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Arthur Cox is one of Ireland's leading law firms. It comprises 300 lawyers including 98 partners. The firm's principal office is located in Dublin and we also have offices in Belfast, London and New York. The practice of the firm encompasses all aspects of corporate, business and finance law.

Arthur Cox Listing Services Limited is the leading Irish listing agent for the listing of debt securities on the Irish Stock Exchange.

## ELIGIBILITY CRITERIA FOR ASSET BACKED REPO TRANSACTIONS WITH THE EUROPEAN CENTRAL BANK

### Introduction

Many asset backed securities and other structured securities are used by investors as repo eligible assets for repo transactions with the ECB and national central banks, especially in the current market conditions. In many cases, arrangers and sponsors of issuing platforms are subscribing securities themselves and making them the subject of repurchase transactions with the ECB or national central banks.

There are a number of criteria that must be satisfied for an underlying asset to be considered eligible for repo transactions and that should be considered when deciding on the jurisdiction of an SPV and the listing of asset backed deals.

### Eligibility Criteria for Asset Backed Securities

The Eurosystem (i.e. the ECB and the national central banks of the euro area and, therefore, the Central Bank of Ireland where the issuer is Irish or listing is in Ireland) assesses the eligibility of asset backed securities<sup>1</sup> against the following criteria.

#### Type of Asset

An ABS must have:

- (a) **a coupon that cannot result in a negative case flow.** In addition, the coupon should be one of the following; (i) a zero coupon; (ii) a fixed rate coupon; or (iii) a floating rate coupon linked to an interest rate reference. The coupon may be linked to a change in the rating of the issuer itself. Furthermore, inflation-indexed bonds are also eligible.

This feature must be maintained until the redemption of the obligation. A debt instrument may not afford rights to the principal and/or the interest that is subordinated to the rights of holders of other debt instruments of the same issuer.

The cash-flow-generating assets backing the asset backed securities must:

- (b) **be legally acquired in accordance with the laws of a Member State** from the originator or an intermediary by the securitisation special purpose vehicle in a manner which the Eurosystem

<sup>1</sup> other than covered bank bonds

considers to be a “**true sale**” that is enforceable against any third party, and be beyond the reach of the originator and its creditors, including in the event of the originator’s insolvency; and

- (c) **not** consist, in whole or in part, actually or potentially, of credit-linked notes or similar claims resulting from the transfer of credit risk by means of **credit derivatives**.

Within a structured issue, in order to be eligible, a tranche (or sub-tranche) may **not be subordinated** to other tranches of the same issue. A tranche (or sub-tranche) is considered to be non-subordinated vis-à-vis other tranches (or sub-tranches) of the same issue, and is “senior” if, in accordance with the priority of payment applicable after the delivery of an enforcement notice, as set out in the offering circular, that tranche (or sub-tranche) is given priority over other tranches or sub-tranches in respect of receiving payment (principal and interest), or is last in incurring losses in relation to underlying assets.

If the relevant ABS are issued as bearer securities, in order to be eligible they must be lodged with a common safekeeper for the clearing systems in **New Global Note** (i.e. dematerialised) as opposed to Classical Global Note form. Although capable of being issued only in Classical Global Note form, registered notes are technically eligible for the Eurosystem. However, the process driven approach adopted by common depositaries can make lodging registered notes more cumbersome. Similarly, securities will be automatically ejected from the Eurosystem if they are affected by one or more “corporate events”. Note that this can include a clearing system generated requirement that the holder (i.e. the relevant Central Bank) certifies as to non-U.S. beneficial ownership to avail of the “safe harbour” provide by Regulation S of the U.S. Securities Act of 1933. Where it is anticipated that the tenor of initial repurchase transactions will extend beyond the relevant certification date, it should be considered whether the issuer requires this protection and instead the notes be **issued in permanent global note form**.

With effect from 1 February of this year (with no grandfathering we assume), ABS will be **ineligible** for the Eurosystem if:

- (a) the counterparty for monetary policy operations (i.e. usually the originating bank in retained deals) or any “close linked party” is the **hedge counterparty** of the issuer under a **currency swap**; or

- (b) the counterparty for monetary policy operations or any “close linked party” **provides liquidity** to the issuer in an amount **exceeding 20%** of the nominal value of the ABS.

Accordingly, combined with the haircuts described at *Currency of Denomination* below, we would expect Eurosystem securitisations of non-Euro denominated receivables to become comparatively more expensive.

The Eurosystem reserves the right to request from any relevant third party (such as the issuer, the originator or the arranger) any clarification and/or legal confirmation that it considers necessary to assess the eligibility of asset backed securities.

### **Credit Standards**

The asset must meet high credit standards. The high credit standards are assessed using Eurosystem credit assessment framework (“ECAF”) rules for marketable assets. It should be noted that ABS were excluded from the ECB’s reduction of minimum rating thresholds in October of last year. The minimum credit standard currently applicable to ABS is **A-** from Standard & Poor’s or Fitch and therefore **A3** from Moody’s. In addition the ABS’ rating on issue must be explained in a published **Pre-Sale Report** or a **New Issue Report** and must be **reviewed at least every three months**. We generally advise that these matters be covered in the credit rating agency’s rating letter delivered on closing.

### **Place of Issue**

The ABS must be deposited/registered (**issued**) in the European Economic Area (“**EEA**”) with a central bank or with a central securities depository which fulfils the minimum standards established by the ECB.

### **Settlement Procedures**

The ABS must be transferable in book-entry form. It must be held and settled in the euro area through an account with central banks or with a Securities Settlements Systems (“**SSS**”) that fulfils the standards established by the ECB.

### **Acceptable Markets**

The ABS must be **admitted to trading on a regulated market** as defined in the Directive 2004/39/EC of the European Parliament and of the Council of 21<sup>st</sup> April 2004 on markets in financial instruments, or traded on certain non-regulated markets as specified by the ECB.

The Main Market of the Irish Stock Exchange is a

regulated market and, therefore, acceptable. To be admitted to trading on the Main Market of the ISE under Directive 2003/71/EC (the “Prospectus Directive”) securities must have a minimum maturity of 12 months. Money market instruments with a maturity of less than 12 months are excluded from the definition of “securities” under the Prospectus Directive.

However, the ISE have listed a European Commercial Paper (“ECP”) programme on the regulated market (the GPB Eurobond Finance Plc (GAZPROM) programme) even though ECP does not fall under the remit of the Prospectus Directive. It seems that while money market instruments cannot be approved under the Prospectus Directive, the ISE still has the capacity (under private treaty) to admit securities to trading on the regulated market.

#### Type of Issuer/Guarantor

The ABS may be issued or guaranteed by central banks, public sector entities, private sector entities, or international or supranational institutions. An ABS<sup>2</sup> issued by a credit institution is only eligible if admitted to trading on a regulated market.

#### Place of Establishment of the Issuer/Guarantor

One point in particular to note is that the issuer of ABS must be established in the EEA. Therefore, securities issued by SPVs located in tax haven jurisdictions will not qualify as eligible assets for ECB repo purposes.

The guarantor must be established in the EEA. International or supranational institutions are eligible issuers/guarantors irrespective of their place of establishment.

#### Currency of Denomination

Unless otherwise eligible as described below, the ABS must be denominated in Euro. Until further notice, for the period ending 31 December 2009, securities (including ABS) denominated in Sterling, Japanese Yen or U.S. Dollars will also be eligible provided that they are “issued in the euro area”. Although this wording is not clear, it is generally accepted that the requirement will be met if the issuer of the securities is established in a European Union member state that has adopted the Euro as its currency in a manner recognised by the Commission. Note that the ECB applies **additional haircuts to non-Euro denominated securities** potentially raising the effective non-

Euro ABS level to 24.4% against that of 16.4% for Euro denominated ABS.

### Assessment of Securities and the ECB’s List of Eligible Marketable Assets

The ECB establishes, maintains and publishes a list of eligible marketable assets.

It is usually the central bank in the jurisdiction where securities are listed which assesses whether securities are eligible assets for repo purposes. The Central Bank of Ireland is responsible for reporting eligible assets listed on the Irish Stock Exchange to the ECB. It is an automatic process between the ISE and Central Bank and there are no separate application forms. In relation to timing, once a deal is listed on the ISE, the criteria test is applied to the notes by the Central Bank. Should the listed notes meet the criteria, they are automatically added to the ECB eligible list. Assets are considered eligible when their inclusion in the list of eligible assets has been published by the ECB on its website. The updated lists are made public each day on the ECB website.

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### Summary

In summary, if there is an intention to repo notes on an ABS transaction in accordance with the ECB rules:

- You will need an EEA SPV. For further information please see our publication:
 

“Structured Finance Guide: Establishing Special Purpose Vehicles in Ireland - For Structured Finance Transactions”

under ‘Capital Markets’ at: <http://www.arthurcox.com/publications/>.
- You will need a central bank to review the ECB eligibility criteria that is fully aware of the issues, such as the Central Bank of Ireland, on a transaction (whether with an Irish SPV or not) with a listing on a regulated market such as the Irish Stock Exchange. Unusually, the ISE will allow for listing of shorter dated money market instruments. For further information please see our publication:
 

“Arthur Cox Listing Services Listing Guide: Specialist Debt Securities - Admission to trading on the Irish Stock Exchange”

under ‘Capital Markets’ or ‘Listing Services’ at: <http://www.arthurcox.com/publications/>.

<sup>2</sup> other than covered bank bonds

## Key Contacts

### **Richard Ambery**

Richard joined Arthur Cox in May 2007 as partner following a secondment to the Office of General Counsel at Merrill Lynch International from the law firm, Paul Hastings. He qualified at Freshfields and has worked exclusively in the area of structured finance and securitisation at a number of City of London firms, including Clifford Chance. Richard has acted for arrangers, originators, credit enhancement providers, servicers and rating agencies across a wide variety of asset classes and jurisdictions and on whole business securitisations. In recent years, Richard has focused on the CMBS market; a topic on which he speaks and publishes articles regularly.

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Glenn is a partner in our Capital Markets Group. Formerly a capital markets partner at Allen & Overy, Glenn specialises in all forms of capital markets transactions, particularly repackagings, CDOs, CLOs, bond issues, debt issuance programmes, LPN structures, derivatives and equity linked products such as convertibles and exchangeables. He also advises on a range of banking and security issues and on the capital markets aspects of restructurings.

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### **Helen Berrill**

Helen is Director of Listings of Arthur Cox Listing Services Limited, having joined the firm from the Irish Stock Exchange. She has extensive specialist debt securities experience and has been involved in the financial services industry since 1995. As Head of Specialist Debt Securities listings at the Irish Stock Exchange from 1999 to March 2004, Helen was responsible, amongst other things, for drafting the Exchange's current listing rules for asset backed debt securities, specialist bonds and specialist warrants, overseeing the listings of all transactions and carrying out senior reviews to ensure understanding of transaction amongst her colleagues and to ensure an efficient, smooth, stream lined approach at all times.

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This memorandum is a general summary and is not a complete statement of the law. It is not intended to give specific legal advice. If you require advice please contact your usual Arthur Cox contact or any of the persons listed above.

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