PCS Update
ECB, Frankfurt, 11 December 2009

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Agenda

Associated Organisations
Formation of PCS Steering Committee
Objectives and Non-Objectives of PCS
Four Attributes of PCS
Issues Requiring Further Consideration
Recommended Timetable
Associated Organisations

European Financial Services Round Table
AFME / ESF
European Banking Federation (EBF)
European Fund and Asset Management Association (EFAMA)
European Insurance and Reinsurance Federation (CEA)
European Federation Retirement Provision (EFRP)

Observers:
• European Central Bank (ECB)
• European Investment Bank (EIB)

All associations include active investor representation
Formation of PCS Steering Committee

Conclusion at 30 September workshop was that although European securitisation issuance was likely to eventually return as a significantly smaller market, the speed at which it would return could be significantly accelerated through potential industry/ECB/EIB cooperation.

ECB recommended that EFR and AFME / ESF to work together, and form a small steering committee (SC) to develop a high-level PCS term sheet.

SC is not mandated to finalise PCS, but rather to develop a workable term sheet for further consideration by members of the various associations.
Formation of PCS Steering Committee

Composition of SC driven by need to address concerns by the four key stakeholders, and to more closely align their sometimes conflicting goals:

• Investors
• Issuers/Originators
• Traders
• Arrangers
Objectives of PCS

**Revitalisation**
Revitalise, as soon as possible, the European securitisation market by restoring investor confidence, with active involvement of ECB and EIB as a necessary precondition.

**Restore Economics**
Incentivise new issuance activity by restoring the economics of securitisation to issuers and by improving the acceptability of ABS investment to investors.

**Investor Goals**
For investors, goals are to improve the consistency of quality, improve data transparency at deal inception and on an ongoing basis, increase standardisation and simplicity and improve liquidity.
Objectives of PCS

Issuer Goals
For issuers, goals are to improve access to the market and to lower the cost of funding and risk transfer, particularly for the Aaa/AAA tranches. Issuers need to see significantly tightened spreads on AAA tranches in the highest quality asset classes in order to close the pricing gap with other funding sources, and to avoid a contraction in lending.

Headline Risk
PCS is intended to assist non-bank asset managers in restoring the ABS investor base, who are deterred by widespread concerns about “headline risk” of the entire ABS sector.

Subset of Securitisation
PCS to be defined as subset of securitisation, not as an alternative to covered bonds or a new asset class or type of structure.
Objectives of PCS

Subset of ECB Repo Eligibility
PCS eligibility criteria will be a subset ECB repo eligibility criteria i.e. it is intended that all PCS will qualify for ECB repo

EIB Standards
PCS for corporate lending should match EIB criteria/standards and use EIB definitions

Pan-European
PCS is intended to be a pan-European initiative, in addition to relevant national initiatives

Restore Liquidity
Large issuance size will encourage economies of scale, with wider investor distribution and improved liquidity
Non-Objectives of PCS

**No Bifurcation**
PCS is intended to create a liquid segment of the overall securitisation market, and not replace the market for other types of high-quality securitisations that may not qualify for various reasons.

**Not a CRA Replacement**
PCS is a screening mechanism/filter – it will not replace the rating agencies or the need for investors to perform their own credit analysis, as will be required under CRD Article 122a.

**Not a Regulation**
PCS is not a regulation, but rather an industry-endorsed market convention.
Governance of PCS

Best Practices
The PCS Secretariat provides a screening mechanism for PCS best market practices

Screening
Prior to issuance the PCS Secretariat will screen eligible transactions, in a similar way as for a listing

Compliance
On an ongoing basis, the Secretariat will monitor/police ongoing compliance with agreed requirements of each issuer/servicer/portfolio manager

Market Committee
The Market Committee will be established by the associations establishing the market convention, and make necessary changes over time

List of Participants
A list of market participants who agree to the market convention will be publicly available on relevant websites
Four Attributes of PCS

Quality

Simplicity

Transparency

Liquidity
Quality

Eligible Assets: Restricted to granular pools of consumer and corporate loans. Residential mortgages must be prime, as defined by country-specific criteria. Granularity specification to be defined.

Form: Cash assets, no synthetic

Tranche: PCS label will only apply to AAA tranches only, MCS (Mezzanine Collateralised Securities) for all other tranches

Asset Location: EU-only assets

No Resecuritisations (CDO squared, CDO of ABS)

Audit: Audit process to check compliance with agreed reporting standards, and origination and servicing processes, with enforcement through PCS Secretariat
Simplicity

**Cash Only:** Cash securitisations only for PCS; MCS for other tranches

**Simple Structures:** Preference for simple structures. Further analysis on master trusts and other structures is required (for example, on many pools the unpredictability of loan cash flows in simple structures may create a prohibitively expensive cost of funding to issuers)

**Discrete vs. Revolving:** Both types are eligible

**Principal Payment:** Amortising and bullet structures are eligible

**Puts and Calls:** Permitted
Transparency

Best Practices: Mandatory compliance with industry best practices on upfront and ongoing reporting, including standardisation of data reporting and definitions (to be determined as well as harmonised over time)

Loan by Loan Reporting: Mandatory compliance with ECB standards on loan by loan reporting

Data Accessibility: All data on publicly-offered/widely distributed transactions should be publicly accessible, with no password restrictions

Data Portal: Recommended development of a PCS Data Portal, which will contain a) list of all EU ABS ISINs b) list of model providers for each ISIN c) list of valuation providers for each ISIN. All PCS issuers will be required to report initial and ongoing data to the Data Portal as well as commercial data providers on a timely basis

Participants: Public register of PCS participants
Liquidity

Two Parameters Missing: Most investors consider that two parameters that have dramatically disappeared in the ABS and covered bond markets during the crisis must be restored to incentivise them to re-enter the market with confidence: ability to price the assets, and liquidity.

Preconditions: PCS provides for a set of conditions that will create the foundation of a greater liquidity for the product: quality, simplicity, transparency.

Economic Impact: These conditions could be enough to restore the liquidity the investors are looking for, but doubtfully in the short to medium term, therefore impairing during that time the contribution of the product to the financing of the economy.

Assistance for Liquidity: In order to accelerate the process, liquidity (or leverage) could be provided directly to investors by “regulators/authorities”, as implemented in the US. An alternative, more consistent with the increased regulatory constraints weighing on the banks, would see the latter providing liquidity through their dealers, to the investors. This liquidity commitment could take the shape of a strong market making commitment for example.
Liquidity

Three Key Preconditions: Such a commitment that would address investors’ request could not be sustainable without support provided by regulators/authorities on three major points:

i) the regulatory treatment attached to these high quality PCS in the trading book,

ii) inclusion of PCS as eligible assets for regulatory purposes in relation to the liquidity book, and

iii) the conditions (volume, price, haircut) under which these assets could be refinanced ultimately by “regulators/authorities” at any time, and more significantly if the market were to shut down again.

Timing: Rather than conflicting with the approach that relies on the inherent qualities of the PCS to attract liquidity, the solution based on commitment and central support expresses a difference of opinion in the speed at which the market freeze must be addressed or will cure itself.

nb: “regulators/authorities” means collectively all banks’ regulators, central banks, financial authorities
Key Issues Requiring Further Consideration

1. **Granularity**: Definition of pool granularity requirements
2. **Definitions**: Standardisation of key definitions (prime vs subprime, LTV, default, recovery, prepayment etc.) on a country-specific basis, in conjunction with national regulators
3. **Data Standardisation**: Analysis and standardisation of historical performance data
4. **Structures**: Analysis of eligible structures, including potentially simplified versions of master trusts
5. **Audits**: Details of upfront agreed upon audit procedures and ongoing data audits; discussions at senior level at EFR bank and other issuers/originators re implementation feasibility and costs
6. **Backup Servicing**: Exploration of backup servicer requirements
Key Issues Requiring Further Consideration

7. **Marketing Period**: Exploration of minimum marketing period
8. **Reporting Best Practices**: Develop implementation timeline for further updating of existing industry issuer/originator best practices on disclosure, standardisation and transparency in upfront and ongoing reporting
9. **PCS Data Portal**: Develop data portal feasibility study – issuer data reports, ISIN collection, model and valuations links
10. **Haircuts**: ECB consideration of appropriate haircut levels for PCS
11. **Liquidity Policy**: Clarification of overall regulatory policy by international authorities on liquidity-related issues
12. **Post Trade Reporting**: Trade reporting practices (comprehensive MiFID review in 2010)
13. **Removals**: Requirements for removal/withdrawal of PCS label
Key Issues Requiring Further Consideration

14. **Loan by Loan Reporting**: ECB consultation process on loan by loan reporting and implementation timeline

15. **Funding for Administration**: Business plan for PCS Secretariat and Market Committee – revenue and budget, monitoring, leadership

16. **Name of Programme**: PCS vs other

17. **Other**
Recommended Timetable

11 December, 2009: meeting at ECB

[Q1, 2010]:
  i) private consultation with key stakeholder groups
  ii) collection of comments from stakeholders and redrafting of term sheet
  iii) redistribution of term sheet to wider group of stakeholders; development of reporting standards for initial asset classes

[Q2, 2010]:
  i) finalisation of term sheet
  ii) announcement of programme and signature of the market convention by relevant associations

[H2, 2010]:
  i) launch of first PCS transaction, for issuers able to implement required IT changes