EUROPEAN CENTRAL BANK

EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 6 December 2019

on a guarantee scheme for securitisations of loans originated by credit institutions

(CON/2019/42)

Introduction and legal basis

On 20 November 2019 the European Central Bank (ECB) received a request from the Greek Ministry of Finance for an opinion on a draft law on a guarantee scheme for securitisations of loans originated by credit institutions (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the sixth indent of Article 2(1) of Council Decision 98/415/EC[1], as the draft law relates to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

1.1 *Objective and scope of the draft law*

The draft law provides for the introduction of a State guarantee scheme for securitisations, setting out the terms and conditions under which the Greek State may guarantee the senior tranche of asset-backed securities (ABS) backed by receivables (the 'Receivables') originated by Greek credit institutions, or subsidiaries of foreign credit institutions established in Greece, and sold and transferred by such institutions (the 'Originator' or 'Seller') to a special purpose vehicle (SPV) (the 'Issuer' or 'Acquirer') under Articles 10 and 14 of Law No 3156/2003 on bond loans, securitisation of claims and other provisions[2]. The Receivables are claims of the Originator arising from loans and other forms of credit provision, including receivables that are in temporary or permanent arrears or that have been restructured.

1.2 *Structure of eligible securitisation transactions*

In order for a transaction to benefit from the State guarantee envisaged in the draft law, it must be structured as follows: (i) the Issuer must finance the purchase of the Receivables by issuing ABS notes comprising at least two tranches (senior and junior), it being possible for the securitisation transaction also to provide for the issuance of a mezzanine tranche; (ii) the capital of the junior

1 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

2 Law No 3156/2003 on bond loans, securitisation of claims and other provisions, Government Gazette A 157/25.6.2003), as amended and in force.

tranche may only be repaid after the repayment in full of the senior tranche and, if issued, the mezzanine tranche; (iii) the consideration received by the Seller for the sale and transfer of the Receivables may not exceed the net book value of the transferred Receivables, which is defined in the draft law as the nominal value of the Receivables minus the provisions taken by the Originator and recorded in the Originator's accounting books and records on the date of the sale and transfer of the Receivables; (iv) the interest rate on the ABS notes is to be floating or fixed and the interest period is to be a 3-, 6- or 12-month period; and (v) the ABS notes must be freely transferable and capable of being listed for trading on a regulated market or a multilateral trading facility.

1.3 *Subscription restrictions*

The draft law provides that the junior tranche and, if issued, the mezzanine tranche may not be subscribed by the State, public law bodies or general government entities, including companies that are directly or indirectly controlled by the State.

1.4 *Waterfall of payments*

The contractual documentation for the securitisation transaction must stipulate that the proceeds received by the Issuer from repayments made under, and from the servicing of, the Receivables, as well as from any loan or credit agreements, hedging and security agreements, including financial derivatives agreements, entered into by the Issuer for the purposes of financing the securitisation transaction will be used for payments in the following order: securitisation transaction costs; taxes; servicer's fees (if not deferred); interest on loans or other liquidity or credit lines which the Issuer may enter into for the purposes of the securitisation transaction; claims of the State for the guarantee premium payable by the credit institutions participating in the scheme; claims of hedging counterparties for hedging transactions entered into by the Issuer for the purposes of the securitisation transaction; interest on the senior notes; claims other than interest under loans or other liquidity or credit lines which the Issuer may enter into for the purposes of the securitisation transaction; interest on the mezzanine notes (if not deferred); capital on the senior notes; capital on the mezzanine notes (provided that the capital on the senior notes has been fully repaid); capital on the junior notes (provided that the capital on the senior and the mezzanine notes has been fully repaid).

1.5 *Servicing*

The servicing of the transferred Receivables must be assigned to a servicer which must be independent (as per IFRS 10) from the Originator.

1.6 *Deferral of payment of interest on the mezzanine and of servicer's fee*

The contractual documentation for the securitisation transaction must stipulate that the payment of (i) interest on the mezzanine notes and (ii) part of the servicer's fee will be mandatorily[3] deferred if the aggregate net proceeds received from the servicing of the transferred Receivables since the beginning of the servicing are at least 20% less than the net proceeds forecast in the servicer's business plan which was taken into account when the senior notes were assigned a credit rating.

3 The contractual documentation for the securitisation transaction may provide for additional cases of deferral where deviations from the forecasted net proceeds are lower than 20%.

Net proceeds are defined in the draft law as the aggregate collections made under the transferred Receivables minus the securitisation transaction costs. This deferral is triggered 12 months after the entry into force of the State guarantee.

1.7 *Amount, conditions and pricing of the State guarantee*

The maximum amount of the State guarantee for the entire scheme is capped at EUR 12 billion, but may be increased in the future by decision of the Minister for Finance following a decision of the European Commission. The State guarantee is an undertaking by the State, subject to the conditions described below, to meet all obligations of the Issuer in connection with the full repayment of senior ABS notes, including claims for the repayment of capital thereof and the payment of interest thereon throughout the life of said notes.

The State guarantee enters into effect if the following conditions are met: (i) at least 50% of the junior notes plus one must have been transferred against a positive value; (ii) a sufficient number of the junior notes (and of the mezzanine notes, if issued) must have been transferred at a positive price such that the transferred Receivables have been derecognised, accounting-wise, from the financial statements of the Originator and the Originator's group on a consolidated basis in accordance with the applicable IFRS; (iii) the senior notes must have been assigned at a minimum a rating of BB-, Ba3, BB-, BBL by at least one external credit assessment institution (ECAI) which is accepted by the ECB at the time the guarantee enters into effect; and (iv) the servicing of the transferred Receivables must have been assigned to an independent servicer.

In addition, in order for the guarantee to be granted, the contractual documentation for the securitisation transaction must provide, among other things, that (i) a delay on the part of the Issuer in paying interest on the senior notes and the call on the State guarantee to cover the relevant amounts will not cause the Issuer's debt obligations to fall due prematurely; and (ii) certain terms of the transaction may not be amended without the prior explicit consent of the Minister for Finance[4].

The State guarantee is explicit, irrevocable, unconditional and payable on first demand, in accordance with Articles 213, 214 and 215(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council[5], as if the State were the primary obligor. Furthermore, it is governed by Greek law and is to be interpreted in accordance with the Commission decision of 10 October 2019 granting State aid clearance to the scheme[6] (the 'Commission State aid decision') and the State aid rules laid down in primary and secondary EU legislation. Lastly, the State guarantee is granted until maturity of the senior notes.

The State guarantee is granted against a premium payable at the beginning of the interest period from the entry into force of the State guarantee and for its entire duration. This premium is

4 These terms are listed in Article 9(1)(b) of the draft law.

5 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176 27.6.2013, p. 1).

6 See Commission Decision C(2019) 7309 final of 10 October 2019 (Case SA.53519 – Greece – Hellenic Asset Protection Scheme ('Hercules'), which concluded that the guarantee scheme contained in the draft law does not constitute aid within the meaning of Article 107(1) TFEU.

calculated on the basis of Annex B to the draft law which reflects Section 3.2 of the Commission State aid decision.

1.8 *Applications for a State guarantee*

Applications for a State guarantee under the scheme may be submitted within 18 months from the date of the Commission state aid decision, namely until 10 April 2021. By decision of the Greek Minister for Finance following a decision by the Commission, this period may be extended, and the terms and conditions of the guarantee may be amended for the future. Applications for a State guarantee under the scheme will be granted on a first-come first-served basis. If the State guarantee does not enter into effect within 12 months from the publication of the relevant ministerial decision, that decision will be revoked *ipso jure* and the relevant amount of the guarantee will be released and become available again. In that situation no new application for a guarantee for the same securitisation may be submitted within 6 months from the revocation of the ministerial decision.

1.9 *Calls on the state guarantee*

The senior noteholders (acting through their representative) may call on the guarantee within a window of 9 months beginning 60 days after non-payment of any of the Issuer's liabilities related to the senior notes. The State must pay the guarantee within 30 days from receipt of the call notification, whereupon it will be subrogated to the claims of the senior noteholders against the Issuer.

1.10 *Information requirements and monitoring of the scheme*

The servicer is required to submit to the Ministry of Finance servicing reports based on the ESMA template reports for securitisation transactions. An adapted report must also be submitted on a regular basis to the Bank of Greece and to a special ministerial committee established for the purposes of monitoring the State guarantees applied for or granted under the draft law[7]. This committee will also receive certain information related to payments made under the securitisation transaction.

The scheme, its implementation and the various specificities in its setup, in particular the rating requirements and their application, will be subject to regular monitoring by a monitoring trustee, to be appointed by the Minister for Finance with the consent of the Commission.

1.11 *Termination of the State guarantee*

The State guarantee will cease to be effective if the terms and conditions of the securitisation are amended in a way that breaches the Commission State aid decision. The senior noteholders may at any time apply to have the guarantee terminated. If the senior noteholders are the Originator, the consent of the competent supervisory authority will also be required.

1.12 *Replacement of the servicer*

Article 11(1) of the draft law provides that if a State guarantee is called on, the servicer servicing the transferred loans may be replaced provided that, for two successive interest periods, the net

7 The committee is made up of representatives from the Public Debt Management Agency, the Bank of Greece, the Ministry of Finance and the Greek Court of Auditors.

proceeds from the servicing of the transferred Receivables has deviated, due to negligence by the servicer, by at least 30% from the cumulative net proceeds forecast for the relevant periods in the servicer's business plan which was taken into account by the ECAI that assigned the rating to the senior notes.

1.13 *Exemption of the guarantee from the guarantee ceiling*

State guarantees granted under the scheme do not count towards the calculation of the maximum guarantee ceiling that the Greek State may provide on an annual basis[8].

2. General observations

2.1 *Effects on the banking sector*

The ECB notes that, for a number of reasons, addressing high levels of non-performing loans (NPLs) has been one of the ECB's supervisory priorities since the inception of the Single Supervisory Mechanism (SSM)[9]. First, NPLs weigh on the balance sheets of credit institutions, curbing their profits. Second, NPLs are distracting for credit institutions, and represent a drain on their resources. Third, NPLs undermine investors' confidence in credit institutions. In addition, internal analysis conducted by the ECB shows that, over recent years, credit underwriting by credit institutions with a high amount of NPLs has consistently been lower than that of credit institutions with loans of better credit quality, thereby providing less support to firms and households and the economy in general[10]. Further, high stocks of NPLs are a macroprudential issue and can affect entire economies[11]. From a financial stability point of view, the presence of significant volumes of NPLs on credit institutions' balance sheets reduces their ability to fulfil their function as providers of credit to the real economy and hampers operational flexibility and overall profitability which are essential to a well-functioning banking sector.

2.2 It is therefore important that NPLs are dealt with in an efficient and effective manner. Risk transfer through asset sales, securitisation and other measures is an important part of the toolkit available to credit institutions to reduce NPLs in an effective manner, in addition to other tools such as the originating credit institutions' internal procedures for handling the work-out of NPLs. In addition, the ECB has been a strong proponent for the development of secondary markets for credit institution assets, particularly for NPLs, as reflected in the action plan of the Council of the European Union to

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8 That ceiling is determined by a decision of the Greek Minister for Finance under Article 104 of Law No 4549/2018 on provisions for the completion of the Agreement on Fiscal Targets and Structural Reforms – Medium-term Fiscal Strategy Framework 2019-2022 and other provisions, (Government Gazette A 105/14.06.2018) and cannot account for more than 1.5% of the primary expenditure of the national budget in the relevant year.

9 See e.g. the speech by Danièle Nouy, former Chair of the Supervisory Board of the ECB, and Sharon Donnery, Chair of the ECB's High Level Group on non-performing loans, 'Introductory remarks to the public hearing on the draft addendum to the ECB guidance to banks on non-performing loans', Frankfurt am Main, 30 November 2017, available on the ECB's Banking Supervision website at www.bankingsupervision.europa.eu.

10 See 'European banking supervision three years on,' Welcome remarks by Mario Draghi, President of the ECB, at the second ECB Forum on Banking Supervision, Frankfurt am Main, 7 November 2017, available on the ECB's website at www.ecb.europa.eu.

11 See paragraph 1 of Opinion CON/2018/32 and paragraph 3.3.3 of Opinion CON/2019/14. All ECB opinions are available on the ECB's website at www.ecb.europa.eu.

tackle NPLs in Europe[12]. In the context of the large stocks of NPLs that remain on the balance sheets of some European credit institutions, and as part of a comprehensive solution to NPL resolution[13], the development of secondary markets may contribute to reducing NPLs. Therefore, a carefully designed scheme resulting in incentivising the transfer of the risks of NPLs off credit institutions' balance sheets would generally have a positive effect on financial stability and the reduction of NPL levels.

2.3 The elevated level of NPLs in Greece has been one of the key areas of focus in recent years and is being closely monitored from a supervisory perspective. The four significant Greek credit institutions directly supervised by the ECB have committed to achieve certain NPL reduction targets by 2021. The Greek authorities have also committed to 'implement reforms aimed at restoring the health of the banking system, including NPL resolution efforts by ensuring the continued effectiveness of the relevant legal framework'[14].

2.4 The ECB understands that the scheme envisaged by the draft law for banks to use in the context of NPL securitisations is voluntary. The ECB notes that this Opinion does not assess the regulatory treatment of the state guarantee foreseen by the draft law. The ECB suggests that the consulting authority engage in meaningful and timely consultations with all relevant stakeholders, including with the supervisory authorities, as such consultations might shed light on aspects of the draft law which may otherwise not be immediately apparent.

3. Specific observations

3.1 *Legal certainty*

Clear drafting of the draft law is required in order to ensure legal certainty. The ECB notes that achieving legal certainty is necessary to ensure that: (i) the scheme attracts significant third-party investor interest, especially for the junior tranche and, if issued, the mezzanine tranche, the placement of which would contribute to the banks achieving a significant risk transfer with accounting deconsolidation; and (ii) disputes and/or litigation arising out of the validity, amount, duration or other features of the State guarantee are avoided. Some provisions in the draft law might give rise to legal uncertainty and could be helpfully redrafted to enhance clarity and reduce risks[15].

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12 See the Council of the European Union's press release of 11 July 2017 on the 'Council conclusions on Action plan to tackle non-performing loans in Europe', available at: http://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/. See also Opinion CON/2018/31.

13 See, for example, Special features, Section B of the ECB's November 2016 Financial Stability Review, available at: https://www.ecb.europa.eu/pub/pdf/other/sfbfinancialstabilityreview201611.en.pdf.

14 See Annex to the Eurogroup Statement on Greece of 22 June 2018, available on the Council's website at https://www.consilium.europa.eu.

15 For example, Article 2(13) defining securitisation costs which in turn affects the definition of net proceeds; Article 3(4) determining the conditions for the deferral of payment of interest on the mezzanine tranche and of the servicer's fee; Article 6(1) on increasing the maximum amount of State guarantee that can be granted under the draft law following a decision by the Commission; and Article 9(1)(f) read together with Article 14 of Law No 3156/2003 and paragraphs 2(8) and 3 of Annex C2 to the draft law determining the taxes, fees or charges, if any, payable in respect of the State guarantee and the party liable to pay them.

Most importantly, the following aspects of the draft law must be sufficiently clarified in the draft law, or in secondary legislation to be enacted pursuant to that law, since they all have a bearing on the enforceability of the State guarantee and, therefore, an impact on the effectiveness of the scheme as a whole: (i) the date of entry into effect and the date of termination of the State guarantee; and (ii) the detailed rules for the submission of applications for a State guarantee under the draft law[16]. It is also crucial that the exact procedure from a call on a guarantee to the payment of said guarantee is clearly drafted in the draft law or in secondary legislation enacted pursuant to that law, in a way that safeguards the concept of the first demand guarantee as stated in the draft law.

Lastly, it is suggested that the detailed rules applying to the monitoring of securitisation transactions entered into under the draft law would benefit from further clarification in the draft law, or in secondary legislation to be enacted pursuant to the draft law, as would the associated documentary requirements and frequency of the monitoring[17]. A qualified independent entity is recommended as it would be well positioned to monitor the compliance of the issued guarantee with stated conditions, servicer performance and events that would trigger a call on the guarantee[18].

3.2 *Clearer wording when allowing full repayment of the senior tranche prior to any payment of interest on the mezzanine tranche in the waterfall structure*

Article 3(3) of the draft law seems to regulate the waterfall in a strict, pre-defined way. It is suggested that the draft law should present in a clearer way the ranking of the payment of interest on the mezzanine tranche in the waterfall structure, in a way that does not preclude that full repayment of the senior tranche (including principal) may occur prior to any payment of interest on the mezzanine tranche. From a prudential point of view, this will ensure faster repayment of the senior tranche and could therefore reduce the term of the guarantee.

3.3 *Credit assessment of senior notes*

Article 7(1) of the draft law requires the senior notes to be rated by an ECAI 'approved by the ECB at the time the State guarantee enters into effect'. The ECB notes that it does not approve ECAIs. The Eurosystem accepts certain ECAIs whose ratings are considered suitable for the specific purpose of its monetary policy operations. Such ECAIs must comply with the general acceptance criteria for ECAIs, one of which is that they be registered by the European Securities and Markets Authority in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council[19].

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16 See also paragraph 3.2.2 of Opinion CON/2016/17. For example, the date of entry into effect of the State guarantee should be uniformly applied in the draft law and be clearly distinguished from the date the guarantee was granted. In addition, the date of termination of the State guarantee would be more clearly defined if it were linked to breaches of the draft law, as opposed to breaches of the Commission State aid decision.

17 For example, the competences of the monitoring committee established by Article 16 of the draft law could be drafted more clearly.

18 See also paragraph 3.2.4 of Opinion CON/2016/17.

19 Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1). See Article 120(1) of Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (General Documentation Guideline) (ECB/2014/60) (recast) (OJ L 91, 2.4.2015, p. 3). The list of ECAIs accepted by the Eurosystem can be found on the ECB's website at https://www.ecb.europa.eu/paym/coll/risk/ecaf/html/index.en.html.

3.4 *Term of the State guarantee*

Article 6(7) of the draft law provides that the State guarantee will remain in place until the set maturity date of the senior notes. It is suggested that the term of the guarantee should endure until repayment has been made in full of all amounts owed in respect of the senior notes.

3.5 *Regular reviews*

Finally, it would be advisable to provide for an independent qualified entity to regularly review and assess the effectiveness of the scheme envisaged in the draft law by reference to its objectives and its impact on the credit institutions covered in the short and medium term. One year following its introduction might be a reasonable point at which to review the overall operation of the new scheme[20].

3.6 *Compliance with state aid rules*

It is for the Commission to assess the draft law's compliance with Union State aid rules.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 6 December 2019.

[signed]

The President of the ECB

Christine LAGARDE

20 See paragraph 3.3 of Opinion CON/2013/34 and paragraph 3.9 of Opinion CON/2019/9.