# The current trends and the ECB tools in the Portuguese market

By Paula Gomes Freire and Benedita Aires, Vieira de Almeida & Associados, Sociedade de Advogados, RL

In the current market conditions it is crucial to analyse the new trends and the alternative structures that have been adopted in the Portuguese jurisdiction. In this sense, the following article presents an overview of the innovative paths that have been carried out, focusing on public sector bonds, state guaranteed deals and new types of assets, as well as providing an outline of the European Central Bank's transactions prepared in, and issued out of Portugal.

The financial market turmoil has created a number of serious challenges to market players worldwide, namely in what concerns the search for feasible alternatives to raise liquidity, also strongly felt in the Portuguese market. Portuguese banks are, in this sense, using the - possible alternative mechanisms and structures to find a manner of funding their activities and, in such scenario, new types of assets have been used and credit institutions have been turning to solutions presented by the European Central Bank instruments.

Specifically in relation to the Portuguese context, public sector bonds have been put in place and have been issued (namely for subscription by the European Investment Bank). The highlights of these public sector bonds are that these provide for a collateralisation percentage of not less that 100% and are collateralised by credit assets over central administrations, regional or local authorities of any EU Member State and by receivables secured by an express and legally binding guarantee issued by any of such central administrations, regional or local authorities of any EU Member State, together with other assets not exceeding 20% of the portfolio that may also be included, such as deposits with the Bank of Portugal in cash or securities and deposits with credit institutions.

On the innovative assets front and in terms of securitisation, the Portuguese vehicles have also purchased for securitisation purposes receivables pertaining to electricity tariff deficits due from the Portuguese National Electricity System, which reflect positive adjustments in the electricity tariffs.

Additionally and also a novelty which has been verified across other European jurisdictions, the Portuguese State Guaranteed Deals, provided for in Law no. 60-A/2008 of October 20, 2008 have been established for the purposes of reinforcing the financial stability and availability of liquidity in the Portuguese financial market. In fact, the State guarantee which is a temporary framework may be put in place to guarantee debt issuances of a maturity of up to three years (or five years, in justified cases) of Portuguese credit institutions, an amount of €20bn being available from the Portuguese State to such effect, representing around 13% of the Portuguese GDP. Should the State Guarantee be enforced, the Portuguese State will be subrogated in the right of the issuer's creditor to be fully paid. Portuguese banks have favoured this new structure and in the last semester seven of such credit institutions have accessed to the State Guarantee, corresponding to a volume of €4.95bn of guaranteed deals.

Even though the search for new assets and structures has persisted in the Portuguese jurisdiction, the Issuers have not been able to place debt into the market and the light at the end of the tunnel in search of liquidity has been to use such debt instruments, when eligible, as collateral for European Central Bank repo transactions. However, the ECB has in 2008 and yet in 2009 reviewed its risk control measures for Eurosystem credit operations and banks tapping the ECB in order to raise liquidity by borrowing central bank funds are now in a position where more collateral is required to be posted, both due to the ECB criteria applicable to the determination of eligible collateral and due to the results of the valuation carried out in relation to such assets.

In fact, the designated "refinements" that have been included in the ECB framework, in full force and effect since February 1, 2009 represent, on the one hand, an adoption of certain temporary measures to further expand the collateral framework and enhance the provision of liquidity (such as expanding the list of assets

that are eligible as collateral to debt instruments denominated in currencies other than euro), and, on the other hand, establish a tight access to its lending possibilities by imposing stricter risk control measures.

This has been the case in connection with the amendments at ECB criteria level, and specifically concerning asset backed securities, as, for example: a single haircut rate of 12% is applicable to all ABS, regardless of their residual maturity and coupon structure. Also as disclosed in January 2009, ABS require a AAA credit threshold in order to be eligible as of March 2009, while other assets may be rated BBB- and, with effect from March 2010, securitisations including underlying assets which correspond to repackaging (including tranches of other ABS) will not be eligible.

In connection with this understanding, the Portuguese securitisation structure of credit securitisation fund which issues securitisation units held by a foreign SPV and collateralising securitisation notes is not considered a repackaging and have still been frequently used for ECB Eurosystem operation purposes.

On the other hand, where ABS do not have a market price, the ECB has determined that a theoretical valuation will be carried out centrally by one of the EU Member State central banks for all European ABS, instead of being carried out by the central bank of the jurisdiction of the participant in the system. The absence of a market price will determine a markdown of 5%, corresponding to an additional haircut of 4.4% which will apply on top of the 12% for ABS.

In practice, ABS theoretically valued by the Eurosystem in the absence of a market price are subject to a total haircut of 16.4%, which is applied in addition to the result of the valuation decrease, where the ECB has been asserting valuations below 80% of the nominal value of the underlying asset.

Finally, banks in Portugal are looking towards the ECB programme for the purchase of private debt in order to increase market liquidity - Covered Bonds Acquisition Programme - where, until June 2010, the ECB may purchase European covered bonds or public sector bonds with at least AA rating and which are Eurosystem eligible, in the primary or secondary markets, up to a maximum volume of €60bn.

Overall, Portuguese players are taking firm steps along the way, turning to possible solutions which allow them to manage the current liquidity shortfall and to promote a balanced development of economy in future years.

**This article was written by Paula Gomes Freire and Benedita Aires, Vieira de Almeida & Associados, Sociedade de Advogados, RL, Avenida Duarte Pacheco, 26, 1070-110 Lisbon, Portugal.**
**Tel: +351 21 311 3479, +351 21 311 3447, Fax: +351 21 352 2239**
**Email: pgf@vda.pt, bla@vda.pt, Web: www.vda.pt**