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Subject: RBS Ratings Rest on Rot - Collateral Damage from Slow Implosion of RBS
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Date: Friday, April 4, 2014, 9:03 AM

Mr. Flinterman:

I draw your attention to Moody's Announcement of 3 April 2014: "Moody's updates on impact of RBS' execution of deeds of undertaking on Granite Master Issuer and Granite Mortgages"
https://www.moodys.com/research/Moodys-updates-on-impact-of-RBS-execution-of-deeds-of--PR_296262?WT.mc_id=NLTITLE_YYYYMMDD_PR_296262

RBS decision to neither post collateral under swaps with Granite Trust RMBS nor transfer the swaps to a higher-rated counterparty imperils the financial health of both RBS and the Granite Trust RMBS. As a result, the ratings of both RBS and the Granite RMBS are inaccurately high.

1. By not transferring swaps with Granite Trust RMBS, RBS becomes more exposed to its own credit risk by operation of the swaps' flip clauses. In the event that RBS defaults, or transfers the swaps to a "bad bank", RBS agrees to write off the gross amount of swap assets.

In other words, RBS has a massive, undisclosed hole in its balance sheet.

Has ESMA briefed the EBA on flip clause risk for European banks, using RBS as an example? Does the EBA model the vaporization of gross swap assets under flip clauses in stress-testing European banks? Do Moody's RMBS analysts brief Moody's RBS analysts of growing risk to RBS, and other European banks, under flip clauses? Does anyone brief the Bank of England of the growing hole in the RBS swap book, or similarly brief the European Central Bank with respect to European banks?

2. By not posting collateral against swap liabilities vis-a-vis the Granite RMBS, RBS exposes the Granite RMBS to material credit risk. None-the-less, Moody's not only leaves the ratings of Granite RMBS unchanged, it greenlights the RBS proposal (for a small fee, of course) to NEITHER post collateral NOR transfer the swaps for the next 160 business days.

When RBS still has NOT posted collateral NOR transferred the swaps after 160 business days, it need only petition Moody's again, and pay a small fee, to activate a second grace period of 160 business days.

3. RBS is taking no action with respect to all swaps with ABS, not simply those with Granite RMBS. That's fine by Moody's, too.

"Further, RBS has informed Moody's that it is devoting significant resources to facilitate timely performance of its trigger related obligations under structured finance swaps. On this basis, and since Moody's generally assumes that a downgraded swap counterparty will take significantly longer than 30 days to effect a transfer to a new counterparty, Moody's considers that the extension of the cure periods to 160 business days does not materially affect the likelihood of successful remedial actions."

Please note that "timely performance of its trigger related obligations under structured finance swaps" means that RBS will NOT post collateral, NOR transfer the swaps, NOR obtain a guarantor for rolling periods of 160 business days each.

Structured Credit Investors summarized the main points on 4 April 2014.
http://www.structuredcreditinvestor.com/RMBS/?categories=73|RMBS&p_num=1

"RBS to execute on Granite deeds

"Moody's says the execution of deeds of undertaking by swap provider RBS relating to swap agreements between Granite Mortgages 2003-2, 2004-1 and 2004-2 and RBS will not result in a reduction or withdrawal of the notes' ratings. RBS has chosen not to transfer the swap or obtain a guarantee.

"Moody's downgraded the long term senior unsecured rating of RBS last month, resulting in a ratings trigger event under the swap agreements. RBS has 30 days to take remedial action to prevent an additional termination event.

"RBS intends to take such remedial action by executing the deeds, effectively extending the cure period to 160 business days. Moody's believes the extension of cure periods to 160 days does not materially affect the likelihood of successful remedial actions."

Regards,

William J. Harrington