

Structured Finance EMEA Market Report

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SPANISH RMBS STRUCTURES FEATURE MECHANISMS THAT MAKE THEM WELL ADAPTED TO A CHANGING ENVIRONMENT

The Spanish banking system has the rare privilege in Europe to be able to rely on two mature mortgage refinancing markets: securitisation and covered bonds. Although the Spanish RMBS market is showing signs of the impact of Basel II on structures and on the first-loss investor base, we do not expect a change in the balance between covered bonds and the RMBS market. The maturity of the mortgage refinancing market has been promoted by the oldest legal framework in Europe and yet is still adapting to market needs. For example, access to securitisation techniques has been extended to small and medium-sized banks thanks to the well-designed multi-originator structures that are now commonplace. Also, in a single multi-originator transaction, investors can not only get exposure to a variety of originators, but they sometimes also have the choice of an exposure to either low LTV or high LTV loans (Mixto deals). Finally, Spanish RMBS transactions feature a combined waterfall mechanism with generally reversible sequential/pro rata amortization, which is particularly suitable in a high prepayment-rate environment and in jurisdictions having slow recovery processes.

EMEA STRUCTURED FINANCE MARKET REVIEW AS OF 15 JUNE 2007

Over the last two weeks, 18 transactions, totalling EUR 23.00 billion, have been placed, bringing the year-to-date cumulative volume to EUR 244.47 billion, which is 69% more than for the same period in 2006. DBRS presents a detailed look at the securitisation market, featuring the following graphs and charts:

Total New Issues Volumes	Volumes Breakdown by Country of Risk
Benchmark Curves	Volumes Breakdown by Weighted-Average Life
Launch Spread	Volumes Breakdown by Currency
Volumes Breakdown by Asset Class	Volumes Breakdown by Rating Categories

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(Click on each title to go directly to the article, graph or chart.)

SPANISH RMBS STRUCTURES FEATURE MECHANISMS THAT MAKE THEM WELL ADAPTED TO A CHANGING ENVIRONMENT

General Overview

Spanish banks more often look to alternative sources of funding for their mortgage activity rather than trying to get their mortgage risk off their balance sheets. In this context, the Spanish banking system has the rare privilege in Europe of being able to rely on two mature mortgage refinancing markets: securitisation and covered bonds (*Cédulas Hipotecarias*). Although the Spanish RMBS market is showing signs of the impact of Basel II on structures and on the first-loss investor base, we do not expect a change in the balance between covered bonds and the RMBS market. According to regulation, loans with LTVs of more than 80% are indeed not eligible for *Cédulas* and therefore can only be subject to securitisation. In addition, multi-originator RMBS remain the only viable mortgage refinancing technique for small and medium-sized savings banks.

The maturity of the mortgage refinancing market has been promoted by a legal framework that is one of the oldest in Europe and yet still adapting to market needs. For example, access to securitisation techniques has been extended to small and medium-sized banks thanks to the well-designed multi-originator structures that are now commonplace. Also, in a single multi-originator transaction, investors can not only get exposure to a variety of originators, but they sometimes also have the choice between two series of notes that offer exposure to either low LTV or high LTV loans. These transactions are called *Mixto*. Finally, Spanish RMBS transactions feature a combined waterfall mechanism with generally reversible sequential/pro rata amortisation. These structures allow for different repayment speeds for the asset portfolio on one side and for the bonds on the other. They are, therefore, particularly suitable in a high prepayment-rate environment and in jurisdictions having slow recovery processes.

It is no surprise that Spanish banks have recently marked a deep interest in finding ways to securitise equity pieces of their own originated RMBS transactions. Under Basel II, the retained below-investment-grade risk from a bank's own originated deals is indeed more severely treated than the acquired risk, especially under the standardised approach, which is supposed to be adopted by small to medium-sized banks, which are generally involved in the issuance of Spanish multi-originator deals. Up to now, Spanish banks have had a higher propensity to keep the subordinated tranches of the transactions they originate. They will now have to take into account the marketability of the equity pieces of these transactions to either non-regulated investors or to CDOs, which, in both cases, have a powerful influence on ratings and prices. This trend is true for all European markets but newer for the Spanish market.

Spanish RMBS traditionally refinance non-sophisticated loans involving lower credit enhancement and less subordinated tranches to place, as opposed to U.K. transactions, for example. Sub-prime mortgage lending represents less than 4% of total mortgage lending in Spain. However, some recent developments have been seen with more flexible mortgages, but also riskier mortgages, involving longer repayment periods and higher LTVs, even interest-only loans.

(1) One of the Oldest and Yet Constantly Adapting Legal Securitisation Frameworks

FTH Transactions Date Back to 1992 and Allow for Low LTV Loan Securitisations

Spain's Law 19/1992 is among the oldest laws governing securitisation in Europe, dating back to 7 July 1992. It is the securitisation leg of the legal body for mortgage bonds that was set up in the early 1980s,¹ when credit institutions were authorised to issue three types of securities, among them *Cédulas Hipotecarias* and *Participaciones Hipotecarias* (PH). PH are shares having rights over first-rank mortgage loans with a maximum LTV of 80% when the loan purpose is either home acquisition, construction or refurbishment and 70% otherwise.

Under Law 19/1992, PH can only be securitised via a bankruptcy-remote RMBS issuance vehicle, the *Fondo de Titulización Hipotecaria* (FTH). The FTH has no legal power and is fiscally transparent, so the rights (PH) are held on its behalf by a *Sociedad de Gestora* (management company) that can exercise them in case of problems. There are seven major management companies: Ahorro y Titulización (AYT), Europea de Titulización, Santander de Titulización, GestiCaixa, Titulización de Activos (TDA), InterMoney Titulización and GAT.

FTA Transactions, Dating Back to 1998, Extend the Scope of Eligible Assets

In 1998, a Royal Decree² extended the scope of eligible assets to categories other than mortgage loans. Another vehicle was created, the *Fondo de Titulización de Activos* (FTA). The FTA has now replaced the FTH because it is more flexible as it can securitise any type of assets. Its immediate success on the RMBS side, both from an originator and investor perspective, has resulted from the fact that it is authorised to hold loans with LTVs of more than 80%. Contrary to the FTH, the FTA collateral consists of one of the following:

- PH representing mortgage loans with LTVs of less than 80%.
- *Certificados de Transmisión Hipotecaria* (mortgage transmission certificates, CTH), which are identical to PH but represent loans with LTVs of more than 80%.

The FTA vehicle is also used for the securitisation of SME (PYMES in Spanish) loans or mortgage loans and, since a ministerial order of 1999,³ the bond can benefit from state backing (FTPYMES).

(2) Most Typical Spanish Structures Are Multi-Originator with Combined Waterfall

Multi-Originator and Mixto Structures

Multi-originator transactions are collateralised by very granular pools of loans originated by multiple local banks that, individually, ensure the servicing of the loans to their customers. Business volumes originated by these small and medium-sized savings banks are indeed too small to make stand-alone transactions economically viable. So they agree to pool their loan portfolios. Most of these transactions can be easily identified by the AYT and TDA management companies incorporated in their name. They feature a combined waterfall mechanism where interest and principal payments received from the loans are merged into a single flow.

Mixto transactions, a variety of multi-originator structure, issue two series of notes, each backed by a distinct and independent pool of loans. Pools differ by the type of eligible loans in it. The first sub-pool, generally the largest, offers exposure to mortgage loans (actually *participaciones*) with LTVs of less than 80%, while the other sub-pool offers exposure to mortgage loans with LTVs of more than 80%. Risk associated to each sub-pool must not contaminate the notes associated to the other pool. For this reason, *Mixto* deals incorporate two waterfalls linked to the two sub-pools, each with its own reserve account.

Combined Waterfall Mechanism: Advantages and Drawbacks

The “combined waterfall” mechanism is common to most Spanish transactions but also to many southern European transactions. Interest and principal received from loans are combined in a single flow that is dedicated first to the payment of the coupons due on all tranches, including subordinated ones, and then to the pass-through amortisation of the principal.

This mechanism is particularly adapted to a high prepayment-rate environment such as the current one and also to jurisdictions having slow recovery processes. There is indeed the possibility to adopt, under certain circumstances, different repayment speeds for the asset portfolio on one side and for the bonds on the other. Another advantage is that it ensures coupon payment to subordinated tranches in a timely manner for the life of the transaction and appears simpler than the independent waterfall system.

There are also drawbacks, however. Despite an apparent simplicity, the rules for dividing the single flow between coupon and principal payments may prove to be complex. In addition, the mechanism can in some extreme circumstances threaten the ultimate payment of principal on senior tranches as they are subordinated to the payment of the coupon on subordinated tranches.

Sequential/Pro Rata Amortisation: Advantages and Drawbacks

The first generations of RMBS featured waterfalls strictly with sequential principal payments under which, once all coupons are paid on all tranches, the principal is paid the following way: one tranche starts to be redeemed once the more senior tranches have been fully redeemed.

In the last two years, transactions featuring a reversible switch sequential/pro rata payment have been set up under which sequential payments turn to pro rata as soon as the proportion of outstanding subordinated tranches exceeds a certain threshold and as long as certain quality triggers, based on defaults and delinquency rates, are not exercised. During the pro rata period, the coupon payment remains senior to the principal payment but each tranche receives a pro rata percentage of distributable principal regardless of class seniority. In the case where the above-mentioned quality triggers are exercised, the structure reverts to sequential pay to protect the senior bondholders.

The advantage of a reversible switch sequential/pro rata structure is the stability of the transaction refinancing cost during the life of the transaction, which in turn tends to keep the excess spread level more stable. Contrary to strictly sequential pay, which increases transaction enhancement over time, enhancement levels remain stable in a pro rata structure because senior bondholders don't benefit from all principal paydowns. The quality of the triggers that revert the structure to sequential pay from pro rata becomes therefore crucial to senior bondholders.

Differences with U.K. Transactions

Northern European transactions, principally U.K. and Dutch multi-originator structures, are different in that they do not feature the combined waterfall system but split revenues from the asset pool into two distinct waterfalls:

- Principal due on bonds is repaid by expected, early or forced principal repayments from loans. If required, the flow of principal is enhanced by the excess spread and the reserve fund.
- Interest due on bonds is paid by interest received from the loans.

(3) Credit Enhancement Features Make Spanish RMBS Flexible to a Challenging Economic Environment

We have seen that under certain circumstances, different repayment speeds may be adopted for the asset portfolio on one side and for the bonds on the other. Some credit enhancement features allow this:

Originator Bears the Cost of Any Artificial Write-Off

Excess spread is the first line of defence for investors, generally via the artificial write-off system that is commonly used by Spanish and Italian RMBS. When a loan is in arrears for at least 12 to 18 months, it is assimilated as a loss, which is absorbed by the excess spread. The corresponding amount is repaid to investors. Any amount subsequently recovered is included in the waterfall. As a result, the originator to which unused excess spread is normally due bears the cost of any artificial write-offs.

Independent and Amortisable Reserve Fund

The reserve fund is the second line of defence. The waterfall, or each waterfall for *Mixto* deals, has a corresponding reserve fund that is generally amortisable. Provided that certain triggers relating to the reserve size or to the pool performance are not exercised, the reserve fund is amortised pro rata to the repayment of its associated pool. A floor is usually set below which the reserve fund may not fall.

At issue, the reserve fund for FTH deals is generally set at 1% to 1.5%, with the lower limit about 1% of the pool size and the upper limit at about 3.5%. This is also the case for the first sub-pool (low LTVs) of *Mixto* deals.

For the second sub-pool of *Mixto* deals (higher LTVs), the reserve fund specifications are more complex. The initial upper and lower limits, which are set higher than for the first sub-pool, depend on the sub-pool's initial LTV. The required level of reserves decreases in line with the LTV, which falls over time because Spanish mortgage loans are amortisable.

Coupon Deferral Clause

Most Spanish RMBS feature coupon deferral clauses that benefit senior tranches at the expense of subordinated tranches. For the most common transactions – combined waterfall RMBS – coupon payment can be deferred when interest flow comes under a certain limit or as part of the artificial write-off mechanism. In that case, the excess spread is diverted from the coupon payment to the principal payment. Should excess spread not be sufficient, the reserve fund then comes into action. If the reserve fund is empty, the coupons due on junior bond tranches, normally senior to the principal due on senior tranches, become subordinated to the coupon and principal payments on senior bonds.

¹ Law 2/81 dated 25 March and the Royal Decree 685/82 dated 25 March.

² Royal Decree Law 926/1998 dated 14 May.

³ Ministerial Order 1999, dated 28 May.



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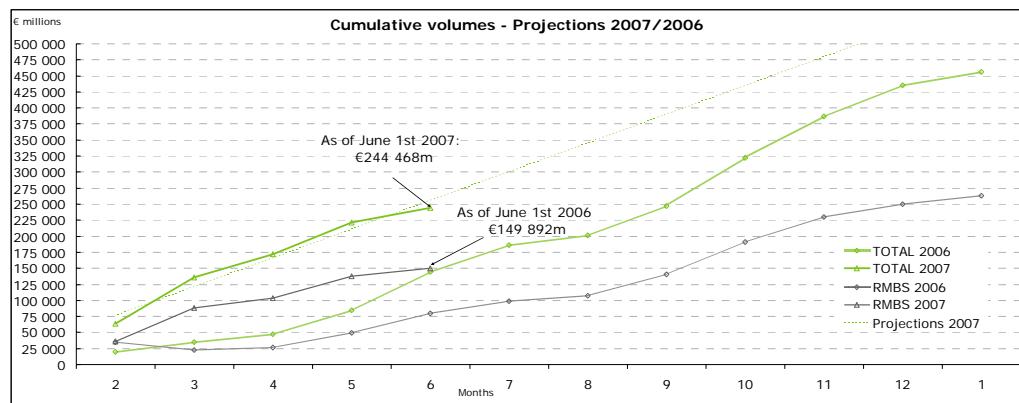
[Return to contents](#)

EMEA STRUCTURED FINANCE MARKET REVIEW AS OF 15 JUNE 2007

Total New Issue Volumes (as of 15 June 2007)

Over the last two weeks, eighteen transactions, representing EUR 23.00 billion, have been placed, bringing the year-to-date cumulative volume to EUR 244.47 billion, or 69% more than for the same period in 2006.

Transactions refinancing U.K. collateral accounted for 36% of the total issued during the previous two weeks, ahead of Danish, 19% (in fact, the EUR 4.3 billion Mermaid Secured Funding deal); Dutch, 14%; Spanish, 7%; German, 6%; and Australian, 4%. The bulk of the difference came from multi-jurisdiction CLOs and CMBS. Euro-denominated tranches have dominated, accounting for 62% of the total, followed by U.S.-dollar and sterling tranches, representing 27% and 8% of the total, respectively. Contributions from AAA tranches were 89%, ahead of AA and "A" tranches at 3%.



Source: DBRS and Bloomberg.

Nine RMBS transactions have been issued, for EUR 17.9 billion, among which four U.K. transactions. The largest, accounting for 40% of the asset class, is the EUR 4.6 billion Holmes 2007-2 deal, refinancing prime mortgage loans originated by Abbey National plc. Then follows the EUR 1.6 billion Arran Residential deal, refinancing residential loans originated by Royal Bank of Scotland (RBS). There were also three Dutch RMBS, including the EUR 2.0 billion Goldfish 2007-1 from Fortis and the EUR 1.2 billion Pearl Mortgage from SNS Bank. A rare event from a geographic location perspective was the Danish EUR 4.3 billion benchmark deal, Mermaid Secured Funding. It was originated by Danske Bank to transfer the credit risk linked to a pool of loans backed by Danish mortgage loans.

Five CLOs have been also priced during the period, among which one Spanish SME-CLO, BBVA 6 FTPYME, totalling EUR 1.5 billion, and four leverage loan CLOs.

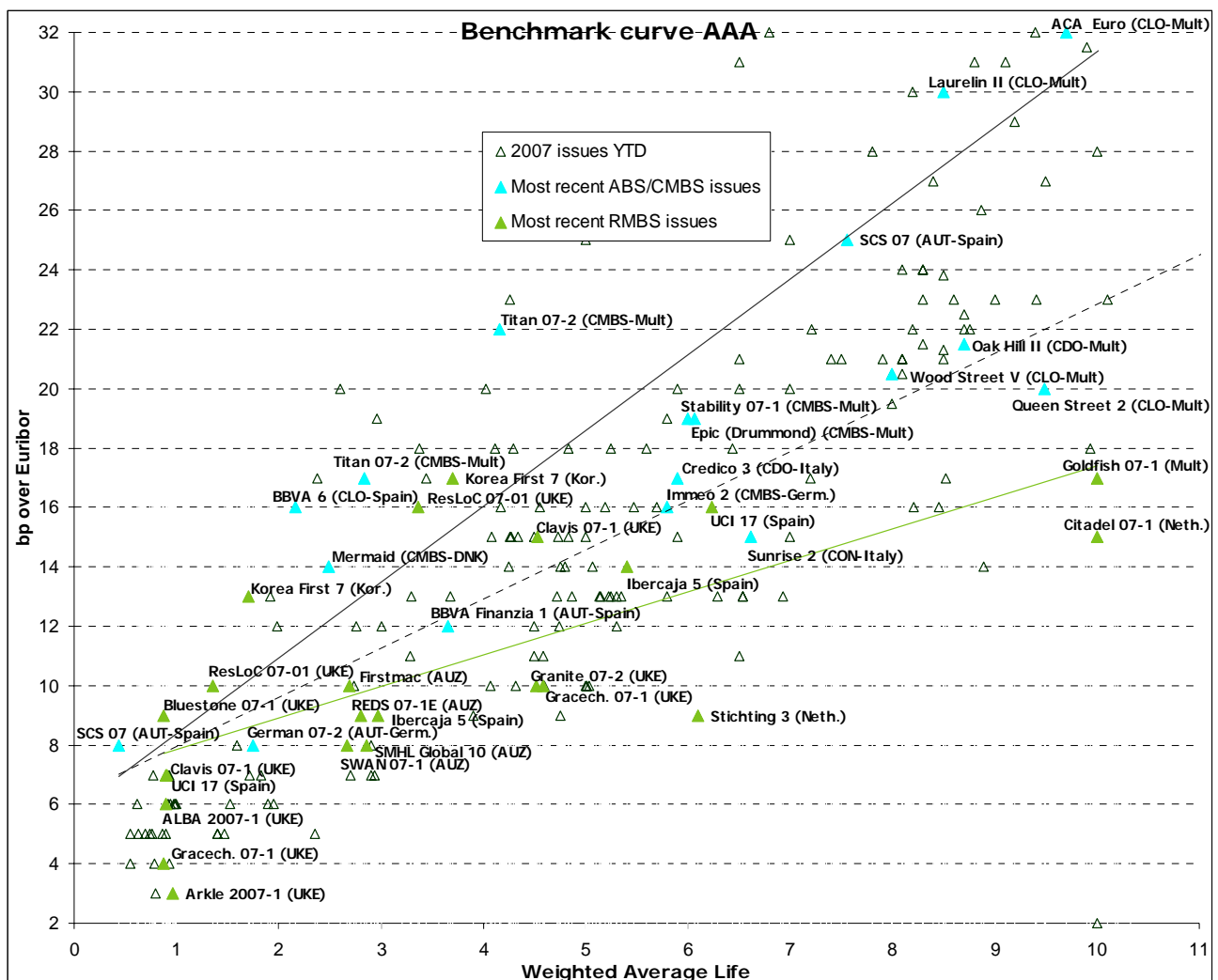
Worth being mentioned is the CPUK Mortgage Finance Limited whole-business securitisation, rated by DBRS, for a total of EUR 1.1 billion. The transactions refinance debt incurred by the acquisition of four Center Parcs holiday villages located in the United Kingdom. The villages were purchased by a number of funds managed by The Blackstone Group.

[Return to contents](#)

Benchmark Curves (as of 15 June 2007)

Foreword: The chart below describes the launch spreads term structure of all deals issued since the start of the year. Almost all the transactions are plotted with an unfilled black triangle. The most recent transactions have labels and are plotted with a triangle filled either in green for RMBS or blue for the others. The asset class and the country of risk of the most recent transactions are put along the label in brackets (e.g., SCS 07 (AUT-Spain)).

There were no major changes over the last two weeks. Overall, RMBS AAA tranches posting two-year WALs are priced about 8 to 9 basis points (bp) on average over Euribor, while those with five-year WALs have been priced 4 to 5 bp higher at 12 to 13 bp. The curve is much steeper for the other asset classes. Indeed, AAA tranches with four-year WALs are priced at 15 to 16 bp while those with seven-year WALs are priced 7 bp higher, at around 22 bp. Not surprisingly, the U.K. non-conforming Bluestone Securities 2007-1 has been priced around 4 to 5 bp wider, at 9 bp over three-month Euribor, than its peer from the prime category. This was in line with the other non-conforming ResLoc 07-01 priced early in May.

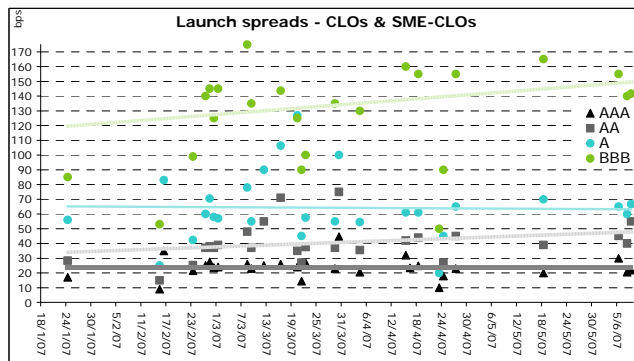
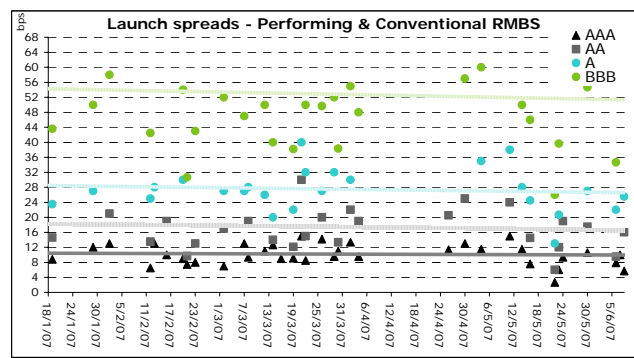
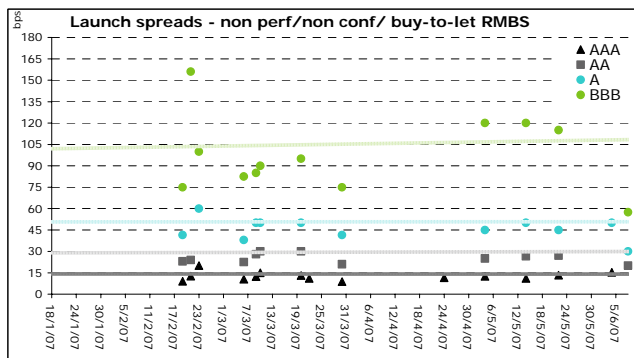
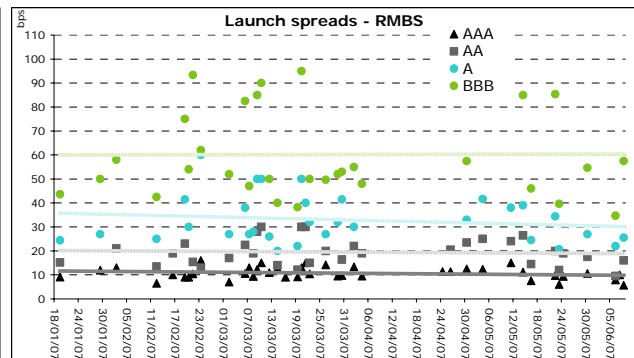
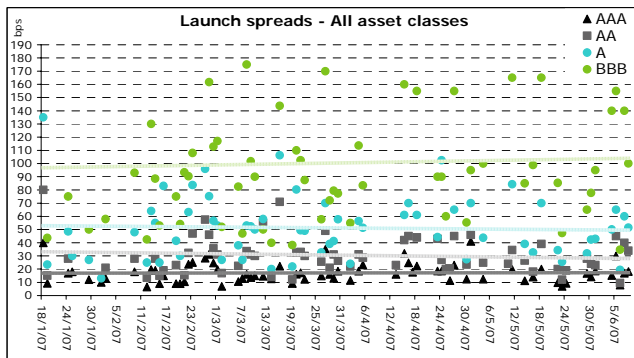
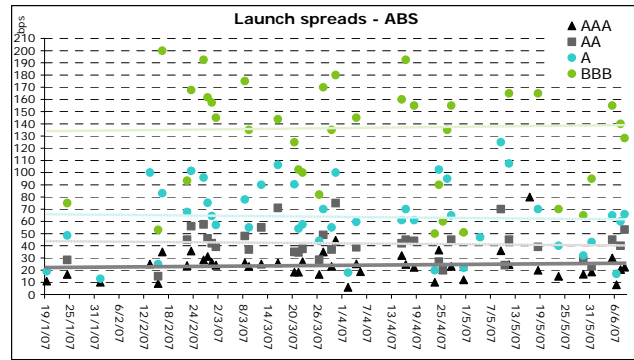
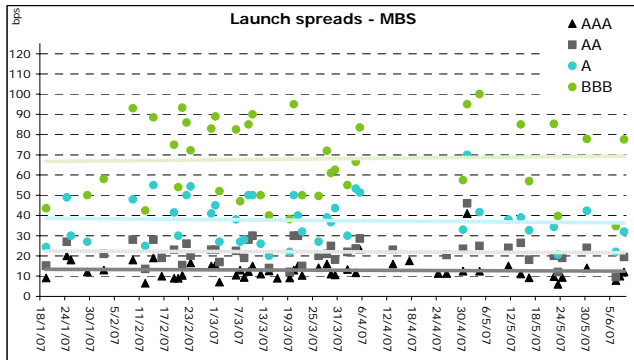


Source: DBRS and Bloomberg.

[Return to contents](#)

Launch Spreads up to 15 June 2007

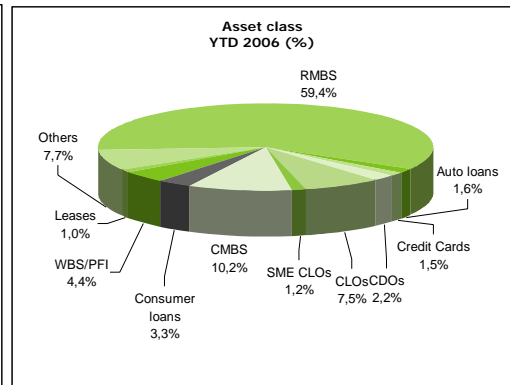
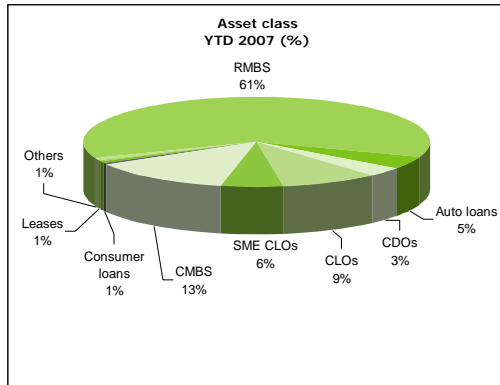
The widening trend observed since the start of the year, especially among ABS is not ending. Within the MBS asset class, the widening trend is visible for non-conforming/buy-to-let U.K. RMBS. Conversely, more conventional RMBS are resisting well, showing stable spreads overall. Of course, the average launch spread level at a certain point in time may reflect not only changes in the pricing of risk, but also a temporary concentration of a (sub) asset class that may be the result of a large deal. To compensate for this, we have deleted the most abnormal points.



Source: DBRS and Bloomberg.

[Return to contents](#)

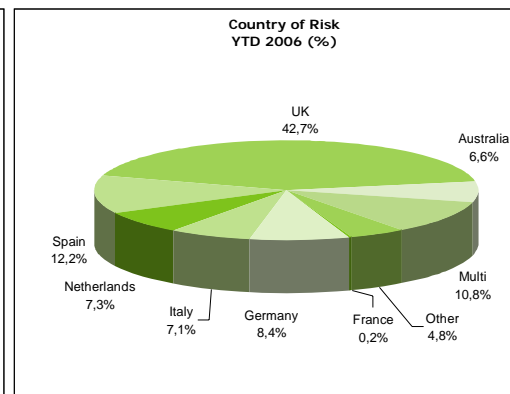
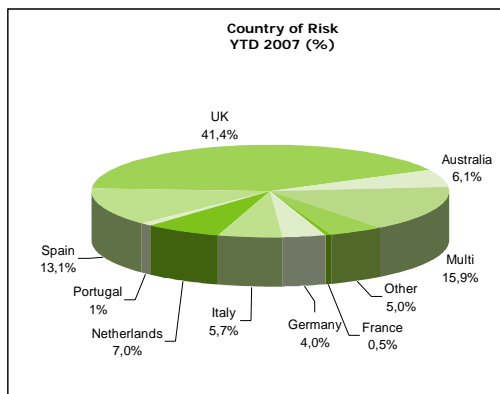
Volumes Breakdown by Asset Class (as of 15 June 2007)



Source: DBRS and Bloomberg.

[Return to contents](#)

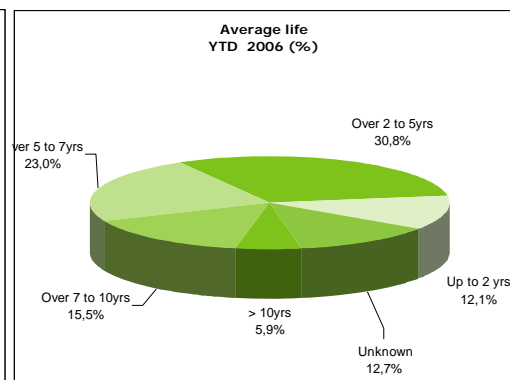
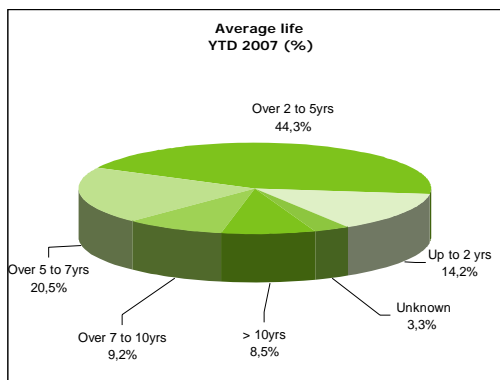
Volumes Breakdown by Country of Risk (as of 15 June 2007)



Source: DBRS and Bloomberg.

[Return to contents](#)

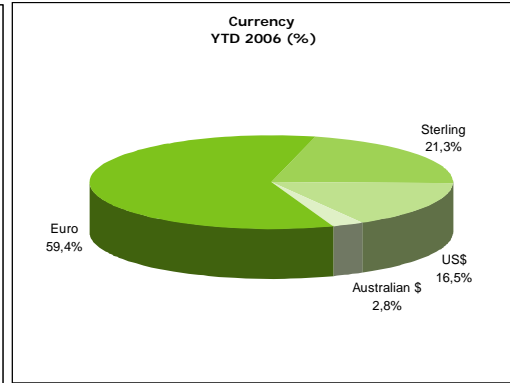
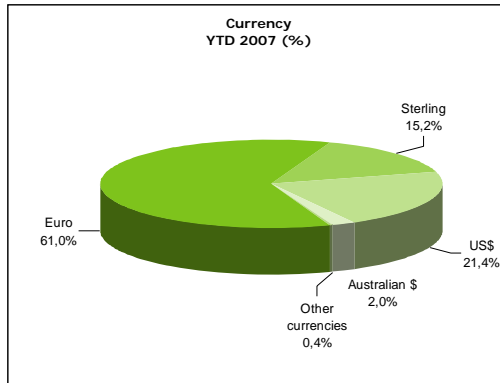
Volumes Breakdown by Weighted-Average Life (as of 15 June 2007)



Source: DBRS and Bloomberg.

[Return to contents](#)

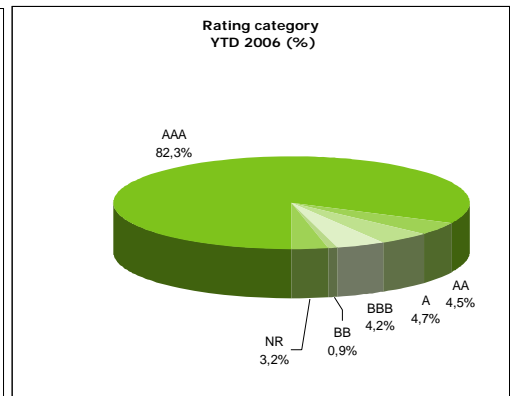
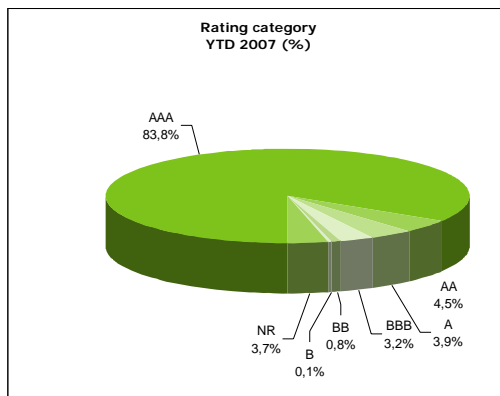
Volumes Breakdown by Currency (as of 15 June 2007)



Source: DBRS and Bloomberg.

[Return to contents](#)

Volumes Breakdown by Rating Categories (as of 15 June 2007)



Source: DBRS and Bloomberg.



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[Return to contents](#)

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[Return to contents](#)

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