ANNEXE 1

Rapport sous-groupe structuration (traduction en anglais)

« Using securities for mobilizing credit claims »

In answer to a market demand, a project is currently being set up by the French financial community in order to allow the mobilization of eligible credit claims in the form of securities. In order to implement this project, working groups involving market participants and Banque de France have been set up in order to design the scheme. This document, which is produced by the working group in charge of defining the structure of the envisaged scheme, provides the main features of the securities issuance framework. This document will also be used as a basis for promoting the acceptance of the new securities as eligible collateral by the Eurosystem.

In parallel of the Eurosystem's analysis, the project is going to enter into an implementation phase with a view to perform the first issuance of securities in the course of 2013 (Q3 currently targeted). This requires the finalization of term sheets on which basis private tenders will be launched for the selection of a Legal counsel firm, depository, management company, account holder etc...

In order to meet this target, the scheme is expected to be as simple and transparent as possible, as well as sufficiently robust and risk-adverse to cope with the Eurosystem requirements for eligibility purposes. In that respect, depending on the Eurosystem analysis, some features of the envisaged scheme may need to be adapted in order to meet the Eurosystem eligibility requests. The main features of the scheme are presented below.

The design of the scheme aims at keeping it simple, transparent and robust. The simplicity and transparency objectives aim at avoiding the introduction of biases in the transformation of eligible credit claims into securities, so that securities' holders – incl. Eurosystem's NCBs - can benefit from the same guarantee as if they had directly received the credit claims as collateral. The goal of the scheme is to be robust by ensuring that adequate measures are foreseen and implemented to address default situations and protect securities' holders in case such default is ever materialized.

1. Features of the issuance

Basically, the issuance process will rely on a single Special Purpose Vehicle (SPV) composed of several compartments. Each participating financial institution will have its own compartment[1] for its own issuance. This process will rely on the collateralization of the credit claims in favor of the relevant compartment and on the issuance of the corresponding securities by the considered compartment.

In particular, regarding the composition of the underlying portfolio of the issuance, the instrument will be featured as follows:

- Underlying claims will be fully compliant with the current standard Eurosystem collateral eligibility criteria (excluding ACC), which are defined in the Eurosystem General Documentation (possible requirements that may apply to the new instrument can be found in Annex A);
- Underlying credit claims will be assigned as security interest by the originator as a guarantee to an intermediary loan, provided by an intermediary bank to the originator, which is assigned to the SPV's compartment. Therefore, the underlying credit claims are assigned as security interest to benefit of the SPV's compartment;
- Underlying credit claims will be pledged twice a week to the dedicated compartment of the SPV (by a cancel and replace mechanism) in order to allow the pledge of credit claims which have very short term maturity and protect the Eurosystem against risks of anticipated reimbursement of the credit claims (identical to the current framework currently in place for the mobilization of credit claims with Banque de France);
- A minimum compulsory overcollateralization of the portfolio will be defined. The overcollateralization of the underlying portfolio will depend on the credit claims composing the portfolio and on the haircut applied on the issued securities (see also annex B). The portfolio characteristics will be detailed in the legal documentation along the lines described below. At this stage, it is foreseen that:
  - In case the portfolio is exceeding the minimum overcollateralization requirement, the financial institution will be allowed to issue additional securities;
  - In case the portfolio does not meet the minimum portfolio overcollateralization requirement, the financial institution will either have to (i) anticipate the reimbursement of some securities, or (ii) add cash to compensate the lack of credit claims in order to keep the securities eligible. In that respect, it is reminded that a minimum overcollateralization of the portfolio will be a critical criterion for

[1] See below, possibility for an institution to have several compartments.

Eurosystem's eligibility.

As far as the securities issued by the dedicated compartment are concerned, they will be featured as follows:

- The securities will be guaranteed by the credit claims (included drawn credit lines) pledged to the compartment, i.e. by the whole portfolio of credit claims pledged to the considered dedicated compartment of the SPV ;
- The securities will be *pari passu* bonds (with possible refinement of the bonds features per compartment) in order to allow the issuance of securities with different expected maturities;
- The instrument will allow securities having different expected maturities (in that respect, it is likely that the legal maturity of the securities will be probably longer and will in any case depend on the maturity of the underlying credit claims);
- The features of the securities will match (including in terms of expected maturity) with the features of the collateralized loans transferred to the dedicated compartment of the SPV, i.e. each security issued :
  - will have exactly the same features (e.g. interest rate, expected maturity) as the corresponding collateralized loan;
  - will not include any interest rate swaps nor FX swaps (or any kind of derivatives instrument);
- The securities will be *pari passu* (i.e. no tranching) ;
- The securities will all be accelerated (monthly frequency and variable interest rate) in case of (i) default of the institution having provided the credit claims or (ii) of default/acceleration of one of the securities issued (cross acceleration clause).

Should a credit institution be willing to issue securities specialized per type of underlying credit claims, e.g. securities based on SME credit claims only, the considered credit institution should open one dedicated compartment per type of security (i.e. per risk profile). This would ensure that the risk profile of the securities is correlated to the risk profile of the underlying collateralized loan (and underlying credit claims). However, within each compartment, the credit institution will have the possibility to issue different securities featured by different maturities and rates.

Finally, the legal documentation will ensure that:

- the holder of securities, which are issued by a dedicated compartment will have a dual recourse, i.e. both on the underlying portfolio and on the financial institution (i.e. the creditor) ;
- In case of default of the credit claims servicer, a back-up servicer will have to be appointed. The obligation to appoint a back-up servicer in case of default of the initial servicer will be specified within the contractual documentation as a key element to protect the securities holders (i.e. trigger events);
- each shareholder will provide cash when setting up the SPV so that the latter will be able cover 6 months of operating costs (i.e. costs of the asset manager, account holder, depository, external auditor etc...) ;
- Regarding cash accounts, Banque de France is currently investigating the possibility to open the account within its books[2] in order to ring-fence the scheme against risks of a cash account holder default.

In that respect, it should be highlighted that the legal documentation will be standardized and will apply to all compartments of the vehicle. This contractual standardization will ensure the robustness of the scheme and the protection of the securities holder. For this purpose, the contractual documentation (which is going to be prepared in the upcoming phase of the project), will of course be designed in order to integrate *ab initio* the Eurosystem's requirements with a view to comply with the Eurosystem's permanent collateral eligible framework and hence protect the Eurosystem against default risks.

2. Credit assessment and calculation of the collateral value

Credit assessment and eligibility check of the underlying credit claims

Once the credit assessment methodology proposed below will have been endorsed by the Eurosystem, it is proposed that the asset manager should be entrusted with most of the eligibility and credit assessment related tasks (similarly to triparty repo services). The asset manager will be regulated and subject to supervision from authorities (see below).

The following credit assessment methodology is proposed. The credit quality of the instrument will be assessed by transparency, that is to say directly by assessing the credit quality of the underlying

[2] If Banque de France were not the cash account holder, in case the cash account holder would eventually belong to the banking group of the creditor credit institution, the contractual arrangement will identify a substituting institution in order to guarantee the segregation of accounts in case of the default of the creditor.

portfolio just as if the underlying credit claims were directly posted as collateral under the permanent framework.

This credit assessment methodology will rely on the ECAF sources as it is currently the case under the permanent framework, i.e. the vehicle will rely on ICAS and/or approved IRB and/or PSE ratings.

On the basis of the information retrieved from its central bank's ICAS (or from the IRB of the relevant banks), the asset manager will identify the Credit Quality Steps[3] (CQS 1 / CQS 2 / CQS 3) of the credit claims. For each credit claim, on the basis of the information transferred by the credit institution to the SPV, the asset manager will also determine the maturity bucket (0-1 year / 1-3 years / 3-5 years / 5-7 years / 7-10 years / >10 years) and the interest rate types (fixed / floating). This information will allow the asset manager calculating the minimum overcollateralization and checks that it is met.

All the eligibility checks and credit assessment activities performed by the asset manager will be submitted to a strict control:

- these collateral management activities (i.e. checks on credit claims etc…) will be performed according to an outsourcing agreement comparable to the outsourcing agreement already in place for the triparty repo services;

- the asset manager will be a distinct institution from the credit institutions involved in the scheme ; it will be submitted to the regulation and control of the local Securities and Market Authority;

- the asset manager will transfer detailed information on the credit claims composing the portfolio to its local central bank, in order to allow the latter performing additional *ex post* controls if necessary; the transmission of such information through a standardized template will ensure a high level of transparency (inspired from the spirit of the loan-by-loan approach);

- finally, the asset manager will have to be submitted to the control of an external auditor.

[3] http://www.ecb.int/paym/coll/risk/ecaf/html/index.en.html

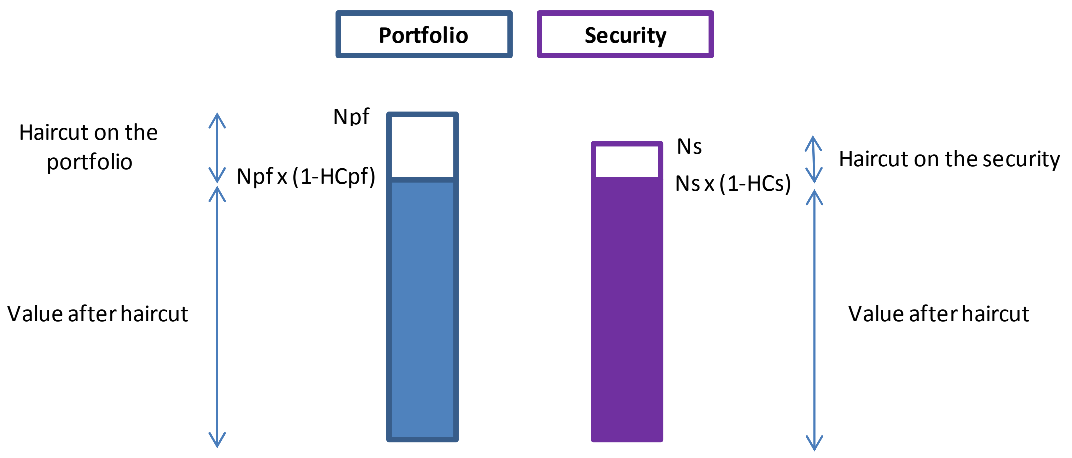
Calculation of the collateral value (value after haircuts) and minimum level of underlying over collateralisation

In order to avoid arbitrage opportunities between a direct pledge of the credit claims to the NCB and a pledge of the security, the value after haircuts of the issued security will be equal to the value after haircuts of the underlying credit claims. The scheme will rely on the following hypotheses:

- The haircut applied to the security is fixed at x% (x being strictly positive);
- The underlying credit claims are haircut according to the existing haircut schedule;
- The value after haircuts of the security should be equal to the value after haircuts of the portfolio.

Therefore, as the haircut on the security is strictly positive, the legal documentation of the vehicle will stipulate which minimum level of over-sizing is required (see diagram below).

EQUIVALENCE BETWEEN THE VALUES AFTER HAIRCUTS OF THE PORTFOLIO AND THE SECURITY



Legend: Npf : notional of the underlying portfolio;

Ns : notional of the security;

HCpf : haircut of the portfolio (sum of the haircuts applied to every underlying credit claim);

HCs : haircut of the security (fixed haircut).

As the value after haircuts of the portfolio has to be at least equal to the collateral value of the security, the minimum over-sizing of collateral has to be the maximum of (i) 100% [4]and (ii):

$$(ii) = \frac{\mathrm{Npf}}{\mathrm{Ns}} = \frac{(1 - \mathrm{HCs})}{(1 - \mathrm{HCpf})}$$

The asset manager will calculate the minimum overcollateralization – on the basis of the credit quality distribution of the portfolio and of the haircut schedule for credit claims - and check that the minimum overcollateralization level is reached.

3. Corporate structure and governance of the Special Purpose Vehicle

The corporate structure and governance of the common special purpose vehicle are expected to be as simple as possible, in order to promote transparency and neutrality. The shareholding will be opened to any eligible counterparty for Eurosystem monetary policy operations and each stakeholder will have the same number of shares. Regarding stakeholders' rights, stocks' features should be as simple as possible. As regards governance, the governance structure will aim at ensuring neutrality (e.g. the Board can be composed of a limited number of experts appointed *intuitu personae,* i.e. not representatives of the institutions providing the credit claims). The Board will also include a representative of the asset manager who can be appointed as CEO of the SPV (hence contributing to increase the independency of the management of the SPV vis-à-vis the banks issuing the securities).

[4] A minimum of 100% has been introduced to ensure that no under-collateralization is allowed. Without this requirement, this case could happen if the underlying credit claims are of very high quality and therefore have a very low average haircut (HCpf) which could be lower than that of the security (HCs) and therefore could imply an overcollateralization of less than 100%.

Annex A – Possible requirements applicable to the new instrument and comparison with ABS and Individual credit claims

This table is a working option that needs to be confirmed on the basis of the Eurosystem's analysis of the instrument's eligibility.

	Use of securities to mobilise credit claims	ABS	Individual credit claims
Asset type	Possible classification as a non-marketable asset within the General Documentation – but criteria to be defined based on Eurosystem's assessment.	Debt instruments (securities) with a coupon that cannot result in a negative cash-flow[5]. Subordinated debt instruments are not acceptable.	Credit claims with: a) fixed and unconditional principal amount; and b) an interest rate that cannot result in a negative cash flow.[6]
Credit assessment systems accepted	The underlying credit claims rating can be based on NCB in-house credit assessment systems (ICAS) or counterparties' internal ratings-based systems (IRB).	ECAI	ECAI, ICAS, IRB and RT
Credit standards	The underlying credit claims rating have the threshold: BBB- or probability of default (PD) equal to 0.4%. This PD has to be fulfilled at the level of each individual credit claim. Only one rating would be required.	General Documentation framework: Two AAA ratings at issuance date (second-best rating rule) and a 'single A' level (i.e. A-) over the life of the security. The minimum rating corresponds to a PD equal to 0.1%. Decision ECB/2012/18: acceptance of some ABS with at least two BBB- ratings at issuance and during the life of the security, given they fulfil additional criteria.	ECAI rating threshold (long-term): BBB- (Fitch and S&P), Baa3 (Moody's) or BBB (DBRS); Other credit assessment sources (IRB, RT and ICAS): PD at least equal to 0.4%. A single rating is required.
Place of issuance	Similar to ABS (i.e. European Economic Area)	EEA	Not applicable

[5] Please see ECB Guideline ECB/2012/25 for details.

[6] In addition, the interest rate should be one of the following: (i) zero coupon-style; (ii) fixed; or (iii) floating linked to another interest rate reference. Furthermore, credit claims with interest rate linked to the inflation rate are also eligible

	Use of securities to mobilise credit claims	ABS	Individual credit claims
Settlement/handling procedures	Settlement of the securities: Similar to ABS (i.e. euro area), i.e. instruments must be centrally deposited in book-entry form with NCBs or a SSS fulfilling the ECB's minimum standards. Handling procedure for the underlying credit claims: Eurosystem/ NCBs'procedures	Place of settlement: euro area. Instruments must be centrally deposited in book-entry form with NCBs or a SSS fulfilling the ECB's minimum standards	Handling procedure: Eurosystem/NCBs'procedures
Type of issuer/ debtor/guarantors	Issuer: similar to ABS Debtors: similar to credit claims.	Issuer: SPV (private sector) Debtors: Public and private sectors	Public sector, non-financial corporations, international and supranational institutions
Place of establishment of the issuer, debtor, guarantor and underlying assets	Issuer: euro area Debtor: euro area Guarantor (at a security level): not foreseen in the framework Originators, intermediaries and underlying assets (and relevant security): euro area	SPV: EEA Originators, intermediaries, obligors, underlying assets and related security must be established/located in the EEA	Euro area
Acceptable markets	Not applicable	Regulated markets and non-regulated markets accepted by the ECB	Not applicable
Currency	Euro	Euro	Euro
Minimum size	Not applicable, neither to the instrument nor to underlying assets	Not applicable	Minimum size threshold at the time of submission of the credit claim — for domestic use: choice of the NCB, — for cross-border use: common threshold of EUR 500 000
Governing laws	For the underlying assets: Equal to individual credit claims. At the vehicle level, the acquisition of the underlying assets must be governed by the law of a euro area country.	For asset-backed securities the acquisition of the underlying assets must be governed by the law of an EU Member State. The law governing underlying credit claims must be the law of an EEA country	Governing law for credit claim agreement and mobilisation: law of a Member State The total number of different laws applicable to: a) the counterparty; b) the creditor; c) the debtor; d) the guarantor (if relevant); e) the credit claim agreement; and f) the mobilisation agreement shall not exceed two
Cross-border use	Yes	Yes	Yes

Annex B – Annex on the Minimum Overcollateralisation computation

In the currently envisaged approach (to be confirmed based on Eurosystem's feedback), the asset manager will use the following information to assess the credit claims:

- The credit quality of a loan: such credit quality will be based either on ICAS or on IRB Probability of Default (PD) using the Eurosystem categories (CQS1, CQS2, CQS3, etc.…) according to the table below.

	PD
CQS 1	0,01%
CQS 2	0,10%
CQS 3	0,40%
CQS 4	1,00%
Ineligible	

- The final maturity of the loan: such maturity will fall within one of the defined bucket of maturities (0 to 1 year / 1 to 3 years / 3 to 5 years / 5 to 7 years / 7 to 10 years / above 10 years).
- The type of interest rate: if the interest rate is floating according to an index then we will assume the floating haircut, for any other interest rate type (whether fixed rate or a more complex pattern) we will assume the fixed rate haircut.

For each of those categories, the table below identifies the possible applicable haircut.

	Variable Rate	Fixed Rate					
		0-1 y	1-3 y	3-5 y	5-7 y	7-10 y	>10 y
CQS 1	10,0%	10,0%	17,5%	24,0%	29,0%	34,5%	44,5%
CQS 2	10,0%	10,0%	17,5%	24,0%	29,0%	34,5%	44,5%
CQS 3	17,5%	17,5%	34,0%	46,0%	51,0%	55,5%	64,5%
CQS 4	100%	100%	100%	100%	100%	100%	100%
Ineligible	100%	100%	100%	100%	100%	100%	100%

Those haircuts are equal to the haircut defined for Credit Claims, but excluding any Additional Credit Claims.