SME CDOs
Spain
New Issue

# BBVA Empresas 5, FTA


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## Related Research

**Applicable Criteria**

- *Rating Criteria for European Granular Corporate Balance-Sheet Securitisations (SME CLOs) (July 2009)*
- *Counterparty Criteria for Structured Finance Transactions (March 2011)*
- *Global Criteria for Cash Flow Analysis in CDOs (September 2010)*
- *Criteria for Interest Rate Stresses in Structured Finance Transactions (February 2011)*
- *Criteria for Structured Finance Loss Severity Ratings (February 2009)*
- *EMEA Residential Mortgage Loss Criteria Addendum - Spain (February 2010)*
- *Servicing Continuity Risk Criteria for Structured Finance Transactions (March 2010)*
- *Criteria for Rating Caps in Global Structured Finance Transactions (June 2010)*

## Contents



## Ratings

| Class | Amount (EURm) | Final Maturity | Rating | LS Rating | CE[a] (%) | Outlook |
|---|---|---|---|---|---|---|
| A[b] | 975.0 | 14 Sep 2052 | AAAsf | LS1 | 42.0 | Stable |
| B | 275.0 | 14 Sep 2052 | BB+sf | LS3 | 20.0 | Stable |
| **Total Issuance** | **1,250.0** | | | | | |

Closing occurred on 16 March 2011. The ratings assigned above are based on the portfolio information as of 8 February 2011 provided by the originator
[a] Gross credit enhancement considering the EUR250m cash reserve subordinated to the notes
[b] Class A is rated for the ultimate return of principal and the timely payment of interest. Class B is rated for the ultimate return of principal and interest, as interest on the class B notes may be deferred to protect the class A notes

## Transaction Summary

BBVA Empresas 5, FTA (the issuer) is a cash flow securitisation of a static pool (the collateral) of loans originated and serviced in Spain by Banco Bilbao Vizcaya Argentaria (BBVA, 'AA–'/Stable/'F1+') for liquidity purposes. BBVA granted the loans to unrated corporates (27% of collateral value), large companies (21%), as well as to small and medium-sized Spanish enterprises (SMEs, 39%) and self-employed individuals (SEIs, 13%). 7% of collateral value is exposed to real estate SMEs. The pool comprises mortgages on real estate (RE, 42% of portfolio notional considered secured by Fitch Ratings) and unsecured loans.

### Key Rating Drivers

- **Internal ratings systems of BBVA:** The agency analysed the portfolio using obligor-specific probabilities of default (PDs) that Fitch derived from the regulatory PDs reported by BBVA. The agency adjusted obligor PDs to be representative of empirical default frequencies in 2009, a year of significant stress.
- **Obligor concentration:** Fitch considers obligor concentration is the primary risk driver, as the largest obligor represents 5.4% of collateral value after consolidation by risk groups (see *Obligor Concentration* on page 6). The top 36 risk groups (ie each represents more than 50bp of the collateral value) jointly represent 38.1% of the pool. Fitch has applied a one-category downgrade to these obligors, and then a one-year PD floor equal to the weighted-average PD of the collateral (ie 8%), to compensate for the lack of a Fitch credit opinion on these large obligors.
- **Exposure to real estate (RE) and construction:** The combined exposure to real estate (RE) and the building and material sectors represents 29% of the collateral value. Fitch has applied a minimum one-year PD of 11% to all obligors in these sectors given the current economic environment. Otherwise, industry diversification of the collateral is good.
- **Moderate regional concentration:** Fitch believes the collateral is well diversified geographically (the largest region, Catalonia, represents 26% of collateral value).
- **Unrated corporates:** Fitch believes that these obligors (ie 21% of the pool) have lower PDs than SMEs (0.6% versus 3.3%, according to raw BBVA data before Fitch-applied adjustments) and improve the average credit quality of the collateral.
- **Recovery-rate risk:** Fitch applied stressed recovery rates (RRs) for all assets in the portfolio as future recovery rates are expected to be lower than those observed historically.

## Rating Sensitivity[1]

In addition to Fitch's stated criteria, the agency analysed the structure's sensitivity to the potential variability of key model assumptions.

Fitch explicitly highlights that this sensitivity analysis only seeks to assess what assumptions would produce the largest change in the ratings, in the event that actual values differed from its estimates. The agency does not consider the likelihood of any of these sensitivity scenarios. It emphasises that this sensitivity analysis does not and cannot cover for other risks to which the transaction is exposed, such as changes in legislation covering securitisation.

## Rating Sensitivity to Defaults

Fitch notes that the 'AAAsf' rating is sensitive to the PD assumption for the obligors in the pool. As the current PD assumptions are already conservative, any further obligor downgrade represents a relatively large absolute increase in the PD, given the exponential nature of the PD curve. In the harshest scenario considered, if all obligors in the pool were downgraded by one notch, the rating of the class A notes would descend by five notches to 'Asf'. A deterioration in the credit quality of the largest industry would provoke a two-notch downgrade of the class A notes to 'AAsf' while a simultaneous default of the largest obligors in the pool would result in a three-notch downgrade of the class A notes to 'AA–sf'.

Fitch is reassured that the rating of the junior class B notes shows little sensitivity to unexpected changes in the PD of the obligors in the pool. The class B notes would suffer a two-notch downgrade to 'BB–sf' from 'BB+sf' in a scenario of a general deterioration of the credit quality of the pool or in the case of a default of the largest obligors. The rating for the class B notes is unaffected by a decline in the credit quality of the largest industry.

### Rating Sensitivity to Defaults

| | Class A | Class B |
|---|---|---|
| Original rating | AAAsf | BB+sf |
| All obligors downgraded by one notch | Asf | BB–sf |
| Obligors in the largest industry downgraded by two notches | AAsf | BB+sf |
| Default of all obligors representing >1% of the pool notional | AA–sf | BB–sf |

Source: Fitch

## Rating Sensitivity to Recovery Rates

Fitch has assessed that class A exhibits little sensitivity to deviations in realised recoveries. In the harshest scenario, a 50% reduction in recovery rates, the rating of class A would drop by two notches to 'AAsf'.

### Rating Sensitivity to Recovery Rates

| | Class A | Class B |
|---|---|---|
| Original rating | AAAsf | BB+sf |
| Recovery rate reduced by 25% | AA+sf | BB–sf |
| Recovery rate reduced by 50% | AAsf | CCCsf or below |

Source: Fitch

The agency considers potential deviations in realised recoveries to be one of the key drivers of rating volatility for the junior class B notes. This class is reliant, to a significant extent, on recovery proceeds. A 25% reduction in expected recovery rates would lead to a two-notch downgrade of the notes to 'BB–sf', while a 50%

[1] These sensitivities only describe the model-implied impact of a change in one of the input variables. This is designed to provide information about the sensitivity of the rating to model assumptions. It should not be used as an indicator of possible future performance

reduction of expected recoveries would cause the rating of the class B notes to drop six notches to 'CCCsf' and risk default. For the avoidance of doubt, Fitch does not consider any of these reductions in recovery rates as likely.

### Rating Sensitivity to Correlation

Fitch is reassured that the ratings exhibit little sensitivity to changes in portfolio correlation (ie the level of synchronicity of defaults in the pool). Doubling the portfolio correlation level would just produce a one-notch downgrade on the class A notes while leaving the rating of the class B notes unaffected.

**Rating Sensitivity to Correlation**

| | Class A | Class B |
|---|---|---|
| Original rating | AAAsf | BB+sf |
| 2x correlation structure | AA−sf | BB+sf |

Source: Fitch

### Rating Sensitivity to Shifts in Multiple Factors

Fitch has determined that a combination of increased PDs and reduced recovery rates would place a significant stress on the entire capital structure. The rating of the senior class A notes would descend by five notches to 'Asf' while the junior class B notes would be downgraded by six notches to 'CCCsf' and would be at risk of default.

**Rating Sensitivity to Defaults and Recoveries**

| | Class A | Class B |
|---|---|---|
| Original rating | AAAsf | BB+sf |
| All obligors downgraded by one notch; recovery rate reduced by 25% | Asf | CCCsf or below |

Source: Fitch

## Criteria Application, Data Adequacy and Model

### Criteria Application

Fitch mainly relied on two criteria reports when rating this transaction: "*Rating Criteria for European Granular Corporate Balance-Sheet Securitisations (SME CLOs)*", dated July 2010; and "*Counterparty Criteria for Structured Finance Transactions*", dated March 2011. Additional criteria used in the agency's analysis are listed on the front page of this report or referenced in the main criteria reports.

Fitch also applied its "*Criteria for Rating Caps in Global Structured Finance Transactions*", dated June 2010. Consequently, the agency assessed that investment-grade (IG) ratings are expected to pay timely interest in a base-case scenario.

Fitch used its market value decline (MVD) framework to formulate recovery expectations for the pool. It applied the assumptions published under its "*EMEA Residential Mortgage Loss Criteria Addendum - Spain*", dated February 2010, for the calculation of recovery rates (RRs) for residential properties. The agency applied MVD assumptions for non-property assets outlined in its SME CLO criteria for productive land and non-residential properties.

### Data Adequacy

Fitch received enough detailed portfolio data for the rating analysis from the originator. BBVA provided internal ratings (IRs), through-the-cycle PD estimates and loss given default (LGD) estimates for all obligors in the portfolio. Historical performance was reported in the form of transaction performance reports of comparable deals (ie four previous and similar BBVA Empresas deals). The agency is comfortable that the data covers a period of significant stress.

Fitch formed a view on the credit quality of the portfolio using empirical data (ie back-testing data reflecting observed defaults for the different internal rating categories of the originator's risk models) and by referring to its comprehensive coverage of similar transactions.

The agency relied on BBVA's IRs after a comprehensive study of its rating models and back-testing data.

The agency complemented the information received by performing an operational review with BBVA's managers and risk analysts. It also analysed BBVA's origination and servicing practices during this operational review.

### Other Information

In addition to the aforementioned sources, Fitch used Bank of Spain public statistical data, public reports provided by the management company, the legal opinion by the transaction counsel (ie Cuatrecasas, Gonçalves Pereira, S.L.P.), and the portfolio audit report produced by Deloitte S.L. in its rating analysis.

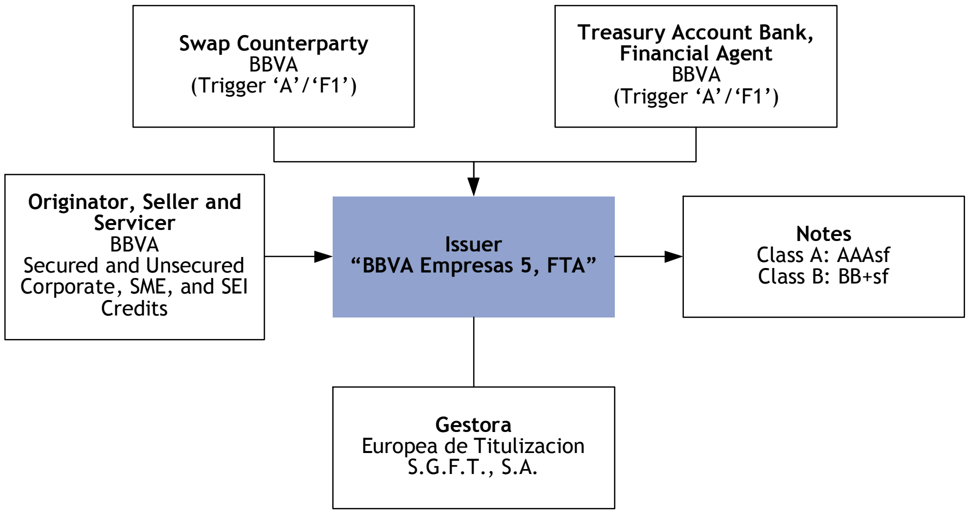
### Model

The portfolio was analysed with Fitch's Portfolio Credit Model (PCM), which implements the agency's criteria for SME CLOs (see *Asset Analysis* for further details). It also analysed the structure using a proprietary cash flow model customised for the specific structural features of the deal, as described in the transaction documentation.

## Transaction and Legal Structure

Figure 1

**Structure Diagram**




Source: Transaction documents

Fitch has reviewed the Spanish legal opinion for this transaction and gained comfort on the bankruptcy-remoteness of the issuer. The issuer is a special-purpose vehicle incorporated in Spain under Spanish Securitization Law 19/1992 and Royal Decree 926/1998, the sole purpose of which is to acquire the credit rights from the originator as collateral for the issuance of quarterly-paying notes.

Fitch is satisfied that the transfer of mortgage loans to the issuer via mortgage transfer certificates (CTH) is equivalent to a true sale of the credit rights. This transfer mechanism is regulated by Laws 2/1981 and 3/1994, and Royal Decree 716/2009 and is standard among Spanish securitisations to avoid the lengthy and costly process of re-registering the mortgages with the property registry.

The cash bond administration (CBA) function for this transaction will be carried out by Europea de Titulizacion, S.G.F.T., S.A. (the management company or gestora).

Fitch takes comfort that the gestora is supervised by the Spanish securities commission (CNMV) and has ample experience in managing similar securitisation funds. The gestora is responsible for cash reconciliation, waterfall calculations and their reporting, including the monitoring of applicable triggers. As trustee, the gestora will also be responsible for taking any action in the interests of the noteholders, such as the replacement of the servicer, account bank or swap counterparty.

## Representations and Warranties — Market Standard

Fitch has analysed the representations and warranties concerning the credit rights in the securitised portfolio and deemed them as comparable to those found in other Spanish SME transactions. The key representations and warranties, as of closing, are: all loans have been formalised in public deeds; all loans are serviced via direct debit from the obligor's account held by the originator; all loans are less than 30 days in arrears at closing; no loans allow for interest deferral; and no loans had principal grace periods introduced after closing.

Fitch believes these representations and warranties directly affect the credit quality of the portfolio: it does not contain loans granted to refinance previously delinquent contracts and the portfolio does not contain loans granted to finance RE development projects. All properties backing mortgages have been valued by appraisal firms registered with and regulated by the Bank of Spain, and must be insured by the obligor against damages for as long the mortgage is outstanding.

Fitch has gained comfort that the characteristics of the final pool will not materially differ from the preliminary pool as the method for constructing the final pool outlined in the transaction documentation limits the discretionary powers of the originator. BBVA will select the final pool by ordering the loans in the preliminary pool by the outstanding amount in ascending order and then adding up loans from smallest to largest until reaching an aggregate outstanding amount of EUR1.25bn.

## Substitution

Fitch is reassured that only those loans that do not comply with the representations and warranties (as the result of hidden errors during the loan selection process) will be allowed to be substituted. Such substitution must follow the rules laid out in the transaction documentation and Spanish securitisation law.

Loans that are found to be in breach of the transaction's representations or warranties will either be amended, fully amortised or substituted with an eligible credit, similar in amount and characteristics. The substitution will have to be approved by the gestora. The substitution cost will be paid by the originator.

## Permitted Variations — Market Standard

Fitch takes comfort that the legal framework for this securitisation sets limits to mortgage loan modifications (Article 25 of Royal Decree 685/1982). The servicer may not voluntarily cancel the mortgages that make up part of the collateral for reasons other than the full amortisation of the loan, unless the gestora grants its consent.

Fitch understands that the provision in the documentation that limits loan modifications is very generic, but allows the agency to be reassured that contracts will not generally be modified. The documentation establishes that loan modifications are a breach of contract by the originator for which it shall be liable. The gestora can either urge the replacement or repurchase of affected loans, or claim any damages resulting from such modifications. Fitch would otherwise expect that loan modification and restructuring programmes become more usual as part of loss mitigation strategies. In the past, limited loan modifications or restructurings have been reported for existing SME CDO transactions.

## Disclaimer

For the avoidance of doubt, Fitch relies, in its credit analysis, on legal and/or tax opinions provided by transaction counsel. As Fitch has always made clear, Fitch does not provide legal and/or tax advice or confirm that the legal and/or tax opinions or any other transaction documents or any transaction structures are sufficient for any purpose. The disclaimer at the foot of this report makes it clear that this report does not constitute legal, tax and/or structuring advice from Fitch, and should not be used or interpreted as legal, tax and/or structuring advice from Fitch. Should readers of this report need legal, tax and/or structuring advice, they are urged to contact relevant advisers in the relevant jurisdictions.

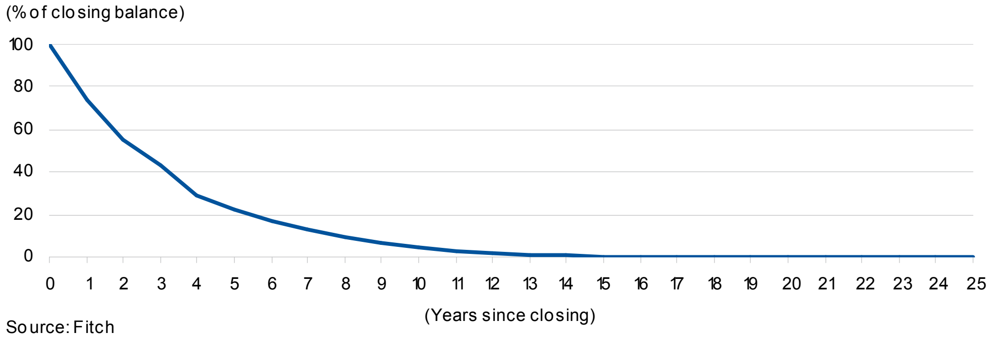
# Asset Analysis

The collateral consisted of 7,626 loans totalling EUR1,418m as of 8 February 2011. BBVA granted the loans to unrated corporates (27% of collateral value), large companies (21%), as well as to small and medium-sized Spanish enterprises (SMEs, 39%) and self-employed individuals (SEIs, 13%) in Spain. The SME segment includes real estate developers (7% of collateral value) as borrowers, although no real estate development loans are being securitised. The pool comprises mortgages on real estate (RE, 42% of portfolio notional considered secured by Fitch) and unsecured loans.

The agency expects credit enhancement (CE) to accumulate quickly given the weighted-average life (WAL) of the loans is relatively short at 3.6 years, despite high prepayments not being expected in a recessionary environment.

Figure 2

**Amortisation Profile With 0% Prepayments**




Source: Fitch

## Obligor Concentration

Fitch considers obligor concentration is the primary risk driver. The agency has considered obligors consolidated by risk group to assess obligor concentration. Risk groups may comprise several subsidiaries or otherwise unrelated firms that share a single ownership structure; and/or may also reflect cross-guarantee agreements and shared collateral between different subsidiaries or related firms. BBVA groups risk-related entities in a single obligor group as part of its risk-control strategies.

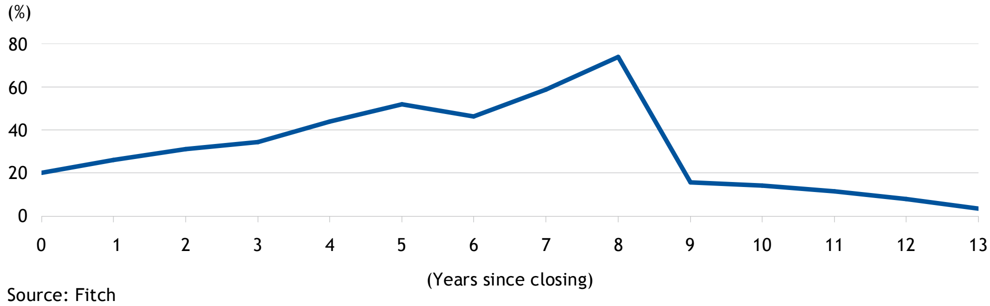
The top risk group represents 5.4% of collateral value and the top 36 risk groups (ie each represents more than 50bp of the collateral value) jointly represent 38.1% of the pool. Fitch notes that the top obligors in the portfolio potentially pose significant idiosyncratic risk, as limited data was available for these names.

Fitch has applied a one-category downgrade to these obligors, and then a one-year PD floor equal to the weighted-average PD of the collateral (ie 8%), to mitigate non-diversifiable risk in the portfolio and to cover for the inapplicability of statistical analysis when assessing the PDs of these large obligors.

Figure 3

**Dynamic Top 10 Concentration**

Top 10 Obligors/Outstanding Pool Balance




Source: Fitch

Fitch expects the concentration of the top 10 obligors to increase significantly over the life of the deal. The agency has addressed this risk by stressing the PDs assigned to large obligors. The above figure shows the dynamic top 10 obligor concentration profile.

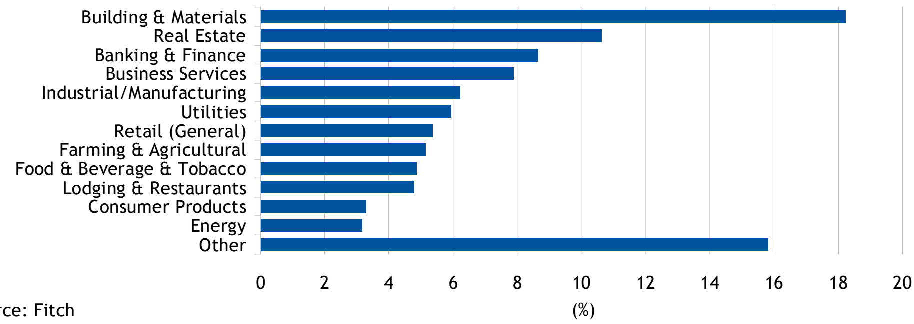
## Industry and Regional Concentration

The agency notes the high portfolio concentration in the RE and building and materials sectors (29% of the total balance). Fitch addressed the higher risk of obligors in these RE-related sectors via a minimum one-year PD assumption of 11%.

Figure 4

**Industry Concentration**

By volume



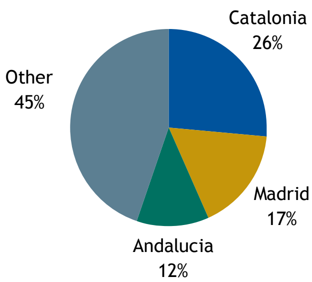

Source: Fitch

The agency took into account the moderate regional distribution of underlying loan collateral when formulating recovery expectations. The largest region, Catalonia, represents 26% of collateral.

Figure 5

**Regional Concentration of Obligors**

By volume

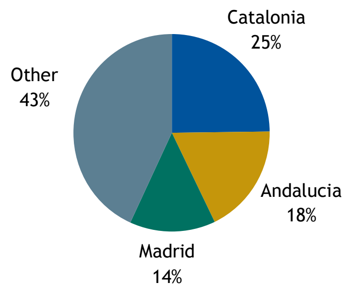



Source: Fitch

Figure 6

**Location of Loan Collateral**

By collateral value




Source: Fitch

## Probability of Default

The agency analysed the portfolio using obligor-specific PDs that Fitch derived from the regulatory PDs reported by BBVA. The agency adjusted obligor PDs to be representative of empirical default frequencies in 2009, a year of significant stress.

Fitch applied two adjustments to the PD distribution of the pool to reflect the agency's credit view on the sector exposure and idiosyncratic exposure to large obligors of each credit.

The agency applied a minimum one-year PD of 11% to loans to the RE and building and materials sectors (ie 29% of the collateral value), as Bank of Spain delinquency data for these sectors is indicative of a significantly higher PD and the agency considers recovery of these sectors to be unlikely over the effective life of this transaction.

Fitch has considered the structural link between enterprises reported by BBVA to be part of the same risk group. It has applied a three-notch downgrade to 36 risk groups treated as "large" obligors as each represent more than 50bp of the collateral value (or 38.1% jointly). Furthermore, it considered a minimum one-year PD equal to the weighted-average PD of the portfolio (ie 8%), to compensate for the lack of a Fitch credit opinion on these large obligors.

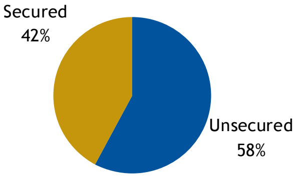
As a result, Fitch has considered a below-average total benchmark weighted-average one-year PD of 9.8% for this portfolio, when compared to other Spanish SME deals, corresponding to a rating proxy of 'B−'/'CCC+'.

Fitch notes that the performance of previously issued BBVA Empresas deals would suggest a lower PD benchmark. The agency nevertheless highlights that non-diversified large exposures to unrated corporates pose significant idiosyncratic risk despite bearing statistically low PDs. This is because the PDs produced by internal rating systems rely on averages and statistical analysis that would no longer be valid if risk is not diversifiable.

Figure 7

**Underlying Loan Collateral**

By volume




Source: Fitch

## Recovery Rate

Fitch believes that historical recovery rates (RRs) are not a good reflection of expected recoveries in the distressed Spanish RE market. It assigned calculated RRs to all assets in the portfolio, using its market value decline (MVD) framework, and considered foreclosure durations of four years.

Secured loans, as considered by Fitch, make up 42.1% of the pool. The agency did not credit mortgage collateral value when relevant information on the collateral was missing (ie appraisal value and property type or location or when senior charges to a second-lien mortgage were not available).

For secured assets in the portfolio, Fitch established RR estimates using the MVD approach to capture the reduced proceeds resulting from distressed sales of foreclosed properties. See "*EMEA Residential Mortgage Loss Criteria*", dated February 2010.

The agency assumed more severe MVDs for non-residential collateral as statistics on market transactions and price indices are not generally available. It has applied non-property MVDs (as listed in the SME CLO criteria) to non-residential properties.

Fitch does not expect strong recoveries on this portfolio due to the high proportion of unsecured credits and the commercial nature of most properties. It expects that in a 'AAAsf' scenario, unsecured assets in this portfolio will have a moderate recovery rate of 9.7% after cures, while recoveries on secured assets are expected to be 48.6%.

Figure 8

**PCM Results**[a]

| (%) | RDR | RRR | RLR |
|---|---|---|---|
| AAAsf | 50.1 | 25.3 | 37.4 |
| BB+sf | 37.5 | 60.8 | 14.7 |

[a] For the avoidance of doubt, the precision (ie number of decimal places) shown in the results should not be considered an indication of accuracy (ie margin of error)
Source: Fitch

### Portfolio Credit Model

The portfolio was analysed using Fitch's Portfolio Credit Model (PCM), available at *www.fitchratings.com*. This model implements the agency's criteria for granular SME CLOs and takes loan-by-loan portfolio and obligor data as inputs. The PCM produces rating default rates (RDR), rating recovery rates (RRR) and rating loss rates (RLR) for the portfolio under all rating scenarios (ie portfolio modelling inputs).

The Adjacent figure shows the RDR, RRR and RLR for the portfolio under various rating scenario. The RDR and RLR correspond to the default and loss attachment points, respectively, for which the statistical confidence matches that of the target rating level. For example, in a 'AAAsf' scenario, losses from the portfolio are expected to be less than 37.4% of the outstanding portfolio balance with a 99.97% confidence level; and no more than 50.1% of the outstanding portfolio balance is expected to ever be more than 90 days in arrears over the life of the transaction, again with a confidence level of 99.97%.

Fitch addressed obligor concentration risk by stressing the top five risk contributors in the portfolio via the PCM's obligor concentration uplift (OCU) feature. OCU increases the default correlation between these obligors by adding 50%, and haircuts the recovery rates by 25% when these obligors default. Additionally, it applied a one-category downgrade to these obligors and then a one-year PD floor equal to the weighted-average PD of the collateral (ie 8%).

## Financial Structure and Cash Flow Modelling

The notes issued by the fund are floating-rate quarterly-paying securities, based on three-month Euribor plus a margin (ie 30bp and 50bp for the class A and B notes, respectively).

### Cash Reserve — To be Depleted in Rating Scenarios

The structure features a subordinated cash reserve fund (RF) holding that provides 20% CE to the notes.

Fitch understands this RF provides liquidity for the early amortisation of the notes via the provisioning of defaults mechanism. The RF also traps excess spread as the structure aims to top up the balance of the RF up to the RF "required amount". In fact, Fitch rating scenarios make full use of this RF to support the different ratings on the notes.

The RF required amount is defined as the minimum of EUR250m (ie the initial amount available at closing) and 40% of the current notes' balance, and never less than EUR125m. However, a reduction of the required amount is not allowed if: i) the RF was not fully funded on the previous payment date; ii) less than three years have elapsed since closing; and iii) non-defaulted loans more than 90 days in arrears represent more than 1% of the total balance of non-defaulted loans.

### Swap — Guaranteed Excess Spread of 50bp

The transaction includes a balance-guaranteed swap. The hedging agreement swaps actual interest collected from the pool for the WA interest rate of the notes plus a guaranteed excess spread of 50bp on a notional defined as the daily average of the outstanding amount of performing loans (ie loans less than three months in arrears) over each payment period. The SPV will also receive an amount covering senior administrative costs.

The agency is reassured that the swap helps mitigate negative carry — which would occur if the yield on the pool fell below the WA interest rate payable on the notes — and supports the transaction by covering administrative costs. Therefore, Fitch notes that the gestora may have difficulty replacing the swap counterparty in the unlikely event of BBVA becoming ineligible under Fitch criteria.

## Priority of Payments — Designed to Protect the Senior Notes

The structure features a combined payment waterfall that allows for interest deferral of class B interest upon performance deterioration and implements a default provisioning mechanism out of available funds (which would include the cash reserve).

Fitch considers the combined waterfall in the transaction to benefit the senior notes, as principal collections can be used to cover interest on the senior notes, thus aiding liquidity.

The agency highlights that the interest deferral trigger is irreversible. This is because interest on class B will be deferred if cumulative defaults exceed 20% of the initial principal balance of the pool. Fitch expects that interest will be deferred on class B under all scenarios analysed. However, it expects that deferred interest will ultimately be paid before the legal final maturity.

## Note Amortisation

Fitch is comfortable with the provisioning mechanism embedded in the calculation of principal accrued for repayment on the notes. The fund aims to match the combined balance of the notes with the balance of non-defaulted assets on every payment date. This is done by allocating as much cash as needed for principal repayment. Fitch notes that this mechanism would also correct any principal deficiency as soon as enough cash is available.

Fitch is reassured that the transaction does not permit pro-rata amortisation, thereby conserving CE for the senior class A notes.

### *Clean-Up Call*

In its analysis, Fitch has not considered the clean-up call option in favour of the sociedad gestora when the pool factor falls below 10%. This can only be executed if all notes can be repaid in full and would just be possible with the support of the originator (ie it was willing to purchase impaired loans at par) under Fitch's rating scenarios.

## Cash Flow Modelling — Pushing the Structure to the Limit

Fitch customised its proprietary cash flow (CF) model to accurately implement the structure of the fund. It implemented the interest deferral mechanism in the model.

Fitch notes that the structure is not that efficient at protecting the class A notes. The long 18-month default definition delays provisioning for losses, thus exposing the transaction to significant negative carry. As the deal lacks a liquidity facility, a high level of CE is needed to ensure timely payment of interest in a 'AAA' scenario for the class A notes.

Fitch acknowledges that the CE available to the classes allows the ratings to pass all CF scenarios, with temporary shortfalls of interest where they are allowed by the documentation (only for class B). The CF model stresses three factors to create scenarios that the notes must pass: i) default timing; ii) prepayments; and iii) interest rates.

The agency applied severe interest-rate stresses at the 'AAAsf' level. A short-term stress reaches a peak interest rate of 12.6% only 40 months after closing, up from a three-month Euribor spot rate of 1.03% at the time of the analysis. It assumes long-term stress levels at a rate of 10.0%.

Fitch considered three different default timing stresses in its CF analysis: i) front-loaded; ii) stochastic; and iii) back-loaded. Under the front-loaded stress, 70% of all defaults are allocated in the first two years of the transaction. The stochastic default timing is obtained from the PCM simulation and is also front-loaded, but has a longer tail. The back-loaded scenario accumulates 65% of all defaults in the third and fourth years of the life of the transaction.

Fitch considered the current lack of availability of credit and the recessionary environment in Spain and applied a high prepayment stress in the form of an annualised constant prepayment rate (CPR) of 10%. The agency believes that higher CPRs would only be possible with the support of the originator, and this support is not considered possible in high IG scenarios. The agency also considered a low prepayments scenario with a CPR of 0%.

Fitch tested all possible combinations of the above stress factors. The notes passed all stress scenarios tested. The harshest scenario for the class A notes is the one with rising interest rates, low prepayments, and back-loaded defaults. The agency does not think this scenario is likely.

### *Jump-to-Default of the Account Bank and Rating Cap Tests*

Fitch is reassured that the class A notes would be able to maintain an IG rating if a jump-to-default of the account bank holding the reserve fund were to occur.

To test whether the exposure to the account bank is excessive, Fitch modified its cash flow model to simulate a sudden loss of the reserve fund (ie due to a default of the account bank).

Fitch assessed that all ratings are expected to pay timely interest in a base-case scenario, following its "*Criteria for Rating Caps in Global Structured Finance Transactions*", dated June 2010.

## Counterparty Risk

### Key Parties

- **Originator:** BBVA
- **Servicer:** BBVA
- **Trustee/Arranger/ Manager/Cash Bond Administrator:** Europea de Titulizacion, S.G.F.T., S.A. (EdT)
- **Treasury Account Bank /Paying Agent:** BBVA
- **Reinvestment Account Bank:** BBVA
- **Swap Provider:** BBVA

Figure 9

### Counterparties and Triggers

| Key parties | Name | Current rating | Triggers[a] in documentation | Action upon breach of trigger |
|---|---|---|---|---|
| Seller, originator and servicer | Banco Bilbao Vizcaya Argentaria (BBVA) | 'AA−'/Stable/ 'F1+' | A/F1<br>BBB− | If the servicer's rating falls below 'A'/'F1', then collections from the assets are transferred daily directly into the treasury account. Additionally, a deposit will be created within 14 calendar days and obligors will be instructed to pay directly into the treasury account at the financial agent.<br>If the second trigger is breached, the servicer will find a replacement servicer. |
| Treasury account bank and financial agent | BBVA | (See above) | A/F1 | Within 30 days of the trigger breach, the gestora will: 1) obtain a guarantee from an entity rated at least 'A'/'F1'; or 2) move the treasury account to a bank rated at least 'A'/'F1'. |
| Swap provider | BBVA | (See above) | A/F1<br>BBB+/F2<br>BBB−/F3 | Within 30 calendar days of the first trigger breach, either a guarantee or replacement must be appointed or collateral be pledged within 14 calendar days (as per Fitch criteria). If after the first trigger breach a deposit was placed, then the deposit amount will have to be reviewed according to Fitch criteria within 14 days of breaching the second trigger.<br>Within 30 calendar days of a third trigger breach, only either a guarantee or replacement will have to be appointed. |

[a] In line with Fitch's counterparty criteria, for the purpose of this eligibility assessment only, an entity on Rating Watch Negative (RWN) is considered to be rated one notch below its IDR

Source: Transaction documents

Fitch believes that the structure provides adequate coverage of the counterparty risk exposure to BBVA via the downgrade language associated with every role considered in the transaction documents. The agency has found the remedial actions associated with a deterioration in credit quality of the counterparties (as evidenced by a reduction in their ratings) to be in line with its counterparty criteria.

The figure above summarises the counterparties and corresponding downgrade language as defined in the transaction documents to address counterparty risk. Any costs of remedial actions would be borne by the affected counterparties.

## Performance Analytics

Fitch will monitor the transaction regularly and as warranted by events with a review conducted, on average, at least yearly.

Fitch's structured finance team ensures that the assigned ratings remain, in the agency's view, an appropriate reflection of the issued notes' credit risk. The agency will report the performance of this transaction via its "*SME CLO Compare Tool*". Along with this tool, other details of the transaction's performance will be available to subscribers at *www.fitchratings.com* on the " *CDO S.M.A.R.T.* " (Surveillance Metrics Analytics Research Tools).

Periodical quarterly performance reports will be provided by the manager after every payment date, besides additional monthly reports on the assets.

The surveillance process is conducted on the basis of the then-current portfolio. Furthermore, the surveillance process considers any situation where the status of the counterparties to the transaction may imply a rating migration and/or the need and implementation of remedial actions, as outlined in the documentation.

Please contact the Fitch analysts listed on the first page of this report with any queries regarding the initial analysis or the ongoing surveillance.