

The Eurosystem's Collateral Framework

General Principles and Recent Developments

Evangelos Tabakis
Eloi Espargilière

DG-Market Operations – Financial Market and Collateral

Money Market Contact Group meeting
21 March 2012

Outline

- Overview
- General Eligibility criteria
- Restrictions on the use of collateral
- Risk Control Framework
- Recent developments (ABS and Additional Credit claims)
- Useful links

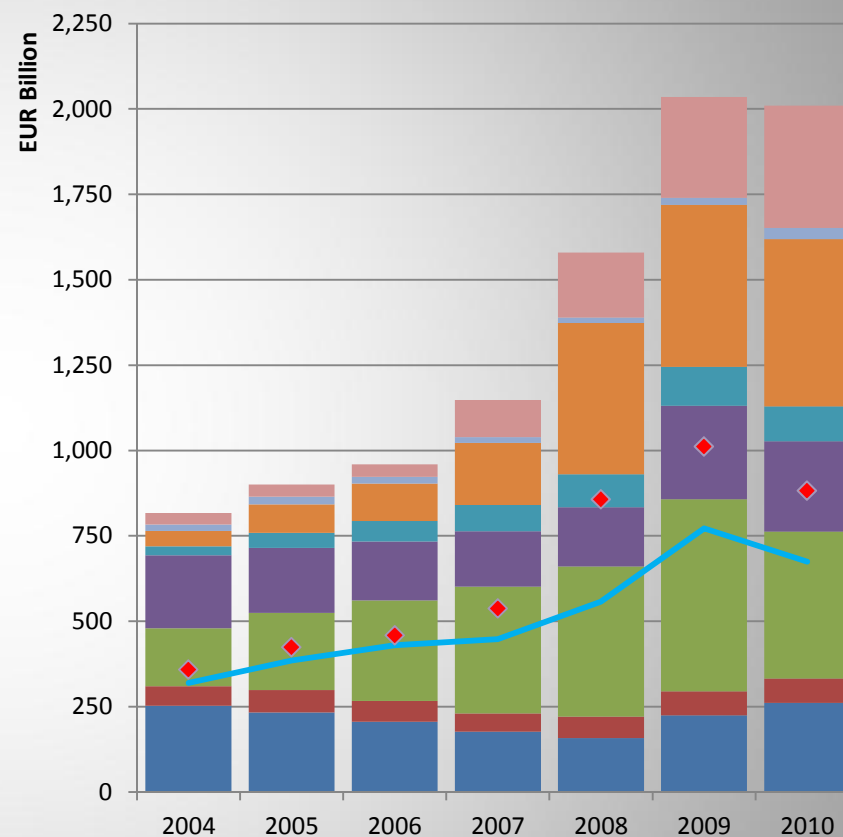
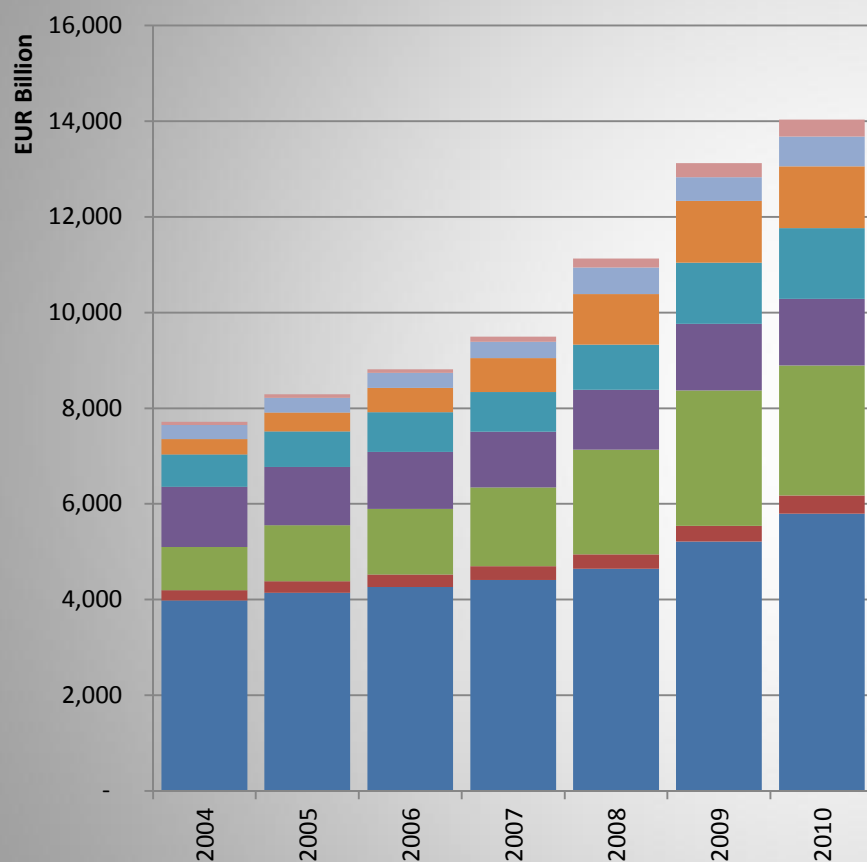
Overview

Guiding Principles

- Eligible counterparties must be financially sound
- Article 18.1 of the Statute requires all credit operations by the Eurosystem to be “**based on adequate collateral**”
- The concept of adequacy has **2 notions**:
 - Collateral must be able to protect the Eurosystem from incurring losses in its credit operations
 - There must be sufficient collateral potentially available to ensure that the Eurosystem can carry out its tasks.

Overview

Some Figures



- central government securities
- uncovered bank bonds
- corporate bonds
- other marketable assets
- Outstanding credit
- regional government securities
- covered bank bonds
- asset-backed securities
- non-marketable assets
- Peak outstanding credit

General Eligibility criteria

	Marketable assets	Non-marketable assets
Asset type	<p>Debt securities with:</p> <p>a) fixed and unconditional principal amount (Except for ABS)</p> <p>b) a coupon that cannot result in a negative cash-flow.</p> <p>E.g.: ABS, Covered bonds, Uncovered bank bonds, Government bonds, Corporate bonds...</p>	<p>Credit claims (bank loans) with:</p> <p>a) fixed and unconditional principal amount</p> <p>b) an interest rate that cannot result in a negative cash flow.</p>
Accepted Credit assessment systems	<p>Moody's, Fitch, S&P and DBRS (ECAIs)</p> <p>Other credit assessment sources are available for unrated marketable assets.</p>	<p>Moody's, Fitch, S&P and DBRS (ECAIs)</p> <p>Other credit assessment sources are available for unrated non-marketable assets.</p>
Credit standards	<p>ECAI rating must be equal or above BBB-</p> <p>Other credit assessment sources: Should not exceed a 1-year probability of default of 0.4%</p> <p><u>Exceptions:</u></p> <ul style="list-style-type: none"> - ABS: 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 Eurosystem rating threshold is currently suspended for marketable assets issued/guaranteed by the Central Governments of Greece, Ireland and Portugal. 	<p>ECAI rating threshold (long-term): BBB- (Fitch, S&P), Baa3 (Moody's) or BBB (DBRS);</p> <p>Other credit assessment sources (IRB, RT and ICAS): 1-year probability of default equal to 0.4%.</p>

General Eligibility criteria

	Marketable assets	Non-marketable assets
Place of issuance	European Economic Area	Not applicable
Settlement/handling procedures	Euro Area Instruments must be centrally deposited with NCBs or a SSS fulfilling the ECB's minimum standards	Eurosystem procedures
Type of issuer/debtor/guarantors	NCBs, public sector, private sector, international and supranational institutions	Public sector, non-financial corporations, international and supranational institutions
Place of establishment of the issuer, debtor, guarantor and underlying assets	Issuer: EEA or non-EEA G10 countries (US, CH, JP, CA) Guarantor: EEA ABS: originators, intermediaries, obligors, creditors , underlying assets and related security must be located in the EEA	Euro area
Acceptable markets	Regulated markets and non-regulated markets accepted by the ECB	Not applicable
Currency	Euro	Euro
Minimum size	Not applicable	for domestic use: choice of the NCB for cross-border use: min threshold of EUR 500 000. In 2013: introduction of common minimum threshold of EUR 500 000 throughout the euro area
Cross-border use	Yes	Yes

Restrictions on the use of collateral

- A counterparty must not submit as collateral an asset issued by any entity with which it has close links (own use)
 - Except for ABS, Covered bonds and GGBBs
- A counterparty cannot have more than 5% of its collateral pool composed of assets issued by the same banking group
 - Except for Covered bonds and GGBBs
 - Except if the amount is below EUR 50 million

Risk Control Framework

Marking to market

- The Eurosystem requires that the market value of the collateral used in its liquidity-providing reverse transactions (MRO, LTRO...) is maintained over time. (A theoretical price is determined if no market price is available)
- This implies that if the value of the assets falls below a certain level, the Eurosystem will require the counterparty to supply additional collateral.
- Similarly, if the value of the underlying assets, following their revaluation, exceeds a certain level, the counterparty may retrieve the excess assets or cash.

Risk Control Framework

Valuation haircuts

- The Eurosystem applies 'valuation haircuts' in the valuation of assets used as collateral
- This implies that the value of the collateral is calculated as the market value of the asset less a certain percentage (haircut)
- Currently, the haircuts applicable depend on the type of asset, issuer, residual maturity, coupon and credit quality

Risk Control Framework

Liquidity Categories

- **Category I:** Debt instruments issued by central governments or by CBs
- **Category II:** Debt instruments issued by:
 - Local/regional governments
 - Agencies
 - Supranational institutions
 - Or jumbo covered bank bonds
- **Category III:** Debt instruments issued by:
 - Non-financial corporations and other issuers
 - Or traditional and other covered bank bonds
- **Category IV:** Unsecured debt instruments issued by:
 - Credit institutions
 - Financial corporations other than credit institutions
- **Category V:** Asset-backed securities

Risk Control Framework

Haircuts for Marketable Assets

Liquidity categories											
Credit quality	Residual maturity (years)	Category I		Category II		Category III		Category IV		Category V	
		Fixed Coupon	Zero Coupon	Fixed Coupon	Zero Coupon	Fixed Coupon	Zero Coupon	Fixed Coupon	Zero Coupon	Fixed Coupon	Zero Coupon
Steps 1 and 2 (AAA to A-)	Until 1	0,5	0,5	1,0	1,0	1,5	1,5	6,5	6,5	16,0	
	1 to 3	1,5	1,5	2,5	2,5	3,0	3,0	8,5	9,0		
	3 to 5	2,5	3,0	3,5	4,0	5,0	5,5	11,0	11,5		
	5 to 7	3,0	3,5	4,5	5,0	6,5	7,5	12,5	13,5		
	7 to 10	4,0	4,5	5,5	6,5	8,5	9,5	14,0	15,5		
	> 10	5,5	8,5	7,5	12,0	11,0	16,5	17,0	22,5		
Step 3 (BBB+ to BBB-)	Until 1	5,5	5,5	6,0	6,0	8,0	8,0	15,0	15,0	Not eligible	
	1 to 3	6,5	6,5	10,5	11,5	18,0	19,5	27,5	29,5		
	3 to 5	7,5	8,0	15,5	17,0	25,5	28,0	36,5	39,5		
	5 to 7	8,0	8,5	18,0	20,5	28,0	31,5	38,5	43,0		
	7 to 10	9,0	9,5	19,5	22,5	29,0	33,5	39,0	44,5		
	> 10	10,5	13,5	20,0	29,0	29,5	38,0	39,5	46,0		

Risk Control Framework

Haircuts for Non-Marketable Assets

Credit quality	Residual maturity (years)	Fixed interest payment and valuation based on a theoretical price assigned by the NCB	Fixed interest payment and valuation based on the outstanding amount assigned by the NCB
Steps 1 and 2 (AAA to A-)	Until 1	8,0	10,0
	1 to 3	11,5	17,5
	3 to 5	15,0	24,0
	5 to 7	17,0	29,0
	7 to 10	18,5	34,5
	> 10	20,5	44,5
Step 3 (BBB+ to BBB-)	Until 1	15,5	17,5
	1 to 3	28,0	34,0
	3 to 5	37,0	46,0
	5 to 7	39,0	51,0
	7 to 10	39,5	55,5
	> 10	40,5	64,5

Recent Developments

Background information

- Shortage of collateral in some jurisdictions
- Danger of hampering the transmission mechanism in these regions
- Decision to increase collateral availability with emphasis on those assets whose eligibility would foster bank lending, especially to SMEs and private households
 - **ABS** (securitised form of claims)
 - **Credit claims** (un-securitised form)

Recent developments

8 December 2011: Governing Council decision on measures to support bank lending and money market activity

ABS

Rating requirement at issuance lowered from 'AAA' to 'single A', for ABS that have:

- Homogenous pool (only SME loans or only retail mortgages)
- No non-performing (at issuance), structured, syndicated or leveraged loans (at any time)
- The ABS must contain servicing continuity provisions
- Rules for the use: the counterparty submitting the asset may not act as interest swap provider to the transaction

More information available on ECB's website under

<http://www.ecb.europa.eu/paym/coll/html/questions.en.html>

Recent developments

8 December 2011: Governing Council decision on measures to support bank lending and money market activity

Additional credit claims

- Temporary acceptance of additional performing credit claims that satisfy specific (national) eligibility criteria under the responsibility of NCBs
 - Better knowledge of the domestic economy and legal framework
 - Assess eligibility and credit worthiness
- Depending on the jurisdictions, loans may for instance:
 - Be granted to private households (residential mortgage loans)
 - Be provided by leasing or factoring companies
 - Have a probability of default up to 1.5%
 - Be denominated in USD, GBP, CHF, JPY...
- Average haircut: about 2/3rd of the value
 - Total of EUR 600bn outstanding amount → EUR 200bn additional liquidity
- Pools of credit claims are accepted in IE, IT and PT
- Latest disclosed figures (*cf. Press Conference of 08 March 2012*)

Jurisdiction	Amount (EUR billion)
FR	40
IT	3
Other	10
Total	53

Useful links

ECB website collateral section:

<http://www.ecb.europa.eu/mopo/assets/html/index.en.html>

Latest Annual report (see chapter 2):

<http://www.ecb.int/pub/pdf/annrep/ar2010en.pdf>

Latest General Documentation (especially chapter 6):

http://www.ecb.europa.eu/ecb/legal/pdf/en_ecb_2011_14_f_sign.pdf

21 September 2011 Press Release:

<http://www.ecb.europa.eu/press/pr/date/2011/html/pr110921.en.html>

8 December 2011 Press Release:

http://www.ecb.europa.eu/press/pr/date/2011/html/pr111208_1.en.html

Link to the FAQ on the 8 December Press Release:

<http://www.ecb.europa.eu/paym/coll/html/questions.en.html>

9 February 2012 Press Release:

http://www.ecb.europa.eu/press/pr/date/2012/html/pr120209_2.en.html