

ECB releases first details of its covered bonds purchase programme

On 7 May 2009, the Governing Council of the European Central Bank ("ECB") announced its plan to introduce a programme for the purchase of euro-denominated covered bonds issued in the euro area in a total volume of about EUR 60 bn (the "**Programme**").

The Programme is intended to serve as an additional measure for enhancing the liquidity of European banks in response to the continuing constrained market conditions. The details, however, have so far been subject to vivid speculation in the press and among market participants. In the absence of further information from the ECB, it was unclear which types of covered bonds would be eligible, in particular whether the Programme would only extend to "covered bank bonds" that are compliant with the requirements of article 22 (4) of the European Directive 85/611/EEC on Undertakings for Collective Investment in Transferable Securities ("**UCITS**"), or possibly also to certain non-UCITS-compliant structured covered bonds.

In a press release of 4 June 2009, the Governing Council of the ECB now released some details of the Programme¹. This Newsletter summarises these details, gives a first brief analysis on their implications and identifies some remaining questions.

1. The Programme

Further to the press release of the ECB, the Programme will be structured in accordance with the following criteria:

Execution of purchases: The purchases will be "distributed across the euro area" and will be carried out by means of direct purchases. The purchases will be conducted in both the primary and the secondary markets.

Purchase volume: The total volume of covered bonds to be purchased by the ECB amounts up to EUR 60 bn.

Timeframe: The purchases will start in July 2009 and are expected to be fully implemented by the end of June 2010 at the latest.

Eligible instruments: In order to be eligible for purchase under the Programme, covered bonds must:

- be eligible for use as collateral for Eurosystem credit operations;
- comply with the criteria set out in Article 22 (4) of the UCITS Directive or similar safeguards for non-UCITS-compliant covered bonds;
- have, as a rule, an issue volume of about EUR 500 m or more and, in any case, not lower than EUR 100 m;

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¹ See http://www.ecb.int/press/pr/date/2009/html/pr090604_1.en.html

- have, as a rule, been given a minimum rating of AA or equivalent by at least one of the major rating agencies (Fitch, Moody's, S&P or DBRS) and, in any case, not lower than BBB-/Baa3; and
- have underlying assets that include exposure to private and/or public entities.

Eligible counterparties: The counterparties eligible to sell under the Programme are those eligible for the Eurosystem's credit operations, as well as euro area-based counterparties used by the Eurosystem for the investment of its euro-denominated portfolios.

2. Analysis

By clarifying that it will buy covered bonds both in the primary and secondary markets (i.e. from issuers as well as from investors), the ECB avoids the charge of discriminating countries that have no or only a few covered bond issuers against countries with more developed covered bond markets (such as Germany). Hence, banks that are not issuers of covered bonds themselves may still sell to the ECB covered bonds from other issuers in which they had previously invested.

Apart from that, it remains to be seen whether the statement according to which purchases will be "distributed across the euro area" means that the purchases will be carried out via some kind of a tender allotment procedure that is open to all Eurosystem counterparties in general (as is usual with respect to the Eurosystem's standard credit operations), or whether there will be certain fixed quotas in respect of issuers and/or market participants located in single European countries.

It probably comes as no surprise that covered bonds eligible under the Programme must fulfil the general requirements on eligible marketable assets for Eurosystem credit operations (as set forth in chapter 6 of the ECB General Documentation on Eurosystem Monetary Policy Instruments and Procedures). More

remarkable is that not only covered bonds within the meaning of article 22 (4) of the UCITS Directive (i.e. certain statutory covered bonds), but also non-UCITS-compliant covered bonds that comply with "similar safeguards" are eligible. This approach could possibly include certain non-UCITS-compliant structured covered bonds which are nevertheless eligible as collateral in Eurosystem credit operations (for example, as "normal" bonds). However, further clarification by the ECB on which instruments can be considered as meeting the requirement of having "similar safeguards" as UCITS-compliant covered bonds is highly desirable.

The requirement that eligible covered bonds "have underlying assets that include exposure to private and/or public entities" is not entirely self-explanatory. With this statement, the ECB presumably wants to invalidate previous concerns according to which covered bonds backed by public loans might not be eligible, due to restrictions on extending credit to the public sector.

Finally, it remains to be clarified how the ECB intends to apply its "as a rule" requirements in regard of the minimum rating and issuance volume of eligible covered bonds.

3. Summary

To summarise, the ECB's new press release is helpful as it invalidates some of the major concerns and speculations that came up in public since the ECB's first announcement of 7 May 2009. However, a number of details, especially with regard to the eligibility criteria for covered bonds and the execution of purchases under the Programme still need to be defined more accurately. Whether this will happen in further announcements or by amendments to the ECB Guidelines remains to be seen. Finally, what market participants should also be curious about is the position that the ECB will take on possible exit strategies in regard of the Programme (which might involve selling back covered bonds to the market at a certain point in time).

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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