1]

Source: HSBC Asset Management, (1) AFME, SIFMA, Australian Statistics Bureau, Reserve Bank of Australia, JPMorgan and Wells Fargo, 31 July 2025.

Commercial Mortgage Backed Securities (CMBS)

- **The underlying collateral is commercial property mortgage loans** issued by banks and other financial institutions
- This property may include **housing developments, hotels, factories, shopping centres and office buildings**
- The pool of loans **may be to one large borrower**, or to fund a variety of smaller projects
- Unlike other Securitised Credit sectors which are floating rate, **CMBS can be both floating and fixed rate**
- CMBS accounts for approximately 19% of all Securitised Credit outstanding globally[1]

Consumer ABS

- **The typical underlying collateral are credit card receivables, auto loans and other personal loans**
- Consumer ABS collectively accounts for around 18% of all Securitised Credit outstanding globally[1]

Student Loan ABS (SLABS)

- This is ABS backed by loans made to **finance university degrees**. The underlying loans can be either privately originated loans or government backed loans
- SLABS accounts for around 3% of all outstanding Securitised Credit globally[1]

Whole Business Securitisation (WBS)

- The underlying collateral is **cash flows generated by business operations**
- The underlying company is able to continue with its business operations as usual
- WBS accounts for around 4% of all outstanding Securitised Credit globally[1]

What drives Securitised Credit valuations?

Securitised Credit valuations are driven by some of the same factors that drive other credit instruments as well as factors unique to Securitised Credit, and unique to sectors within Securitised Credit:

- **Credit conditions:** As with traditional corporate bonds, Securitised Credit valuations depend on credit conditions in the wider economy. When credit conditions are strong, it is expected that borrowers will repay their loans, meaning default rates on the collateral is expected to be low, consequently supporting valuations. When credit conditions deteriorate, loan defaults are expected to increase and therefore prices fall to reflect this risk. However, different tranches react differently, with senior tranches exhibiting less volatility than junior tranches given they are less exposed to defaults than the junior tranches
- **Fundamentals:** Factors affecting the underlying collateral will drive Securitised Credit valuations. For example, if a residential mortgage-backed security is highly exposed to property loans from a particular geographic region and house prices are falling in that region, the RMBS will likely fall in price to reflect the increased risk of defaults
- **Interest rates:** Unlike traditional fixed income, **Securitised Credit is largely floating rate.** This means that there is no rates effect on prices as with traditional bonds. However, as the coupon is linked to interest rates, as rates rise, the total return from coupons can increase. Whether price changes depend on the impact the change in rates will have on the underlying; rising rates can increase the probability of default within the collateral pool and therefore increase the risk of the Securitised Credit security
- **Structural Features:** These include the level of credit enhancement within the bond, which support prices as they reduce the chance of default, embedded call options which can put a ceiling on the price, and the details that govern how principal and interest from the collateral flow from the senior to junior tranches which impact relative valuations

Source: HSBC Asset Management, (1) AFME, SIFMA, Australian Statistics Bureau, Reserve Bank of Australia, JPMorgan and Wells Fargo, 31 July 2025.

The market has evolved since the crisis

- Following the financial crisis, Securitised Credit received a reputation for being 'toxic' following widespread defaults in the US housing market and the subsequent losses suffered by holders of US sub-prime RMBS and CDOs (Securitised Credit in which the collateral consists of other Securitised Credit instruments, including sub-prime RMBS).

- The entire asset class was tainted as a result, with investors perceiving all Securitised Credit sectors to have suffered extensive defaults and losses. This is not true.

- US sub-prime RMBS (securities backed by mortgages to poor quality borrowers) and ABS CDOs did suffer extensive defaults, other sectors performed much better:

Global Structured Finance Losses: 2000 – 2018 Issuance

	Prime RMBS		Non-conforming RMBS		Leverage Loan CLO		CDO	
	US	EMEA	US	EMEA	US	EMEA	US	EMEA
Expected future loss	0.4%	0.1%	**1.4%**	0.5%	0.1%	0.0%	**31.7%**	**1.1%**
Loss realised to date	2.1%	0.0%	**6.0%**	0.0%	0.1%	0.1%	**22.8%**	**7.9%**
TOTAL	2.5%	0.1%	**7.4%**	0.5%	0.1%	0.1%	**54.5%**	**8.9%**

Fitch Ratings, Global Structured Finance Losses: 2000 – 2018 Issuance, Special Report. EMEA 2019.

	CMBS		Commercial ABS		Student Loan ABS	
	US	EMEA	US	EMEA	US	EMEA
Expected future loss	0.9%	0.3%	2.6%	0.1%	0.7%	-
Loss realised to date	2.5%	2.9%	0.5%	0.0%	0.0%	-
TOTAL	3.4%	3.2%	3.2%	0.1%	0.7%	-

Fitch Ratings, Global Structured Finance Losses: 2000 – 2018 Issuance, Special Report. EMEA 2019.

- As shown above, the losses were largely concentrated in US residential mortgages and CDOs. Other sectors have performed robustly, with CLOs in particular exhibiting strong performance – no AAA or AA rated CLO tranche has, to the best of our knowledge, ever defaulted.

- The result of the **poor performance of sub-prime RMBS reflected the "originate to distribute" model adopted by banks**, the poor-quality collateral backing the bonds, and the conflicts of interest and flaws inherent in the way the ratings agencies assessed these bonds.

- This has however **resulted in regulators and policymakers paying attention to the entire industry and passing extensive legislation** that has resulted **in greater investor protections and has improved transparency**, consequently allowing for a more informed perception of risk. Changes in regulation and legislation include:

    - **Risk retention and alignment of interests:** One of the reasons for the poor quality of collateral in pre-crisis sub-prime RMBS was that many lenders adopted an "originate to distribute" model whereby loans were made with the intention to sell into securitised credit. The lenders therefore had no incentive to monitor the quality of the loans. **EU and US regulation now require sellers to maintain a 5% or more stake in all new issue securitised credit**. Such rules that encourage **'skin in the game'** align interests.

    - **Ratings agencies:** One of the key areas of focus from the crisis was the role played by rating agencies. **New regulations have been introduced** to require multiple ratings, rotation of rating agencies for more complex deals and extra disclosure with an aim of encouraging new rating agencies to emerge. **Transparency of rating methodologies has been improved** and almost all **rating methodologies for Securitised Credit have been updated**. This has resulted in simpler structures and increased subordination required to support a given rating. **Issuers/sponsors will also be required to disclose substantially more information** in relation to new transactions regarding cash flows, deal structure and quality of the collateral, which will better help investors to evaluate the risks of deals.

Source: HSBC Asset Management, Fitch Ratings.

Why HSBC Asset Management?

Significant Resources	◆ 11 dedicated specialists whose sole focus is Securitised Credit research and client investment ◆ Investment Forum over 34 years experience each and worked together at HSBC for over 20 years ◆ Sector specialisation and a focus on credit research are critical for success ◆ Proprietary systems are essential to monitor positions continuously and process available data efficiently ◆ ESG integration: rated by the PRI in September 2020
Market Access	◆ USD 10.3bn Securitised Credit AUM ◆ The size of our platform and the market standing of our team gives us access to full deal flow ◆ Accessing such a wide range of investment opportunities and trading flows is not easily replicated in the Securitised Credit sector
Accessing Global Relative Value	◆ A dynamic, global approach is key to unlocking this asset class's potential ◆ We invest in all major Securitised Credit sectors and do so "globally" from one platform in London ◆ This allows us to move to where we find compelling opportunities ◆ Where a local or specific capital treatment is required we can tailor solutions to meet clients' needs

Portfolio Construction

- **We usually produce very different allocations across sectors and regions versus more regionally biased strategies**
  - European managers tend to be very UK and EU centric allocations and US managers are very focused in the US, in such areas as legacy non-agency RMBS
  - Opportunities in Securitised Credit move regularly and HSBC adopt a globally dynamic, relative value approach to unlock these opportunities
  - All of this plays to a holistic approach to allocation based on a true evaluation of the relative risks and returns of the different sectors
  - We have no legacy agency RMBS or exposure to CDOs
- **We believe this differentiates us from those focused on either US ABS or European ABS**
- **We believe we can provide clients with a diversified portfolio of quality global Securitised Credit which are aimed at providing compelling returns**

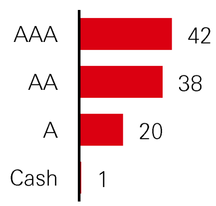
The value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested. The views expressed above were held at the time of preparation and are subject to change without notice. This should not be considered as an investment advice.

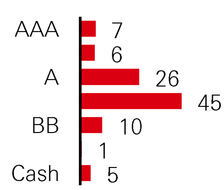
Source: HSBC Asset Management, 31 July 2025.

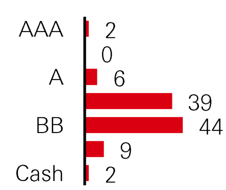
Overview of Securitised Credit strategies

Source: HSBC Asset Management, 31 July 2025.	Investment Grade	Flexible	High Yield
Investment Universe	Investment Grade Securitised Credit	Predominantly BBB or BB rated Securitised Credit	Predominantly non-investment Grade Securitised Credit
Strategy AUM (USD)	4,636m	1,586m	173m
Average credit quality	AA	BBB+	BB+
Duration	0.6 year	0.7 year	0.6 year
Spread duration	2.7 years	3.4 years	3.7 years
Yield to Maturity	5.3%	6.4%	7.6%

Rating Distribution (%)

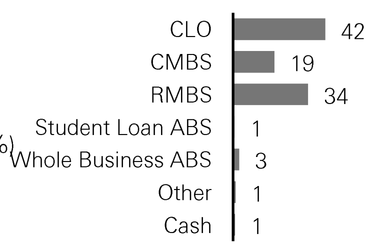


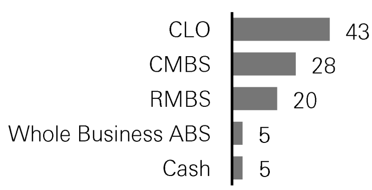


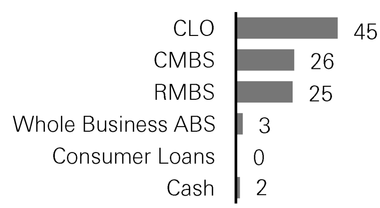


Geographic Distribution (%)

Sector Distribution (%)







Past performance does not predict future returns. The level of yield is not guaranteed and may rise or fall in the future.
Source: HSBC Asset Management, 31 July 2025. Weightings, holdings, distributions and characteristics are subject to change without notice. Each portfolio may differ due to client restrictions and guidelines. Individual results will vary. Ratings are an average of S&P, Moody's, Fitch, DBRS and Kroll. Cash includes actual cash, liquidity fund investments and contributions to NAV from FX forwards. Totals may not add up to 100% due to rounding. The strategies are denominated in USD. Returns and Costs may vary with fluctuations in the exchange rate.

The value of investments and any income from them can go down as well as up and investors may not get back the amount originally invested.

- **Interest Rate Risk:** As interest rates rise debt securities will fall in value. The value of debt is inversely proportional to interest rate movements.
- **Counterparty Risk:** The possibility that the counterparty to a transaction may be unwilling or unable to meet its obligations.
- **Credit Risk:** Issuers of debt securities may fail to meet their regular interest and/or capital repayment obligation. All credit instruments therefore have the potential for default. Higher yielding securities are more likely to default.
- **Default Risk:** The issuers of certain bonds could become unwilling or unable to make payments on their bonds.
- **Emerging Markets Risk:** Emerging markets are less established, and often more volatile, than developed markets and involve higher risks, particularly market, liquidity and currency risks.
- **Exchange Rate Risk:** Investing in assets denominated in a currency other than that of the investor's own currency perspective exposes the value of the investment to exchange rate fluctuations.
- **Investment Leverage Risk:** Investment Leverage occurs when the economic exposure is greater than the amount invested, such as when derivatives are used. A Fund that employs leverage may experience greater gains and/or losses due to the amplification effect from a movement in the price of the reference source.
- **Asset Backed Securities (ABS) Risk:** ABS are typically constructed from pools of assets (e.g. mortgages) that individually have an option for early settlement or extension, and have potential for default. Cash flow terms of the ABS may change and significantly impact both the value and liquidity of the contract.
- **Derivative Risk:** The value of derivative contracts is dependent upon the performance of an underlying asset. A small movement in the value of the underlying can cause a large movement in the value of the derivative. Unlike exchange traded derivatives, over-the-counter (OTC) derivatives have credit risk associated with the counterparty or institution facilitating the trade.
- **High Yield Risk:** Higher yielding debt securities characteristically bear greater credit risk than investment grade and/or government securities.
- **Liquidity Risk:** Liquidity is a measure of how easily an investment can be converted to cash without a loss of capital and/or income in the process. The value of assets may be significantly impacted by liquidity risk during adverse markets conditions.
- **Operational Risk:** The main risks are related to systems and process failures. Investment processes are overseen by independent risk functions which are subject to independent audit and supervised by regulators.
- **Sustainability Risk:** Sustainability risk means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment.

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