6 February 2008

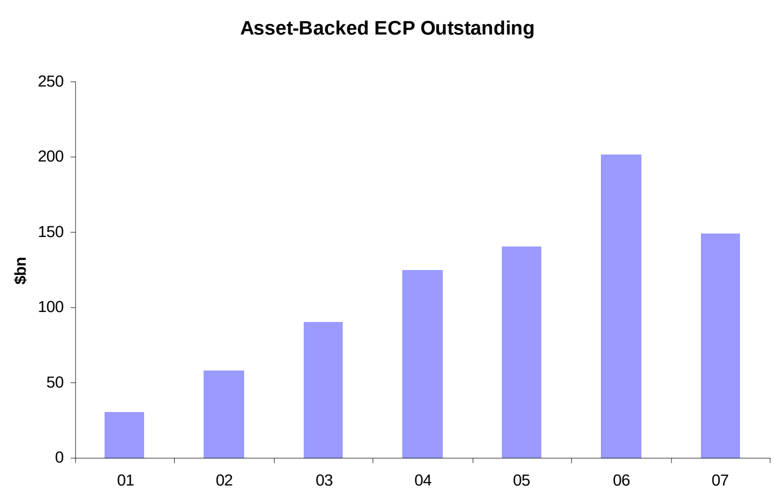
ESF and ICMA Review of the European ABCP Market, Structures, Reporting Practices and Investor Considerations

Executive Summary

The purpose of this report is to review the European asset backed commercial paper (ABCP) market and structures, summarise current issuer disclosure and reporting practices, identify market participant viewpoints about the current state of the ABCP market, and to serve as a discussion paper with ABCP investors as to ways in which current business practices could potentially be enhanced so as to maximise investor participation in the market.

Background - Size of the ABCP Market

The global ABCP market reached $1.5 trillion in outstandings by the end of June 2007. Of this, asset-backed euro commercial paper (ABECP) reached $280 billion, while asset-backed Billets de Trésorerie totalled about $24 billion. European sponsored ABCP programmes issued $275 billion of the $1.2 trillion of U.S. ABCP outstanding. Triggered by investor concerns over potential exposure to US subprime mortgages and RMBS and the ensuing "credit crunch", global ABCP has steadily declined, with ABECP and US ABCP outstandings ending 2007 at $149 billion and $850 billion, respectively. Activity in some ABCP programmes is returning to more normal issuance levels and pricing, but more work needs to be done.



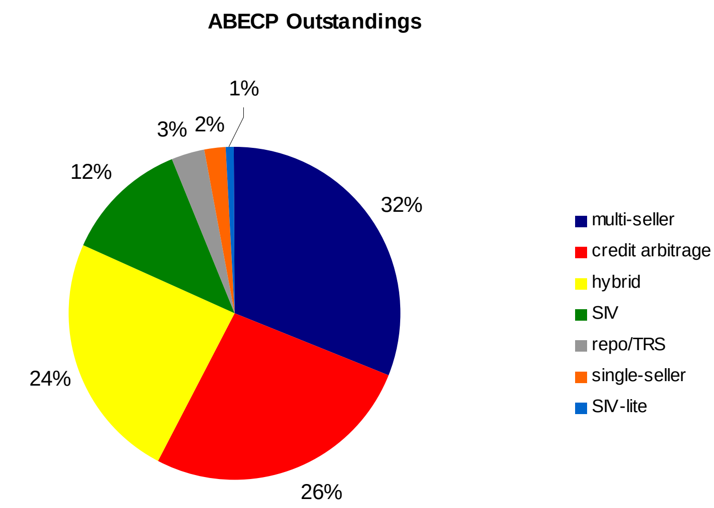
Sources:CPWare, Federal Reserve, Moody's

Rationale and Benefits of the ABCP Market in Europe

ABCP has benefits for both issuers and investors. In terms of benefits for issuers, these include cost-effective financing of both client-driven assets and securities investments; capital relief (in some cases) and capital-efficient financing; flexibility to fund in varying amounts and currencies to match current business volume needs, and also to provide short-term loan or securities warehouse financing prior to ABS term issuance. Issuers also benefit from having access to both European and US ABCP investor markets as well as a diversified investor base with high geographical and type differentiation.

Investor benefits include incremental spread over many corporate CP programmes, a wider investment product offering and diversification; the ability to invest in instruments with a defined purpose, structure, and strategy which can be analysed in detail if desired; a large amount of continuous supply; and flexible maturities. In Europe, more than fifty percent of European ABCP investors are money markets funds.

Types of ABCP Programmes



Data source: CPWare, 30/06/07

For the purposes of this report, we have defined seven basic types of ABCP programmes:

1. Multi-Seller Conduit: A Special Purpose Vehicle (SPV) that buys and holds financial assets from a variety of sellers. Multi-seller conduits are typically administered by a large highly rated commercial bank that establishes the vehicle to provide financing for a variety of bank clients. This programme relies on bank liquidity agreements to back-stop its maturing debt, and the liquidity facilities are typically sized to cover 100% of maturing ABCP. The obligation of the liquidity

provider to fund is much more robust than in the Canadian market, although generally there is no requirement to fund defaulted assets. Most multi-seller conduits purchase a variety of asset types, but in some cases purchase only a single asset type, such as commercial mortgages. Most conduits have very little capital. Ratings of the ABCP are dependent on the ratings of the liquidity facility provider. Most programmes include programme-wide credit enhancement facilities to provide additional credit protection;

2. Single-Seller Conduit: An SPV that buys and holds financial assets from a single seller. These conduits are typically managed by a highly rated bank or an independent finance company and rely on bank liquidity agreements to back-stop its maturing debt, and the liquidity facilities are typically sized to cover 100% of maturing ABCP;

3. Credit or Securities Arbitrage Conduit: An SPV that allows administrators to finance highly rated securities (typically ABS) and other marketable debt. This programme relies on bank liquidity agreements to back-stop its maturing debt, and the liquidity facilities are typically sized to cover 100% of maturing debt. A small subsection of this sector, which is typically less than 1% of the market, is "black box", whereby the investor receives limited or no information on the assets and must rely on 100% support from a total return swap or other backing provided by a highly rated financial institution;

4. Hybrid Conduit: SPV that combines elements of multi-seller and credit arbitrage conduits. Typically these vehicles will own both receivables/loans, as well as securities. The liquidity facilities are typically sized to cover 100% of maturing debt.

5. Repo/TRS Conduit: An SPV that funds highly rated financial institution assets through repo and total return swaps. Programme assets must mature before or at the same time as liabilities since there are no bank liquidity backstops.

6. Structured Investment Vehicle (SIV): Unlike conduits, SIVs have significant capital, which are typically called "capital notes". This capital is typically leveraged 10-15 times through CP and MTN issuance to buy a diversified portfolio of highly rated debt securities (mostly financial institution and ABS issues). Interest rate and FX risks are hedged. SIVs operate under a capital model, which determines the allowable mix of average asset rating and asset/liability gap. Strict compliance tests must be met weekly and daily. Bank liquidity facilities for the CP are much smaller than for conduits, typically sized at fewer than 15% of assets, due to the ability of the SIV to sell assets, assuming normal market conditions, to fund maturing CP.

7. CDO Programmes or SIV-lites: A SIV-lite is a CDO where funding is provided through a combination of term notes and ABCP. These structures are also not fully covered by liquidity facilities.

Primary Causes of Market Retrenchment

As stated earlier, the drop in ABCP outstandings was triggered by investor concerns over potential exposure to US subprime mortgages and RMBS, and the ensuing "credit crunch". Over time, specific events and factors were of particular importance:

1) A few conduits had large ABS holdings that experienced large declines. When investors stopped rolling over ABCP, these conduits relied on backstop facilities which were too large for the banks providing them. While these banks received support to meet their obligations, investor confidence was damaged.
2) SIV-lites suffered declines on their portfolios given unprecedented volatility, which forced them into "work-out" mode. Similarly, declines in asset values forced a few SIVs into administration. This led to the loss of confidence of investors in "Market Value" structures, where programs have limited backstops and capital and may need to pay back non-rolling CP through the sale of assets, regardless of market conditions.
3) Structures in other ABCP markets around the world unsettled investors, including different backstop liquidity agreements and single-seller extendible mortgage conduits.
4) Conservative short term investors are concerned with capital preservation more than returns. These investors are not paid to take risk and cannot tolerate losses. Short term investors exit markets in times of uncertainty.
5) Money market funds must be able to meet redemptions at all times. These funds have been concerned that their underlying investors – who are less knowledgeable about ABCP - might pull out funds given market events and headlines. As a result, funds have built large liquidity positions rather invest as usual.
6) As events unfolded, some investors realised their approval process was too rating agency-based, and stopped buying as they reviewed credit procedures and studied disclosure documents more thoroughly.
7) General concerns about the banking sector have caused investors to buy less bank-related product.

The market will confirm over time the structures that can withstand potential market stress, work to "re-calibrate" others, and reject a few altogether.

Current Disclosure Practices and legal issues

Investors typically rely primarily on four sources of information - information memorandums, rating agency reports, issuer presentations, and programme sponsor-issued "pool reports" to make informed investment decisions.

- Information Memorandums: the primary marketing document of the programme, which includes issuer description, terms and conditions, form of notes, and selling restrictions. This document is normally made available only to actual and potential investors permitted under the selling restrictions, because the commercial paper is sold to institutional investors in the private placement market and usually is not listed on an exchange.

- Rating Agency Reports: Almost all major programmes have top ratings from at least two rating agencies in order to be marketable. To obtain top ratings, issuers must meet structural and credit standards, satisfy documentation requirements, and be subject to ongoing monitoring and surveillance. Once ratings are obtained, agencies produce "pre-sale" and "new issuance" reports describing programmes as well as regular ongoing reports.

- Investor Presentations: Most issuers prepare investor presentations outlining the structure of the programme including details on credit enhancement and liquidity facilities. Further, these could include detail on the sponsoring institution that manages the programme.

- Pool Reports: These reports, which are typically distributed on a monthly basis, broadly describe current assets and verify compliance with programme requirements. Pool reports are generally only made available to programme investors and potential investors, so as to safeguard sensitive client and competitive information. Typically, pool reports provide a significant amount of disclosure on the characteristics of the portfolio holdings. However, if requested and upon signing of a confidentiality agreement (in order to maintain required seller and receivable confidentiality), issuers may be able to provide detailed asset-by-asset level of portfolio holdings to investors. Pool reports are generally distributed to existing and potential investors by e-mail, but a few issuers utilise password-protected websites.

In addition to this information, most issuers and dealers are available to meet on a one on one basis with investors, and attend a variety of industry and rating agency workshops and conferences.

As ABCP conduits normally do not list their ABCP, they are not subject to the obligation under the Market Abuse Directive (MAD) to disclose price sensitive information to the public. However, the legal position is unclear as to disclosure obligations under the MAD where an ABCP conduit or, more usually, an SIV has listed MTN tranches which are pari passu with or junior to the unlisted ABCP tranches in the waterfall of payments.

Study on ABECP Monthly Pool Report Data Supplied by Sector

The ESF and ICMA analysed the monthly pool reports of a random sample of 56 of the 93 issuers (60%) with ABECP outstandings on 30 June 2007. These programmes represented $171 billion of outstandings, or 62% of the European market. The appendix shows the percentage of programmes analysed by outstandings that report the various types of data, by ABECP sector.

ASSET-BACKED EURO COMMERCIAL PAPER
MONTHLY POOL REPORT DATA SUPPLIED BY SECTOR
% Supplying Data by Outstandings

Sector		Programme	Liabilities				Liquidity		Asset Breakdown						
	% mkt Analysed by outstanding	Rating(2)	ABCP Outstandings(3)	market Type(4)	Leverage (5)	w avg Maturity (6)	Providers(7)	Enhancement(8)	Rating (9)	Sector (10)	Country (11)	Ccy (12)	some specific asset info (13)	w avg Term (14)	large exposures to monolines (15)
m+s seller(1)	52	60	90	90	n/a	40	100	80	80	100	90	90	80	30	40
credit arb	64	33	89	67	n/a	33	78	50	78	67	56	78	44	22	56
hybrid	62	80	100	80	n/a	20	100	100	100	100	100	100	80	40	80
SIV	85	0	100	100	100	100	100	0	100	100	100	100	0	100	100
SIV-lite	50	0	100	100	100	100	100	0	100	100	100	100	0	100	100
Repo/TRS	78	0	100	100	n/a	100	n/a	n/a	100	100	25	25	25	25	0

(1) "M+S" means multi and single seller conduits
(2) Percentage of the programmes that list the ratings of the programme
(3) Percentage of the programmes that disclose the amount of ABCP outstanding at the end of the period
(4) Breakdown of ABCP borrowing by market type (EU CP/US CP)
(5) Percentage that disclose the leverage ratio of the vehicle (relevant only to SIVs and SIV lites
(6) Percentage that disclose the weighted average maturity of ABCP liabilities
(7) Percentage that disclose the identity of the bank liquidity provider(s)
(8) Percentage that disclose the type and amount of credit enhancement available to the liquidity provider
(9) Percentage that provide breakdown of assets by rating (%)
(10) Percentage that provide breakdown of assets by sector (%)
(11) Percentage that provide breakdown of assets by country (%)
(12) Percentage that provide breakdown of assets by currency (%)
(13) Percentage that provide some specific information on each asset (e.g. type of asset; type, country, and/or rating of borrower; ISIN (%)
(14) Percentage that disclose the weighted average maturity of assets (%)
(15) Percentage that disclose large exposures (%)
**Analysis of the monthly pool reports of 56 of the 93 issuers (60%) with ABECP outstandings on 30 June 2007. These programmes represented $171 billion of outstandings, or 62% of the market.

Source: Bank of America

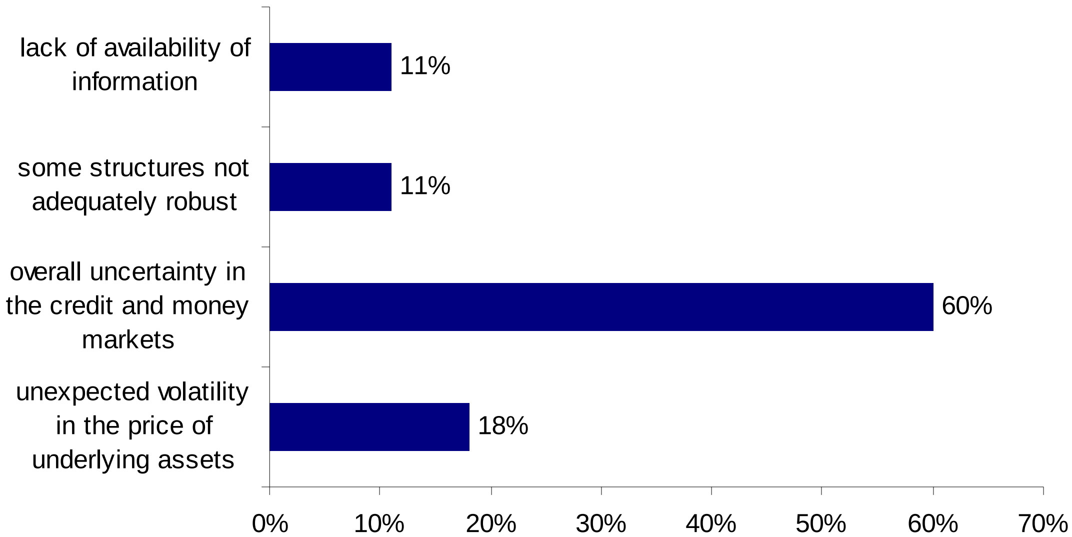
Market Participant Attitudes on Disclosure:

The fifth annual Moody's and ICMA ABCP SIVs conference took place on 18 October 2007 in London. The event was attended by almost 500 market participants. The main results of electronic polls of participants conducted at the conference can be summarised as follows:

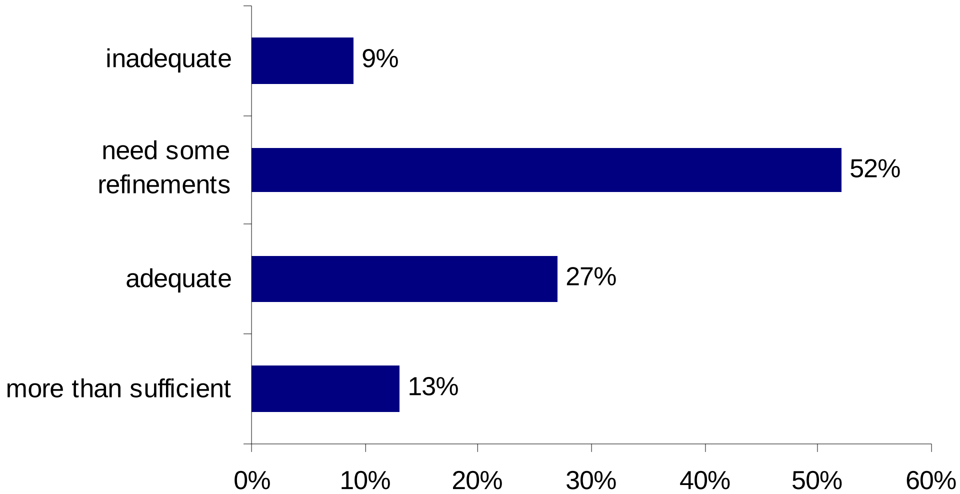
- The decline in ABCP outstanding is mainly due to uncertainty in the credit and money markets;
- Information memos, pool and rating agency reports, investors presentations could use some refinement for investors to make an informed decision on ABCP investments;
- The exit from the market of certain types of ABCP programmes should help restore investor confidence. Issuer disclosure has been thought largely to be adequate, although discussion with investors over enhancements has been and will continue to be welcome;
- Additional regulation is the least likely to assist in the return of investor confidence.

Electronic polls of the audience during the plenary sessions (233 participants: investors 28%, issuers 23%, dealers 18%, other 31%) yielded the following:

What is the main reason for the decline in ABCP outstandings?



In making decisions to invest in ABCP, info memos, pool reports, rating agency reports, investors presentations, and conferences are



What is most likely to assist in the return of investor confidence and growth in ABCP?