SME Initiative Uncapped Guarantee Instruments – Romania –

New Issue Ratings Report - SME ABS - SRT

Ratings

Series	Rating	Notional (EURm)*	Notional (% total risk cover)	CE (% total risk cover)**	Coupon	Final maturity
Senior RON	A-$_{SF}$	Up to 440.4	53.6	42.8	Confidential	31 Dec 2033
Senior EUR	A-$_{SF}$	Up to 48.0	5.8	42.8	Confidential	31 Dec 2033
Subordinated RON	NR	Up to 293.6	35.8	0.0	Confidential	31 Dec 2033
Subordinated EUR	NR	Up to 39.3	4.8	0.0	Confidential	31 Dec 2033
Total risk cover		**821.3**				

Scope's quantitative analysis is based on the portfolio dated 30 September 2019 and the eligibility criteria in the transaction documents, provided by the European Investment Fund. Scope's Structured Finance Ratings constitute an opinion about relative credit risks and reflect the expected loss associated with the payments contractually promised by an instrument on a particular payment date or by its legal maturity and the risk to make a payment under the respective guarantee agreement. See Scope's website for the SF Rating Definitions.

*The notional amounts represent the maximum risk cover sizes contractually agreed in the intercreditor agreement. RON amounts are converted into EUR at the transaction's contractually agreed initial exchange rate of 1 EUR = 4.54488 RON. Scope has analysed the transaction, assuming a fully ramped reference portfolio. The notional amounts of the risk covers reflect the loss coverage factor of 60% per credit agreed for this transaction.

**The credit enhancement calculation accounts for the reported amortisation of the reference portfolio until 30 September 2019.

Transaction details

Purpose	Significant Risk Transfer
Guarantor	European Investment Fund (EIF)
Originator	Multiple
Servicer	Multiple
Closing date	20 Oct 2016[1]
Payment dates	31 March, 30 June, 30 September, 31 December

The SME Initiative Uncapped Guarantee Instruments (SIUGI) for Romania is a risk sharing transaction of Romanian SME credits (i.e. loans and revolving lines). These reference assets are originated by nine Romanian banks participating in the initiative, which is managed by the EIF. The fund enters into bilateral guarantees with each participating bank. The European Investment Bank (EIB), the EIF, the European Union, and the State of Romania are providing the risk covers in this transaction.

A final loss allocation mechanism at the termination date of the transaction effectively combines the RON stream and the EUR stream.

Rating rationale (summary)

The ratings reflect: i) the legal and financial structure of the transaction; ii) the quality of the reference portfolio in the context of the expanding macroeconomic environment in Romania; iii) the exchange rate risk exposure of the transaction; iv) the ability and incentives of the nine originators participating in the SME initiative and servicing their respective reference sub-portfolios; as well as v) the management capacity and supervisory authority granted to the EIF as transaction manager. The rating also takes into account the counterparty credit risk exposure to the nine originators from recoveries of defaulted assets, as well as to Banque et Caisse d'Epargne de l'Etat, Luxembourg (BCEE) as the account bank and paying agent.

[1] Signing date of intercreditor agreement.

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Related Research

General Structured Finance Rating Methodology

SME ABS Rating Methodology

Methodology for Counterparty Risk in Structured Finance

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The rating on the Senior Risk Covers is driven by 42.8% credit enhancement, which protects the risk covers against credit losses and currency conversion costs, as well as by the benefits from its sequential amortisation.

The ratings are driven by the characteristics of the reference portfolio, which is still under ramp-up. Scope estimates the reference portfolio's credit quality to be commensurate with B- credit quality accounting for expected defaults and recoveries. Additionally, we found significant volatility in the performance data available from the participating banks.

Scope's view incorporates the incentives the nine originators have to assign higher-risk assets to the reference portfolio within the limits of the transaction's eligibility criteria, a result of the 65bps guarantee fee paid by each originator to benefit from the SIUGI. The SME initiative supports lending in Romania, a constrained SME lending environment, which is dominated by Western European banks and their restrictive risk-taking attitude towards the country. Scope is also cautious regarding the potential impact of the COVID-19 virus, which may cause an economic downturn, which may occur anytime, following a prolonged period of economic expansion.

The ratings also reflect Scope's assumptions regarding the EUR 864.9m portion of the reference portfolio which is not yet ramped-up. The portfolio eligibility criteria allow for minimum maturities of two years and maximum maturities of 12 years, resulting in a weighted average portfolio life of 3.7 years under 0% prepayments for the assumed fully ramped portfolio. Despite the relatively short portfolio life, Scope's assumptions reflect a negative view on i) the fragile import and export dependent economy, as well as ii) the public finances evolution that might spill over into the private sector, in particular now under the COVID-19 thread. Especially SMEs may suffer, if recent supporting governmental actions have to be reversed, or if the private consumption that has shown to be an economic stabiliser suffers.

Scope also accounts for the currency conversion risk introduced by a loss reallocation mechanism at the end of the transaction. Default and recovery netting and the partial upfront conversion of EUR funds into RON mitigate the risk for the senior tranches.

The counterparty risk for the rated risk covers extending from the collection of recovery proceeds by the originating banks is mitigated through i) the credit enhancement from subordination and the sequential risk cover amortisation, ii) the ability to terminate the bilateral guarantee agreement upon an originator's default, through which the risk-takers' exposure to that originator's portfolio is effectively cancelled, and iii) the netting of collected recoveries with claims from new defaults.

Rating drivers and mitigants

Positive rating drivers

Credit enhancement. Subordination of 42.8% provides protection against portfolio losses and currency conversion costs for the respective rated instrument. The strictly sequential risk cover release may even strengthen the protection during the life of the transaction.

Alignment of interests. Each originator must maintain a minimum economic interest of 20% in each individual credit right assigned to the SME initiative. This mitigates moral hazard and adverse origination practices. Claims on recoveries are enforceable beyond the maturity of the transaction, as part of the 'survival rights'.

Operational supervision. The EIF and the risk-takers benefit from significant contractual supervision rights. This includes the ability to scrutinise credit policy applications and directly monitor originators' operations, which mitigates the risk of originators deviating from standard procedures.

Prudent underwriting. Western European banks and an American hedge fund control seven of the nine participating banks. The parent banks show a rather low risk appetite in Romania, which leads to restrictive origination and reflects positively on the reference loan quality displayed to date. The same holds true to a large extend for the local banks.

Negative rating drivers and mitigants

Romanian economy. Economic imbalances, significant import-export dependencies and relatively weak institutions apart from the central bank make Romania vulnerable to internal and external shocks. The skill drain of the work force and the inefficient administration add to the unstable situation.

Additionally, the current COVID-19 situation might impair the governmental potential to support the economy in the mid- to long run, which is partially mitigated through supportive measures from the central bank.

Flexible eligibility criteria and originator incentives. The asset eligibility criteria offer the originators high flexibility in selecting higher-risk assets. Originators also have incentives to include higher-yielding (high expected loss) assets in order to amortise the guarantee cost paid to the EIF.

The contractual obligation to stick to standard origination processes and the requirement to maintain a minimum 20% share in every exposure partially mitigate the risk.

Asset credit quality. Scope assumes the average credit quality of the fully ramped portfolio to be commensurate with B-, reflected in the high lifetime default rate and default volatility assumptions. The recovery expectations are low, reflecting the generally unsecured character of the reference loans.

Partially ramped portfolio. A material proportion of the underlying portfolio has not yet been ramped up, which exposes the transaction to uncertainties regarding the portfolio's ultimate asset characteristics. This risk is only partially mitigated by asset eligibility criteria.

Exposure to FX fluctuations. The transaction has to bear the currency conversion cost incurred by the EIF to make payments in RON, or convert RON proceeds to EUR. The periodic default and recoveries netting mechanism partially mitigate the exposure.

Upside rating-change drivers

A better-than-expected asset portfolio at the end of the ramp-up period and better-than-expected performance of the assets are two key factors that could positively impact the ratings.

Faster-than-expected portfolio amortisation, due to high prepayments, will reduce risk taker's credit risk exposure faster than anticipated and improve credit enhancement, which may positively impact the ratings.

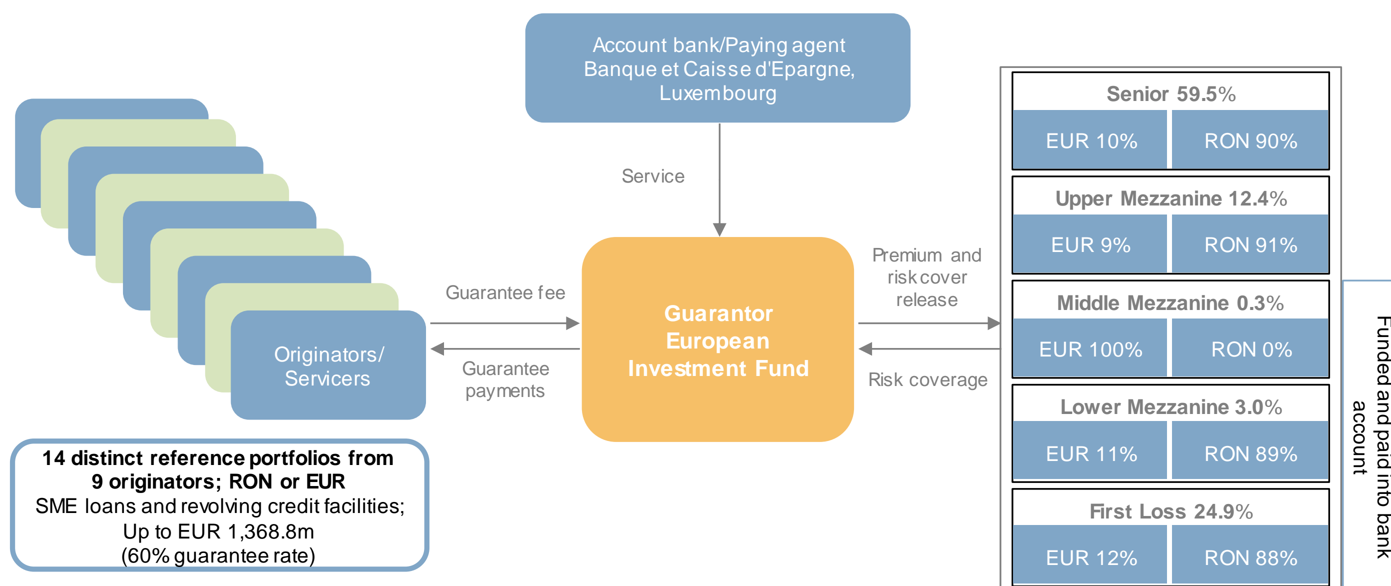
Downside rating-change drivers

Adverse evolution of the Romanian economy with significant fluctuations of the EUR/RON exchange rate may adversely impact the ratings.

1. Transaction summary

The SME Initiative Uncapped Guarantee Instruments (SIUGI) for Romania is a bespoke EU sponsored risk transfer transaction of Romanian SME credit rights (i.e. loans and revolving lines) that are originated by nine Romanian banks participating in the SME initiative for Romania, which is managed by the EIF. The fund enters into bilateral guarantees with each participating bank. The EIB, the EIF, the European Union, and the State of Romania are risk takers in this transaction.

Figure 1: Simplified transaction overview:



Source: Transaction documents and Scope.

The risk-takers in this transaction are the EIB, the EIF, the European Union, and the State of Romania. The banks originating the SME credit rights under this initiative are Banca Transilvania, Banca Comercial Romana, BRD – Group Societe Generale, ING Romania, ProCredit, Raiffeisen Bank Romania, Libra Internet Bank, Unicredit Bank and CEC Bank. Scope did not assign ratings to the Upper Mezzanine Risk Covers, the Middle Mezzanine Risk Covers, the Lower Mezzanine Risk Covers, or the First Loss Pieces in the transaction. The transaction's maturity is 31 December 2033.

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2. The SME environment in Romania

The borrowers in this portfolio benefited from the continuous economic expansion in Romania to date. The strong integration of the country's industry into the European manufacturing chain and low unemployment resulted in sound domestic and foreign demand. However, with an upcoming economic slow-down in western Europe and the current COVID-19 pandemic, also the economic development in Romania is facing tougher times which will likely hit hard the SMEs in the country. The government with the help of the central bank tries to provide support measures, which we however consider only to provide a short-term help.

Romania has gone through a long period of economic expansion over the past 20 years with gross domestic product (GDP) growth ahead of the European average. In addition, Romania's business sector benefits from significant European Union infrastructure investments and support programs. And yet, the strong interlinkage with the global economy, especially Europe, exposes the country to adverse shocks such as during the

financial crisis in 2009, where the impact of COVID-19 remains to be seen. Accordingly, Romania's growth rate shows higher volatility than more mature European peers.

The banking environment is dominated by Western European banks, whose restrictive risk appetite combined with a credible and independent monetary policy control the country's SME credit expansion. Scope acknowledges the positive effect on the credit quality of SME loan portfolios in general. As a reaction to the current crisis situation, fiscal policies have become more expansionary, leading to higher sovereign risk, as the mitigating economic growth is fading away and fiscal reserves are limited. This will likely spill-over to the private sector, as economic support measures will be less effective or just too little to overcome the current situation.

Imbalances and institutional weaknesses challenge the Romanian economic development

Driven by COVID-19, but also an economic slow-down in the Eurozone, Scope expects an economic contraction in Romania in 2020. Over the medium term, a weaker manufacturing sector and reduced domestic consumption following lower social expenditures and softening industrial expansion will reflect negatively on the country's economic profile. Potential support from international organisations, such as the EU, development banks or the IMF might soften the magnitude of the downturn. Additionally, institutional weaknesses, inefficient administrative processes, among others in the planning of infrastructure projects, and a high level of skill drain expose the country to vulnerability from internal and external shocks. Especially the high import dependence of intermediates producers exposes the country to significant spill-over risks from major trading partners, in particular the euro zone. Given that both the private and public sector in Romania hold significant shares of debt in foreign currency, exchange rate speculation could amplify the adverse effects further.

3. Asset analysis

3.1. Securitised assets

The transaction comprises of SME loans and revolving credit facilities originated by nine Romanian banks in their normal course of business. There are nine sub-portfolios denominated in RON currency and five sub-portfolios denominated in EUR. The portfolios are still under ramp up; to date, 36.8% of the target portfolio have been originated. Figure 2 shows the share of each participating bank and the ramping status for the respective sub-portfolio. Most participants provide portfolios both in RON and EUR. For confidentiality reasons, Scope has anonymised the participants' names.

Figure 2: Participants shares and ramping status[2]

	Portfolio	Bank 1	Bank 2	Bank 3	Bank 4	Bank 5	Bank 6	Bank 7	Bank 8	Bank 9
Share in total reference portfolio	**100%**	3.0%	5.0%	12.6%	29.8%	3.5%	13.3%	20.2%	2.2%	10.5%
Maximum portfolio volume EUR (EURm)	**145.3**	0.0	5.0	35.3	49.6	15.6	0.0	40.0	0.0	0.0
Ramping status EUR	**56.6%**	NA	48.4%	50.2%	61.9%	10.3%	NA	74.8%	NA	NA
Maximum portfolio volume RON (EURm)	**1,223.3**	40.9	63.3	137.6	357.6	32.5	182.4	236.0	30.0	143.0
Ramping status RON	**34.5%**	29.6%	51.9%	24.8%	48.6%	27.8%	44.3%	33.3%	0.0%	0.0%

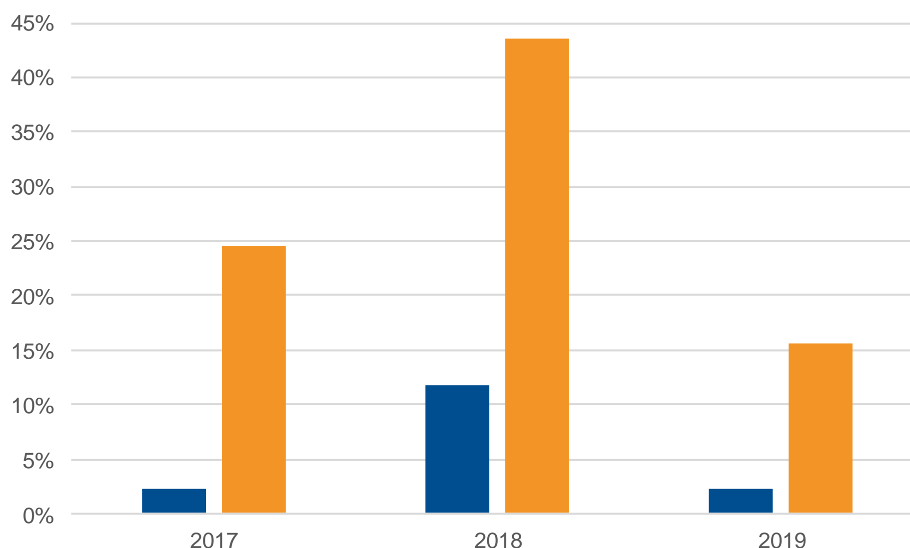
The maximum reference portfolio cannot exceed EUR 1,368.8m, converting the RON exposures into EUR at the initial exchange rate. The risk takers will be exposed to 60% of the losses from this portfolio together with potential currency conversion costs.

[2] The displayed volumes reflect also Scope's assumptions regarding the distribution of EUR 58.3m committed but not yet allocated guarantee amount to the different participating banks.

Scope considered an unseasoned portfolio, which reflects the recent origination of the ramped part during 2017 to 2019 in Figure 3, as well as the non-ramped portion at zero seasoning.

Recent origination reflects currently tighter lending standards

Figure 3: Origination profile of current portfolio



3.1.1. Portfolio characteristics

The ramped portfolio shows limited granularity and sectoral diversification, with the following diversity indices (DI): obligor DI 520; industry DI 4.1; and region DI 7.1. We do not expect granularity and concentrations to change adversely during the ramp-up, due to the transaction's eligibility criteria for the maximum single-obligor exposure and regional minimum volume targets, which is specific to each originator. Only the focus on the Bucharest region might increase, given its economic importance.

Figure 4: Industry sector distribution

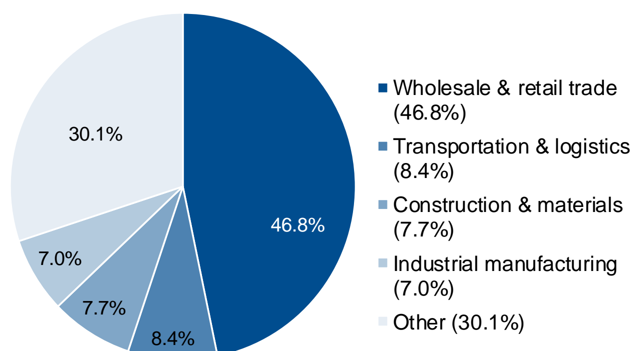
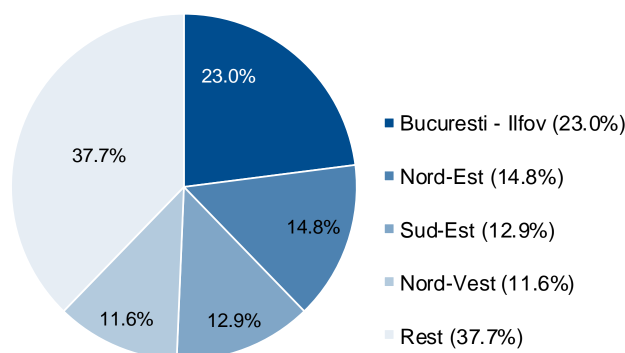


Figure 5: Regional distribution



3.1.2. Portfolio eligibility criteria

Eligibility criteria drive Scope's assumptions for non-ramped portfolio share

Assets eligible for this transaction exclude debt instruments with a credit quality below a minimum level, as measured by each originators' specific internal rating category. Considering the economics of the transaction, originators may have incentives to include higher-risk credit rights in the transaction's reference portfolio. This is because originators would want to maximise the return on the fee they paid for the guarantee. Scope assumes that this higher risk profile will generally just show in larger exposures with longer maturities and less collateral.

Figure 6: Selected portfolio eligibility criteria

Portfolio eligibility criteria	
Maturities	2 to 12 years
Maximum single obligor exposure	EUR 5.0m or RON 22.7m

Scope proxied the non-ramped portion of the portfolio, considering the sub-portfolio specific eligibility criteria. Up to 25% of the sub-portfolio balance can have a tenor of 12 years, with the remainder capped at eight years.

Scope combined the sub-portfolios per currency

4. Portfolio assumptions

Scope has analysed the reference portfolio, reflecting the respective share of the eight originators, of which six have submitted portfolios under both currency streams, i.e. 14 sub-portfolios. Scope has derived specific assumptions for each sub-portfolio, incorporating assumptions for the ramped and non-ramped sub-share. Figure 7 shows the assumptions for each of the respective currency's portfolio.

4.1. Fully ramped portfolio

Scope's analysis is based on the fully ramped portfolio, considering the portfolio as of 30 September 2019. The assumptions for the non-ramped share of the portfolio reflect Scope's view on i) the originators' incentives and capabilities to assign loans to the SME initiative's portfolio; and ii) the originator-specific eligibility criteria as set by the transaction documentation.

The portfolio considered by Scope has a weighted average life of 3.7 years and a weighted average remaining term of 6.4 years. Scope will update its portfolio assumptions as the portfolio ramps up.

Figure 7: Portfolio modelling inputs for the fully ramped portfolio

Portfolio	Portfolio	RON portfolio	EUR portfolio
Share in analysed portfolio	**100%**	89.2%	10.8%
Weighted average life (years)	**3.7y**	3.7y	3.2y
Point-in-time lifetime default rate	**14.4%**	14.6%	12.8%
Point-in-time coefficient of variation	**76.2%**	77.1%	70.2%
Long-term-adjusted lifetime default rate	**16.3%**	16.5%	14.5%
Long-term coefficient of variation	**75.8%**	77.1%	66.1%
Base case recovery rate	**34.7%**	35.4%	29.4%
Constant prepayment rate (low)	**0.0%**	0.0%	0.0%
Conditional prepayment rate (high)	**15.0%**	15.0%	15.0%

4.2. Asset default definition and stress

The guarantees stipulate that a credit event can be exercised by the respective originator upon an asset's default. Such events include '90 days overdue' delinquencies, subjective defaults, asset acceleration, and asset restructuring. The application of these definitions must follow the common practice of each respective originator.

Scope has determined that the guarantee's mechanisms and credit event definitions do not justify an additional stress on the portfolio assumptions related to default rates or recovery rates. In particular, the transaction classifies restructured loans as defaulted if their restructuring results in a loss, which is covered by the credit performance data used in the analysis.

Analysis reflects economically distressed period

4.3. Default rate analysis on portfolio

Scope's analysis considers a point-in-time (PIT) and a long-term adjusted (LTA) case, in order to incorporate both, the performance found in the default and recovery performance data as well as the distressed macroeconomic environment of 2009. Scope derived the default assumptions for the reference portfolio using credit performance data provided by

the nine originators. The provided performance data covers a maximum period from 2007 to 2016 for one bank, while the average covers six years during that period. The data generally covers a period of rather benign economic conditions, showing significant reduction in unemployment and solid economic expansion.

Ramp-up approximation increase the portfolio risk horizon

Figure 7 shows the modelling inputs derived for the two sub-portfolios. The higher mean-default rate for the RON portfolio reflects the significantly lower ramping status of that sub-portfolio, i.e. the impact of the proxy-assets with maximum maturity of up to 12 years.

4.4. Recovery rate

Scope has assumed for the portfolio a base case recovery rate of 34.7% with a recovery lag of 24 months. This assumption accounts for the portfolio's heterogeneous nature and the originators' varying levels of disclosure. In particular, it reflects the historical recovery rate on unsecured exposures, as derived from downturn loss-given-default data and recovery vintage data. Scope assumes that all exposures are 'unsecured', owing to limited information on additional security. In the context of this transaction, 'unsecured' means 'not secured by a mortgage', despite many loans having personal guarantees or other types of security that can generally reduce delinquencies or increase recoveries. Yet these forms of alternative security are difficult to assess without detailed information, however their impact is captured in the performance references used for the analysis. Scope applied rating-conditional stresses to the base case recovery rates and applied hair-cuts to the base case recovery rate of 36% for A-SF.

Analysis incorporates rating-conditional recovery assumptions

Scope has modelled the loan portfolio using fixed assumptions for recovery rates derived from vintage data analysis and down-turn loss-given-default information, which were then stressed with haircuts based on the target rating of the instrument (see Figure 8).

Figure 8: Rating conditional recovery haircuts

	B	BB	BBB	A	AA	AAA
Haircut	**0%**	**12%**	**24%**	**36%**	**48%**	**60%**

Scope incorporated 50% higher haircuts than generally applied for SME transactions in Western European jurisdictions, to reflect the higher levels of volatility found in the recovery performance data. Among others, portfolio sales of non-performing loans are a common recovery method in Romania, which could result in adverse results in a distressed market.

4.4.1. Constant prepayment rate (CPR)

Scope tested the rated instruments against the most conservative 0% CPR assumption

Scope tested the rated instruments against the most conservative CPR assumption of 0% as the senior instruments generally benefit from prepayments under the strictly sequential risk cover release. Scope also tested a high CPR assumption of 15%.

5. Financial structure

5.1. Capital structure and guarantee mechanics

The transaction comprises multiple instruments (the risk covers) regulated by an inter-creditor agreement. Under this agreement, the risk-takers guarantee or cash-collateralise the EIF exposures vis-à-vis the originating banks and cover a proportion of losses incurred from a reference portfolio (still under ramp-up) via payments to the EIF. The risk-takers will make these payments when losses from the portfolio exceed the credit enhancement of their respective risk covers, up to a maximum outstanding risk cover amount. Amortisation in the reference portfolio results in the risk covers being released in order of seniority, which reduces the outstanding risk cover amounts.

Although the portfolio of originated credit rights will ultimately amount to EUR 1,368.8m, this transaction only transfers 60% of the portfolio's credit risk to the risk-takers; the other 40% is initially retained by the eight respective originators subscribing to this initiative[3].

The EIF obtains the credit exposure to the reference portfolio via back-to-back guarantees with the respective originating banks. Under these guarantees, the EIF reimburses the banks in cash for 60% of defaulted assets and then claims this amount from the risk-takers under a back-to-back agreement in reverse order of seniority.

If there are recovery proceeds from defaulted assets, the respective originating bank pays 60% of the proceeds to the EIF. The EIF then transfers this to write back-up credit enhancement or risk-cover notional from the transaction.

5.2. Loss re-allocation mechanism

Loss re-allocation mechanism introduces FX risk

The loss re-allocation mechanism introduces currency conversion risk into the transaction. The mechanism ensures that all conversion costs associated with RON cash-flows have to be borne by the transaction.

The loss re-allocation mechanism ensures that the losses in the RON and EUR stream of the transaction are equally distributed across the risk covers in both currencies. The mechanism will result in a holding of risk cover release, as the EIF will have to ensure that the available funds are always sufficient to distribute all costs and losses equally to both currency streams.

5.2.1. Final loss and conversion cost allocation

1. At the termination of the guarantees, there will be a recalculation of the losses in EUR and a re-allocation to the tranches.
2. The EIF will measure all payments they made or received over the life of the transaction, converting the amounts into EUR at the spot rate of the respective conversion date, i.e. the date the respective EUR amount is converted to RON, to make payments, or the date at which RON have been received and converted to EUR.
3. Romania will provide an initial EUR amount that will be converted into RON at the initial FX rate equivalent to the initial first loss and lower mezzanine piece in the RON transaction. If not used, this amount will be repaid in EUR at the termination of the transaction, converted at the spot rate at that date, exposing the transaction to the risk of a depreciating RON.
4. At the same time, the nominal amounts of the guarantee will also be converted into EUR at the initial FX rate. Following that, the respective guarantee tranches will be combined, i.e. the two senior pieces, the respective mezzanine pieces and the first loss pieces.
5. Finally, the net loss amount, calculated under 2) will be allocated to the tranches as calculated under 3) in a reverse order of seniority.

5.2.2. Currency conversion costs

Scope considered currency conversion costs in the form of the deduction of rating-conditional share in the conversion exposed funds of 23% for A-SF. The stress applies only to transaction cash-flows in the RON stream of the transaction, i.e. i) the net cash flows of periodic default and recovery claims; and ii) the conversion of the remainder amount of the initially funding of the First Loss Piece and the Lower Mezzanine Piece. This amount is converted into RON at inception and converted into EUR at transaction termination.

[3] The minimum retained share must be 20% of each reference exposure, i.e. the originating bank cannot buy third-party protection for that share.

Netting and available RON funds reduce FX exposure

The netting of periodic defaults and recoveries, as well as the quasi-pegging of the RON to the EUR partially mitigate the risk. However, Scope has investigated the historic relationship of the currency pair and incorporated the following deductions into the analysis.

Figure 9: Exchange rate EUR per RON

Figure 10: FX deductions

Target rating	FX deduction
B	5%
BB	11%
BBB	17%
A	23%
AA	29%
AAA	35%

5.3. Operational supervision

Operational supervision from the EIF ensures operational integrity

The operational integrity of the transaction is primarily ensured by the EIF's supervision of the transaction and the information rights available to the risk-takers.

The guarantees and inter-creditor agreement grant significant contractual rights to the EIF and the risk-takers, namely, the ability to scrutinise credit policy applications and credit processing within each of the eight originating banks.

The consistent application of internal credit policies is a material obligation of the respective participating bank. Failure to comply could lead to the guarantee contract being terminated.

5.4. Alignment of interests

Originators have to maintain 20% minimum economic interest in any loan

The originators' interests are well aligned with the risk-takers' because originators must retain a minimum net exposure of 20% in every asset referenced in the transaction.

In addition, the EIF remains entitled to recovery proceeds, even after the termination of the bilateral guarantee agreement. This protects the risk-takers from default- and recovery-timing measures by the originators. The risk-takers can extend the maturity of their claims under the inter-creditor agreement with the consent of the most senior risk-taker.

6. Originators

Western European banks dominate in Romania

The originators participating in the SME initiative account for more than 60% of the Romanian banking market. The business models are generally built along the entire business lending space, where however the bigger market participants focus on corporates and SMEs, while the smaller ones are more focusing on the micro SME space.

Six out of the nine participating banks are subsidiaries of large Western European banking groups, such as Group Societe Generale, Erste Group and ING Group who work under standard guidelines, lending principles and restrictive risk taking strategies of their parents. From the remaining three banks, one is now the largest bank active in Romania, one is among the oldest banks in Romania, and the smallest is owned by an American

hedge fund. Their sophistication level is lower, but their business model also reflects that, i.e. these banks follow a more conservative lending approach.

Despite differing in sophistication, the banks' functions, systems, processes and staff meet the standards for SME lending in Europe. In addition, the banks comply with the regulatory requirements imposed on and supervised by the European Central Bank (ECB) and the National Bank of Romania, an institution that applies similar standards as the ECB. Scope held operational review meetings with most originators and incorporates information obtained into the analysis.

6.1. Underwriting

Loans originate from originators' normal course of business

The nine participating banks have implemented the initiative very similarly in their lending programmes: They generally lend to the same pool of obligors but provide larger loans for longer terms with reduced collateral requirements.

The current reference portfolio quality is a reflection of the risk taking behaviour of the parent banks. The current portfolios as presented to Scope do not show the larger exposures with longer maturities to date. The credit quality only marginally weaker than that of standard SME loan portfolios presented in Western Europe, also due to the transaction's eligibility criteria.

6.2. Servicing and recovery

Scope views the asset servicing and management of non-performing exposures to be adequate, efficient and adhering to the standards of European SME banking. The banks include 'subjective defaults' in their internal default definitions, which require tight monitoring. The classification of an asset as a subjective default follows the banks' regular practice, which is captured in the credit performance data used for the analysis. The potential to excessively use the subjective default definition is mitigated by the alignment of interests and the EIF's entitlement to recovery proceeds from defaulted exposures, even after the guarantee is terminated.

The originators are contractually obliged to treat the assets referenced in the transaction exactly as they would for assets in their SME lending books, that is, in line with their respective credit policies.

7. Quantitative analysis

Scope's key assumptions drive the quantitative analysis

Scope assigned an A-$_{SF}$ rating to the Senior Risk Covers based on its quantitative analysis. The transaction's credit enhancement mechanisms support these results.

For each currency stream, Scope analysed the reference portfolios loan by loan and simulated its performance using a single-step Monte Carlo simulation implementing a Gaussian-copula dependency framework. For each loan, Scope has assumed a specific default probability; ii) a specific recovery upon default; and iii) asset correlations between the loans. Key assumptions from this exercise were then applied to the cash flow analysis, reflecting the risk covers' release and loss-allocation mechanisms under the inter-creditor agreement.

Scope has modelled the portfolio using two distinct sub-portfolios that reflect the specific credit characteristics of the RON and the EUR pool combining the respective sub-portfolios provided by the different originators. Scope has combined the default distribution of the sub-groups, assuming their perfect correlation.

The Senior Risk Covers were analysed with an assumption for the constant prepayment rate of 0%. Both instruments benefit from prepayments, given the absence of excess spread and their seniority in the structure. Scope also tested a constant prepayment rate of 15%, a rate commonly seen in SME securitisations.

Scope's cumulative default-timing assumptions are shown in Figure 11 and Figure 12. These assumptions are derived from the portfolio simulation and reflect the amortisation and credit quality profile of the two portfolios.

The defaults are classified as 90+ days past due, in line with definitions in the documentation.

Figure 11: RON - Default-timing and amortisation

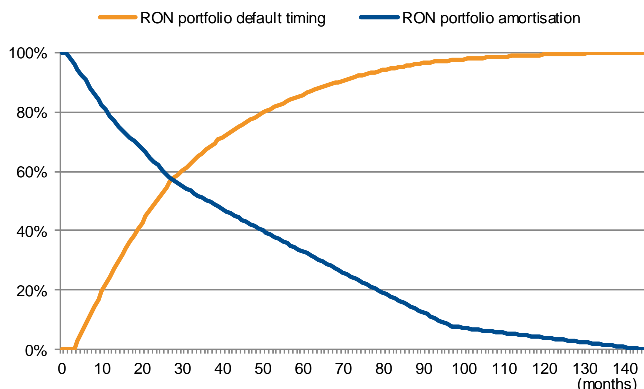


Figure 12: EUR - Default-timing and amortisation

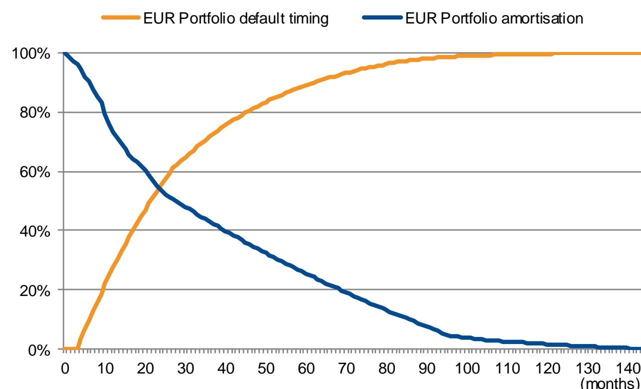
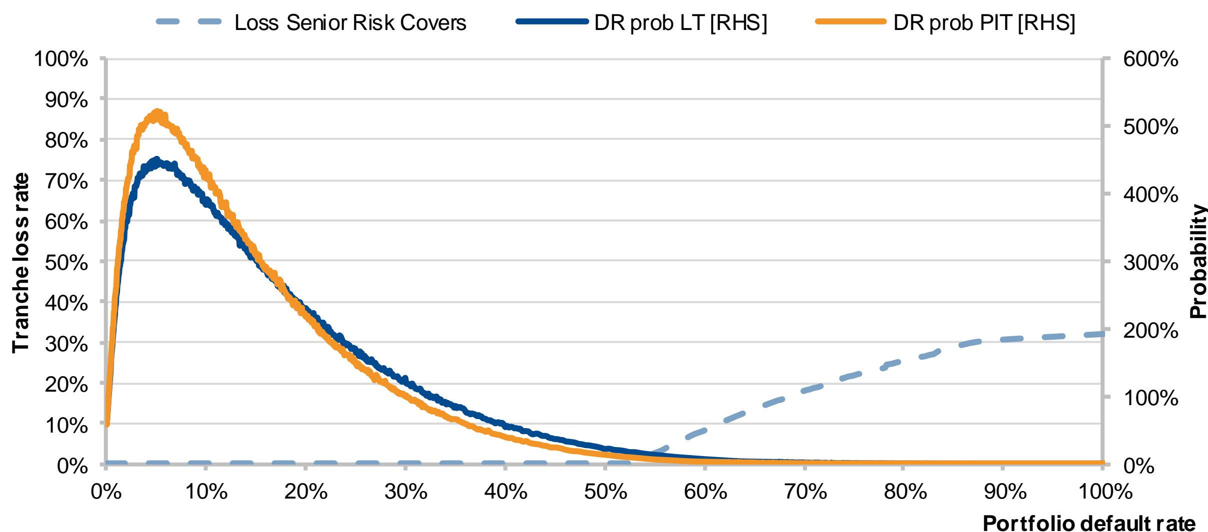


Figure 12 shows the losses of the Senior Risk Covers at all portfolio default rates. The chart shows how credit enhancement and recovery proceeds protect the instruments.

Figure 13: Cash flow results for base case mean DR and CoV; rating case RR



Note: The probabilities displayed on the right hand side axis has to be considered in the context of the calculation of the probability density

8. Rating stability

8.1. Rating sensitivity

Scope tested the resilience of the ratings against deviations of the main input parameters: the portfolio mean-default rate and the portfolio recovery rate. This analysis has the sole purpose of illustrating the sensitivity of the ratings to input assumptions and is not indicative of expected or likely scenarios.

The following shows how the quantitative results for each rated instrument change when the portfolio's expected default rate increases by 50%, or the portfolio's expected recovery rate reduces by 50%, respectively:

Senior Risk Covers: sensitivity to default rate assumptions, one notch; sensitivity to recovery rates, one notch.

The rated notes will not experience losses for default rates of 40.2% or lower

8.2. Break-even analysis

The resilience of the instruments' rating is shown through the break-even default rate analysis. The instruments would not experience any loss at portfolio lifetime default rates of 40.2% or lower, respectively, under a zero recovery assumption. Figure 14 shows the rating case break-even rates for each senior instrument, which would have to be considered vs. a base case recovery rate of 34.7%.

Figure 14: Break-even default rate analysis as a function of prepayments and recovery rates

Break-even default rates	0% CPR		15% CPR	
Portfolio RR	**22.2% (A_{SF} RR)**	**0.0%**	**22.2% (A_{SF} RR)**	**0.0%**
Senior	**52.4%**	40.2%	61.7%	44.3%

9. Sovereign risk

Sovereign risk does not limit the transaction's ratings

Sovereign risk does not limit any of the ratings. We acknowledge the risk of increasing economic volatility, amplified by expansionary fiscal policy beyond sustainable levels. The COVID-19 pandemic is adding an additional layer of stress, which however can be partially mitigated through the supporting measures from the government and the central bank. After the crisis, the central bank might return to its previous objectives to mitigate the impact on increasing inflation, which might than add stress for SMEs, with increasing interest rates or limitations of credit. The short life of the Senior Risk Covers mitigates the potential impact for the instruments.

Scope factors its cautious macro-economic view into the assumptions for the quantitative analysis. The high external dependency and fiscal expansions make the country vulnerable to shocks like COVID-19. These might cause higher default levels, beyond those displayed in the respective originator's performance data, which generally just captures a benign period.

The exchange rate volatility against the EUR might increase as well, in a downturn scenario., However, we consider the central bank to have sufficient reserves to support the economy, while maintaining the exchange rate against the EUR stable.

10. Counterparty risk

Counterparty risk is immaterial

Counterparty risk does not limit the maximum ratings achievable by this transaction. Recovery collections and guarantee premium payments expose the transactions to counterparty risk from i) the nine originators, as the recovery collectors, ii) Banque et Caisse d'Epargne de l'Etat, Luxembourg (BCEE), the account bank and paying agent, and iii) the EIF, the manager of the transaction.

10.1. Operational and commingling risk from servicers

An originator's default may expose the risk-takers to counterparty risk should the EIF have a claim to an originator relating to recovery rate proceeds from defaulted assets. The rated instruments benefit from the available credit enhancement from subordination and sequential risk-cover amortisation. Additionally, when an originator's default leads to a termination of the bilateral guarantee agreement, the risk-takers' exposure to that originator's portfolio is effectively cancelled. Moreover, the netting of collected recoveries with new defaults mitigates the size of counterparty risk exposure.

10.2. Commingling risk from account bank and paying agent

Commingling risk is sufficiently remote as to be immaterial for the rated risk covers

The rated tranches are exposed to the credit quality of BCEE, the account bank, which collects from the originators the guarantee premiums and repayments of recovery proceeds. The Senior Risk Cover notes have an expected weighted average life of just 2.8 years under a 0% constant prepayment rate. Scope considers the risk of commingling losses sufficiently remote as to be immaterial for the transaction, given the high credit quality of BCEE, as derived from public credit ratings.

The bank will keep funds until the termination of the transaction, to settle the different claims under the final loss reallocation mechanism, which exposes more junior tranches over a longer period of time.

The counterparty risk exposure to BCEE was assessed using the bank's public credit ratings, which support the highest achievable rating. The transaction benefits from a substitution trigger based on the credit quality of the bank, as measured by its public ratings.

11. Legal structure

11.1. Legal framework

Legal framework conforms to the EIB Group's standard course of business

The guarantees are governed by English law, while the inter-creditor agreement and the EIB Senior Risk Cover agreement are governed by Luxembourg law. These contracts conform to the standard business conduct of the EIB Group under its guarantee programmes.

The transaction is fully governed by the terms in the documentation and any amendments are subject to the risk takers' consent. Amendments to the guarantee contracts between the EIF and the originating banks that could materially impact the performance of a risk-cover require a majority vote, which always includes the positive vote from the affected risk-taker. Other measures just need majority voting. Additionally, all decisions always require the consent of the most senior risk-taker at the date of the decision

11.2. Use of legal opinions

Scope had access to the legal opinions produced for the issuer, which provides comfort on the legal valid, binding and enforceable nature of the contracts.

12. Monitoring

Scope will monitor this transaction on the basis of the portfolio reporting by the EIF as well as other available information. The ratings will be monitored continuously and reviewed at least once a year, or earlier if warranted by events.

Scope analysts are available to discuss all the details surrounding the rating analysis

Scope analysts are available to discuss all the details surrounding the rating analysis, the risks to which this transaction is exposed and the ongoing monitoring of the transaction.

13. Applied methodology and data adequacy

For the analysis of this transaction Scope applied its SME ABS Rating Methodology, available on www.scoperatings.com.

The nine originators provided credit performance data, in the form of rating transition matrices and observed default frequency data for their internal SME rating categories, or in the form of vintage data. The data sets refer to a '90 days past due' default definition, generally consistent with the default definition under the back-to-back guarantees, and cover periods between 2007 and 2016. Recovery data was provided in the form of downturn loss-given-default data, or recovery vintages.

I. EIB SME initiative comparisons

Comps item	Romania	Spain (initial)	Italy - Bari	Italy – Torre del Greco
Senior rating	**A-**	**AAA (AA)**	**A-**	**BBB**
Senior CE	42.8%	41.7% (34.1%)	22.4%	18.9%
Senior WAL	2.8y	1.4y (2.4y)	2.0y	1.8y
Upper Mezz rating	**NA**	**A+ (BBB+)**	**NA**	**NA**
Upper Mezz CE	29.6%	35.4% (29.2%)	NA	NA
Upper Mezz WAL	5.8y	3.4y (4.9y)	NA	NA
Mean DR – PIT	14.4%	18.6% (19.0%)	18.6%	26.9%
Mean DR – LT	16.3%	8.3% (8.4%)	NA	NA
Portfolio WAL	3.7y	3.5y (3.5y)	3.3y	2.6y
WA portfolio coupon	2.2%	2.8% (3.0%)	3.2%	4.1%
CoV – PIT	76.2%	40.6% (40.7%)	58.5%	60.5%
CoV – LT	75.8%	76.4% (77.0%)	NA	NA
Cure rate	0.0%	0.0%	0.0%	6.8%
B – recovery rate	34.7%	36.5%	63.7%	71.9%
BB – recovery rate	30.5%	33.6%	58.6%	66.2%
BBB – recovery rate	26.3%	30.7%	53.5%	60.4%
A – recovery rate	22.2%	27.7%	48.4%	54.6%
AA – recovery rate	18.0%	24.8%	43.3%	48.9%
AAA – recovery rate	13.9%	21.9%	38.2%	43.1%
CPR high	15.0%	15.0%	14.0%	10.0%
CPR low	0.0%	0.0%	0.0%	0.0%

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