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The ECB Clarifies its Ratings Requirements for ABS Repo Facility Eligibility

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As discussed previously,[1] after a period of intensive speculation, the European Central Bank (ECB) has recently taken the first steps to tighten its criteria for access to its repo facility in an attempt to encourage the ABS market to become less reliant on its emergency funding or repo facility. One of the most significant of the measures taken by the ECB is the increase in the ratings requirements of asset backed securities (ABS) in order to obtain or preserve ECB repo facility eligibility.

On 4 March 2010, the ECB formally issued amendments[2] to its eligibility criteria for ABS access to the ECB's repo facility so as to implement the announcement made by the ECB in its 20 November 2009 press release.[3] Under the amended guidelines, in order to maintain repo facility eligibility, all ABS issued before 1 March 2010 will require two ratings from accepted external credit assessment institutions (ECAI) with effect from 1 March 2011. If such ABS issuance took place prior to 1 March 2009, both ECAI ratings must be at least "single A". If, however, such ABS issuance took place between 1 March 2009 and 28 February 2010, the rating at issuance would have been required to be "AAA"/"Aaa" in line with the ECB's Guideline of 20 January 2009[4], while the new second rating required to be obtained by 1 March 2011 would need to be at least "single A". In each case, in order to maintain ECB repo facility eligibility, all ABS would need to maintain at least "single A" ratings during the life of the ABS.

In 2008 and 2009, considerable volumes of ABS were issued by European banks for the sole purpose of financing such securities through the ECB's repo facility. These transactions were often structured to comply with the ECB's requirements rather than market standards for securities offered in the public markets to third-party investors. As such, many of these deals have been rated by only a single ECAI. Given the specific requirements of particular rating agencies and differences in their methodologies, it is likely that costly and time consuming restructuring will need to be implemented to many deals in order to add a second ECAI and maintain eligibility with the ECB.

With regard to new ABS issuances taking place on or after 1 March 2010, the second ECAI rating requirement is immediately effective. All such new ABS will need to be rated "AAA"/"Aaa" at issuance by two ECAIs and will need to maintain at least "single A" ratings during the life of the ABS.

Whilst there have been some recent activity in the European ABS market (particularly with RMBS) and some encouraging early signs also emanating from the U.S. ABS market as to renewed investor appetite, ABS issuances over the past two years have been predominantly retained by their originating banks and structured to meet the ECB's repo facility eligibility criteria. Anecdotal evidence suggests that the new approach of the ECB (stricter application of existing rules, particularly regarding market valuations, as well as new restrictions) has largely halted the arrangement of new ABS transactions for this purpose, but almost €1 trillion of securities continue to be financed by the ECB. The costs of restructuring such deals to maintain their eligibility for the repo facility and possible further restrictions which may be introduced by the ECB (press reports suggest limits on the total amount of ABS individual institutions may finance with the ECB are being considered) are likely to encourage banks to consider alternative means of financing their assets.

In an active European market for new ABS and with a limited secondary market focusing on distressed assets and deeply discounted sales, banks may have to consider unwinding transactions and either selling assets to fund or private equity investors or (as has begun to emerge in the U.K. in recent months) entering into joint ventures with such investors in relation to these assets. In the alternative, some banks will be able to rely on national programmes for at least some assistance, although often these are less attractive than the finance previously provided by the ECB. Specific options might include “bad bank” schemes such as Ireland’s National Asset Management Agency (NAMA) or the forthcoming Bank of England discount window. More encouragingly reports are also emerging of the recommencement of inter-bank lending and in particular of banks lending to each other against specific ring-fenced pools of collateral.

Accordingly, the steps being taken by the ECB to discourage over-reliance on its repo facility seem to be having some success and have not so far triggered the market shocks predicted by some. However, the markets continue to be fragile and, in some cases, remain closed. As a result, it is likely that European banks will continue to have to rely on programmes such as the ECB’s repo facility for at least some of their funding.

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[1] “*The Beginning of the End of ECB Repo Facility for Securitisation?*” 17 December 2009.

[2] http://www.ecb.europa.eu/ecb/legal/pdf/l_06320100312en00220023.pdf

[3] http://www.ecb.int/press/pr/date/2009/html/pr091120.en.html

[4] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:036:0059:0061:EN:PDF