

EMF ECBC



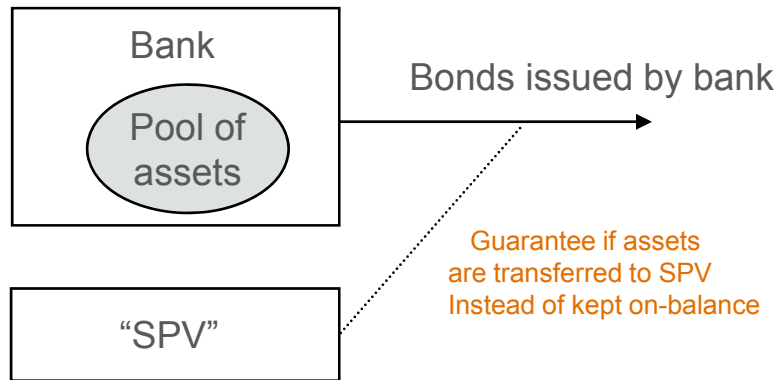
EUROPEAN SECURED NOTE

October 2016

Potential Structures (1/2)

Direct On-balance Issuance

Used for CBs in Germany, Spain, Denmark, Cyprus, Belgium (on-balance) and UK, NL, CAN, AU (SPV)



Key characteristics

- Bank issuing bonds and asset segregation on-balance or in SPV (true sale/pledge or use of collateral directive)
- Double recourse to bank and cover pool of assets
- Specific register or pledge on pool of assets
- Investors have preferential claim over pool

Implications

Advantages

- Simple structure, easy to understand (comparable to CBs) with direct double recourse as bank is issuer
 - No need to transfer assets to a different entity
- If on-balance sheet segregation with register is not feasible, assets can be transferred to legally separate entity SPV (via sale/pledge or using collateral directive)
 - SPV will need to be able to provide guarantee legally
- Most activities remain at Bank (Issuer/Originator) level

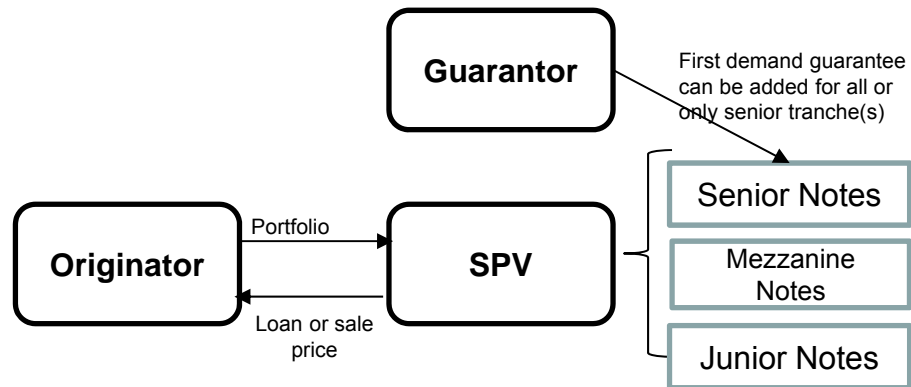
Potential disadvantages

- On-balance sheet option substantial may require changes to bankruptcy, security law in order to avoid challenges from other creditors and conflict with existing negative pledges (collateral directive could allow to circumvent this problem)
- Segregation of assets and swaps on-balance may not be possible in certain countries in current legal set up

Potential Structures (2/2)

Off-balance ABS-like structure (potentially guaranteed)

Single and dual recourse possible (by adding guarantee)



- Transfer of assets to SPV via true sale, pledge or secured loan (similar to STS ABS)
- Guarantee can be added from originator or a supranational (ie EIF) covering senior or all notes

Implications

Advantages

- Can be single (only recourse to assets) or dual recourse (also to originator or guarantor) structure
- On-balance double recourse as well as off-balance feasible
- Major changes in the current regulatory/legal framework only needed in order to streamline and harmonise structures in different countries (for example by uniformisation of collateral directive in Europe)
- Potential capital relief and even deconsolidation purpose possible
- The Senior Notes can be placed to investors and are expected to be REPO eligible with the Eurosystem/bilateral financing
- **Potential disadvantages**
- Few guarantors meeting the criteria and potential costly guarantee
- Limited amount of volume of guarantees

Common Preferred Features and Potential Pitfalls

Common main features of a successful structure

- Robust Legal framework and structure
- Dual recourse possible
- Bankruptcy remoteness of the segregated assets
- Dynamic nature of the assets' pool
- Robust internal/external monitoring
- Uniform/consistent nature of the underlying segregated assets
- Sensible degree of transparency on structure and assets' pool
- Comparable structures

Blocking factors to avoid

- Vagueness on post default structure functioning and supervision
- Limited/insufficient commitment by the local national supervisor
- Assets' eligibility criteria either too strict or too loose
- Weak ALM and liquidity management requirements
- Common name for this product - e.g. ESN – EU wide and comparable structures with certain regulatory support (repo, LCR) would help pricing

Further Desirable Features and Regulatory Treatment

Other main features to be considered

- Banking issuer (rather than a SPV)
- A dual recourse concept reflecting the triggering of the recourse to assets' pool following the default of the issuing bank
- UCITS compliance

Liquidity/prudential treatment

As a result of the above mentioned proposed quality features the product should be:

- Eligible for central banks' refinancing operations (even if with haircut/markdown set at an appropriate level versus covered bonds)
- Eligibility for LCR and NSFR (even if within a cap and a haircut set at an appropriate level versus covered bonds)
- Preferential prudential treatment for investors (again at an appropriate level versus covered bonds)
- Not subject to bail-in

Further Desirable Features and Regulatory Treatment

Eligibility as Eurosystem collateral

- Creation of a new asset class in the Eurosystem's collateral framework
 - Publication of the Orientation ECB/2015/27
- DECCs (Debt instruments backed by Eligible Credit Claims):
 - Claims must be eligible as Eurosystem collateral on an individual basis;
 - Dual recourse feature vis-à-vis: (i) the credit institution that is the originator of the underlying credit claims (ii) the underlying credit claims themselves
 - Loan-by-loan data reporting through the European DataWarehouse (EDW)
- Replicability feasible across all euro area jurisdictions
 - The DECC asset class offers a clear pattern for new ESN issuers

ESN Roadmap



Preliminary discussion on eligibility criteria

Criteria	ESN eligibility criteria proposal
SME/Borrower	<p>SMEs are defined according to the Commission Recommendation of 6 May 2003. Eligibility status can be extended to small mid-caps (companies with less than 500 employees)</p> <p>It is necessary to define when the SMEs requirements have to be verified to comply with eligibility criteria.</p>
Type of asset	<p>All exposure to SMEs is eligible. This includes, but not limited to, loans, working capital facility, overdraft, leasing and factoring.</p> <p>In a second stage, it will be necessary to define the eligibility criteria for other type of asset, such as:</p> <ul style="list-style-type: none"> a) Ship loans, exposures only with LTV below 60%; b) Corporate bonds, financial promissory notes and similar securities; c) ABS with: <ul style="list-style-type: none"> - underlying assets relative to SMEs and to the above exposures non-less than 90% of the pool. - risk weight, under SA, ≤ 50%
Quality standard	In general terms, loans should be performing at the transfer date. Afterwards, past-due loans should be sterilised from the eligible cover pool
Country and currency	EU28 – EURO and other EU currencies
Integration of the covered pool assets	<p>It must be defined which kind of assets may be allowed as integration assets.</p> <p>Once these assets are defined we shall propose the limits for the integration assets within the covered pool (given the expected wal of the eligible assets, we expect a level higher than 15% of the cover pool)</p>
Monitor and reporting	An external asset monitor should audit issuance and testing activity, at least annually, the consistence of the pool by “agreed upon procedures”. The asset monitor should report to the competent public Authority



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