

# ECB increases haircuts

In a press release of 28 July 2010<sup>1</sup>, the European Central Bank ("ECB") published, as previously announced at a press conference on 8 April 2010 in Frankfurt am Main, several amendments to its eligible assets requirements for Eurosystem refinancing transactions. In particular, these amendments deal with the levels of valuation haircuts applied to eligible (marketable and non-marketable) assets, as set forth in chapter 6 of the ECB General Documentation on Eurosystem Monetary Policy Instruments and Procedures ("General Documentation"). The system of applying haircuts will become significantly more complex. However, according to the ECB, "the new haircuts will not result in an undue decrease in the collateral available to counterparties". But this assessment might turn out to be slightly over-optimistic.

The said latest amendments to the General Documentation will include (i) the introduction of additional credit quality (i.e. rating) related categories of distinction, (ii) changes to the liquidity categories, and (iii) the introduction of separate schedules for non-marketable assets and for "inverse floaters":

## 1. Additional credit quality related haircuts

As before, the new schedule (relating to marketable assets) continues to graduate haircuts according to the differences in liquidity categories, on the one hand, and maturities of the assets, on the other hand. However, an additional graduation factor will be added in relation to the differences in the "credit quality" of the assets concerned. The credit quality graduation will be based on an updated assessment of the risk characteristics of eligible assets and the actual use of eligible assets by counterparties. In this respect, the ECB will in the future distinguish between (a) securities rated between AAA and A- and (b) securities rated between BBB+ and BBB-.

## 2. Changes to liquidity categories

Moreover, the definition of liquidity categories for marketable assets and the application of additional valuation mark-downs for theoretically valued assets have been fine-tuned following the ECB's review of the risk control measures in the eligible assets framework. All traditional covered bonds (for example, German law *Pfandbriefe*) will remain classified in liquidity category 3 (in future together with structured covered bonds and multi-issuer covered bonds). Jumbo covered bonds will be classified in liquidity category 2, which again does not mean deviation from their current classification.

The additional valuation mark-down of 5 per cent, currently only applied with respect to theoretically valued asset-backed securities ("ABS") pursuant to section 6.5 of the General Documentation, will be extended to apply also to theoretically valued bank bonds (including uncovered bonds as well as covered bank bonds, namely jumbos, traditional and structured covered bonds and multi-issuer covered bonds).

### Key Issues

Additional credit quality related haircuts

Changes to liquidity categories

Own schedule for non-marketable assets and "inverse floaters"

Timing

If you would like to know more about the subjects covered in this publication or our services, please contact:

[Peter Scherer](mailto:peter.scherer@cliffordchance.com) +49 69 7199 1294

[Rainer Gallei](mailto:rainer.gallei@cliffordchance.com) +49 69 7199 3142

[Christian Wattenberg](mailto:christian.wattenberg@cliffordchance.com) +49 69 7199 3143

To email one of the above, please use [firstname.lastname@cliffordchance.com](mailto:firstname.lastname@cliffordchance.com)

Clifford Chance, Mainzer Landstraße 46,  
60325 Frankfurt am Main, Germany  
[www.cliffordchance.com](http://www.cliffordchance.com)

<sup>1</sup> See [http://www.ecb.int/press/pr/date/2010/html/pr100728\\_1.en.html](http://www.ecb.int/press/pr/date/2010/html/pr100728_1.en.html)

ABS will be subjected to an uniform haircut of 16 per cent, which is 4,0 per cent higher than before. The haircuts on government bonds and jumbo covered bonds rated between AAA and A- will remain unchanged, the haircuts on all other assets will be increased. The updated valuation haircuts, including the additional credit quality graduation, are set out below (for a better comparison, the previous haircuts are set out in brackets in each case).

Levels of valuation haircuts applied to eligible marketable assets										
Credit quality	Residual maturity (years)	Liquidity categories								Category 5
		Category 1		Category 2		Category 3		Category 4		
		fixed coupon	zero coupon	fixed coupon	zero coupon	fixed coupon	zero coupon	fixed coupon	zero coupon	
AAA to A-	0-1	0,5 (0,5)	0,5 (0,5)	1,0 (1,0)	1,0 (1,0)	1,5 (1,5)	1,5 (1,5)	6,5 (6,5)	6,5 (6,5)	16,0 (12,0)
	1-3	1,5 (1,5)	1,5 (1,5)	2,5 (2,5)	2,5 (2,5)	3,0 (3,0)	3,0 (3,0)	8,5 (8,0)	9,0 (8,0)	
	3-5	2,5 (2,5)	3,0 (3,0)	3,5 (3,5)	4,0 (4,0)	5,0 (4,5)	5,5 (5,0)	11,0 (9,5)	11,5 (10,0)	
	5-7	3,0 (3,0)	3,5 (3,5)	4,5 (4,5)	5,0 (5,0)	6,5 (5,5)	7,5 (6,0)	12,5 (10,5)	13,5 (11,0)	
	7-10	4,0 (4,0)	4,5 (4,5)	5,5 (5,5)	6,5 (6,5)	8,5 (6,5)	9,5 (8,0)	14,0 (11,5)	15,5 (13,0)	
	>10	5,5 (5,5)	8,5 (8,5)	7,5 (7,5)	12,0 (12,0)	11,0 (9,0)	16,5 (15,0)	17,0 (14,0)	22,5 (20,0)	

Levels of valuation haircuts applied to eligible marketable assets										
Credit quality	Residual maturity (years)	Liquidity categories								Category 5
		Category 1		Category 2		Category 3		Category 4		
		fixed coupon	zero coupon	fixed coupon	zero coupon	fixed coupon	zero coupon	fixed coupon	zero coupon	
BBB+ to BBB-	0-1	5,5 (0,5)	5,5 (0,5)	6,0 (1,0)	6,0 (1,0)	8,0 (1,5)	8,0 (1,5)	15,0 (6,5)	15,0 (6,5)	not eligible
	1-3	6,5 (1,5)	6,5 (1,5)	10,5 (2,5)	11,5 (2,5)	18,0 (3,0)	19,5 (3,0)	27,5 (8,0)	29,5 (8,0)	
	3-5	7,5 (2,5)	8,0 (3,0)	15,5 (3,5)	17,0 (4,0)	25,5 (4,5)	28,0 (5,0)	36,5 (9,5)	39,5 (10,0)	
	5-7	8,0 (3,0)	8,5 (3,5)	18,0 (4,5)	20,5 (5,0)	28,0 (5,5)	31,5 (6,0)	38,5 (10,5)	43,0 (11,0)	
	7-10	9,0 (4,0)	9,5 (4,5)	19,5 (5,5)	22,5 (6,5)	29,0 (6,5)	33,5 (8,0)	39,0 (11,5)	44,5 (13,0)	
	>10	10,5 (5,5)	13,5 (8,5)	20,0 (7,5)	29,0 (12,0)	29,5 (9,0)	38,0 (15,0)	39,5 (14,0)	46,0 (20,0)	

### 3. Own schedule for non-marketable assets and "inverse floaters"

Furthermore, the ECB announced separate schemes to be applied to inverse floating rate instruments as well as to non-marketable assets. An inverse floater is a type of bond or other debt instrument the coupon rate of which has an inverse relationship to short-term interest rates. The haircuts on inverse floaters are notably higher than on the other marketable assets. The schedule for non-marketable assets also graduates haircuts according to the differences in maturities and the credit quality of the assets concerned.

Levels of valuation haircuts applied to "inverse floaters"		
Credit quality	Residential maturity (years)	
AAA to A-	0-1	7,5
	1-3	11,5
	3-5	16,0
	5-7	19,5
	7-10	22,5
	>10	28,0
BBB+ to BBB-	0-1	21,0
	1-3	46,5
	3-5	63,5
	5-7	68,0
	7-10	69,0
	>10	69,5

Levels of valuation haircuts applied to eligible non-marketable assets				
Credit quality	Residual maturity (years)	Asset categories		
		Credit claims		Non-marketable residential mortgage-backed debt
		Fixed interest payment and a valuation based on a theoretical price assigned by the National Central Bank	Fixed interest payment and a violation according to the outstanding amount assigned by the National Central Bank	
AAA to A-	0-1	8,0	10,0	24,0
	1-3	11,5	17,5	
	3-5	15,0	24,0	
	5-7	17,0	29,0	
	7-10	18,5	34,5	
	>10	20,5	44,5	
BBB+ to BBB-	0-1	15,5	17,5	not eligible
	1-3	28,0	34,0	
	3-5	37,0	46,0	
	5-7	39,0	51,0	
	7-10	39,5	55,5	
	>10	40,5	64,0	

#### 4. Timing

The above-mentioned amendments to the ECB's General Documentation will come into force on 1 January 2011.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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