3.30 SLOVENIA

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I. FRAMEWORK

The legal basis for covered bond issuance in Slovenia is the **Mortgage Bond and Municipal Bond Act** (Official Gazette of the Republic of Slovenia, No. 10/12 and No. 47/12, hereinafter "Covered Bond Act"). Together with the secondary legislation (the regulations of the Bank of Slovenia[1]) outlined below, it represents the legislative framework for mortgage and municipal bonds.

> **Regulation on the conditions for obtaining an authorisation for issuing mortgage and municipal bonds** (Official Gazette of the Republic of Slovenia, No. 17/2012) which regulates in detail the requirements for obtaining an authorisation to issue mortgage and/or municipal bonds;

> **Regulation on matching the cover pool with the outstanding mortgage and municipal bonds** (Official Gazette of Republic of the Slovenia, No. 17/12) which determines detailed rules for matching cover assets and liabilities from issued mortgage or municipal bonds based on the net present value principle, and rules for matching the maturities, interest rate and currency exposure of the cover assets with the liabilities from issued mortgage or municipal bonds;

> **Regulation on the conditions for inclusion of derivative instruments in the cover pool of mortgage and municipal bonds** (Official Gazette of the Republic of Slovenia, No. 17/12) sets out the maximum level of derivative instruments for inclusion into the cover pool, the form of derivative instruments, the type of counterparties and other detailed criteria;

> **Regulation on the documentation for proving the fulfilment of conditions for the cover register administrator appointment** (Official Gazette of the Republic of Slovenia, No. 17/12) regulates the conditions for appointing the cover register administrator[2] of a cover register and for acquiring a Bank of Slovenia's authorisation to act as the cover register administrator of a cover register.

In addition the Bank of Slovenia adopted **Guidelines for managing the records of the cover register** (Governing Board of the Bank of Slovenia, dated 28.2.2012) which set out the guidelines regarding the content, the form and the way of management of the cover register's records.

II. STRUCTURE OF THE ISSUER

The issuer of covered bonds under the Covered Bond Act can be a bank holding a valid banking license issued in accordance with the Banking Act. Further, the issuer must have obtained a license from the Bank of Slovenia for issuing the relevant type of covered bonds (i.e. mortgage bonds, municipal bonds, or both).

In order to obtain the Bank of Slovenia's license for issuing covered bonds, the issuer must prove to the satisfaction of the Bank of Slovenia that it complies with the requirements set out in Article 9 of the Covered Bond Act (detailed provisions set out in Regulation on the conditions for obtaining an authorisation for issuing mortgage and municipal bonds) as outlined below:

> The issuer must have in place systems for managing risks associated with the issuance of the mortgage and municipal bonds, as well as risks associated with cover assets;

1 The central bank.

2 Cover register administrator is entitled to verify the accuracy and completeness of the information on the cover assets and covered bonds, measuring compliance with the statutory tests on an on-going basis and approving the entries in and removals of cover assets from the cover register.

> The issuer must ensure an adequate number of qualified employees, be organizationally and technically qualified for issuing mortgage and municipal bonds and to grant mortgage loans, public loans and other financing to legal entities;

> The issuer must ensure that the activities concerning granting mortgage loans and loans to public sector entities and issuing mortgage and municipal bonds are conducted separately from its other business activities;

> The issuer must have in place rules for maintaining the cover register;

> The issuer must have in place the rules for property valuation and must either employ for indefinite period and on full-time basis or engage contractually at least one independent property valuator.

Covered Bond Act envisages the on-balance sheet structure of covered bonds. The cover assets remain the property of the issuer until the insolvency of the issuer or withdrawal of the issuer's license to issue covered bonds. Upon the said events, the cover assets are segregated from the general assets of the issuer and used for repayment of the obligations under the covered bonds in priority to any other assets of the issuer (Covered Bond Act, Articles 15(1) and 45(1)).

III. COVER ASSETS

The cover assets can only be included in the cover pool of covered bonds to the extent that they satisfy the criteria set out in the Covered Bond Act and are free and clear of any lien or other encumbrance.

The cover pool of mortgage bonds may consist of receivables arising from (i) the loans secured by a mortgage on residential property located in the EEA or Switzerland, (ii) the loans secured by mortgage on commercial property located in the EEA or Switzerland (up to 20% of cover assets), (iii) the complementary cover assets (up to 20% of cover assets) and (iv) the derivative instruments (up to 12% of cover assets).

Cover pool of municipal bonds may consist of receivables arising from (i) the loan granted to, or debt securities issued by, an eligible state[3] or eligible local community[4], (ii) the loans granted to, or debt securities issued by, another legal entity provided that the obligations in respect to such loans or securities are guaranteed by an eligible state under an eligible guarantee, (iii) the complementary cover assets (up to 20% of cover assets) and (iv) the derivative instruments (up to 12% of cover assets).

The complementary cover assets may comprise of (i) cash on the account maintained at the Bank of Slovenia, (ii) marketable debt securities issued by an EEA member state and Switzerland (to the extent that its credit rating is equal to or higher than the Eurosystem's credit rating threshold) or its central bank or ECB, or other debt securities issued by EIB, EBRD or other bank according to criterion of ECB.

Issuer can also include the derivative instruments in the cover pool if they reduce risks associated with the cover assets, interest and/or currency mismatches applicable to cover assets and covered bonds.

There are certain other limits concerning the cover assets which comprise the cover pool (Covered Bond Act, Articles 25 and 38(4)):

> Up to 5% of the cover pool may consist of mortgage loans secured by a mortgage on residential property under construction;

3 Eligible state is an EEA member state and Switzerland, to the extent that its credit rating is equal to or higher than the Eurosystem's credit rating threshold.

4 Eligible local community is a local community in EEA and Switzerland, to the extent that its credit rating is equal to or higher than the Eurosystem's credit rating threshold.

- Up to 10% of the cover pool may consist of mortgage loans secured by a mortgage the registration of which is still pending, provided that the process of registration is completed within 12 months from the date of filing of the application;
- Up to 20% of the cover pool may consist of mortgage loans to the same person or a group of legal entities which qualifies as a group of affiliated persons in accordance with the Banking Act, without prejudice to the rules on largest exposure applicable under the Banking Act.

IV. VALUATION AND LTV CRITERIA

The level of receivables from mortgage loans that can be taken into consideration for the cover assets must not exceed: (i) 80% of the mortgage lending value of the mortgaged property or, if the issuer decides to use the general market value, 50% of the general market value of property for loans secured by mortgage on residential properties; (ii) 60% of the mortgage lending value of the mortgaged property for loans secured by mortgage on commercial properties. When the level of receivables from mortgage loans exceeds the above restrictions, only an appropriate portion of the loan may be considered as cover assets (Covered Bond Act, Article 28).

The value of the residential and commercial properties can be estimated as the mortgage lending value[5] or market value[6]. Both, the mortgage lending value or market value, are determined by an independent property appraiser in compliance with the international property standards (Covered Bond Act, Article 26(4)). Residential properties can alternatively be estimated also by the use of a general market value appraised by the mass appraisal methods (Covered Bond Act, Article 27). The value of a property is determined individually for each real property (Covered Bond Act, Article 30(1)).

During the property mortgage loan term, the issuer must regularly monitor the value of the mortgaged property and re-assess this value at least once a year for commercial property and at least once every three years for residential property. Issuers may use statistical methods to monitor the value and identify the real property that requires revaluation. Further need for revaluation arises should the value of the real property and the general market prices of the real property in the area where the real property is situated have dropped by more than 20% in the period from the last valuation, or if a borrower is late in meeting his obligations for mortgage loans by more than 90 days (Covered Bond Act, Article 30(4)).

V. ASSET - LIABILITY MANAGEMENT

The issuer may issue mortgage or municipal bonds only to the extent that is necessary to ensure the coverage for liabilities from bonds in circulation and derivative instruments at all times by means of cover assets in at least the same nominal amount (Covered Bond Act, Article 22(1)).

Notwithstanding the provision regarding the nominal amount coverage, the matching of the cover assets with the liabilities from mortgage or municipal bonds and the derivative instruments is ensured at all times according to the present value principle; in this case, the cover assets' present value must exceed the present value of liabilities for mortgage or municipal bonds by at least 2% (Covered Bond Act, Article 22(2)).

The maturities, interest rates and currencies of the cover assets included in the cover register are adjusted to the maturities, interest rates and currency of the liabilities under the covered bonds and the derivative instruments (Covered Bond Act, Article 22(3)).

5 The mortgage lending value of real property shall be the value of real property as determined on the basis of prudential analysis of the possibilities of selling the property in the future carried out by an independent property appraiser by taking into consideration the long-term sustainability aspects of such property, the usual and the local market conditions, and its current and alternative proper uses without consideration of the speculative elements.

6 The market value of property is the price determined by an independent appraiser, at which the property could be sold by the seller to the buyer on the basis of a purely commercial relationship, without coercion.

The compliance with the conditions referred to in previous paragraphs must be verified at least once a month.

In addition, stress tests (test of the impact of the change in interest rates and foreign exchange rates) must be performed at least once a month. The issuer must initiate the procedure to increase the cover pool assets should the stressed present value of covered assets not exceed the stressed present value of liabilities of covered bonds by at least 2%.

The issuer must keep cover assets reserves by comparing the amount of matured receivables from cover assets entered in the cover register with the amount of matured liabilities from the issued mortgage or municipal bonds and the matured liabilities from the derivative instruments entered into, on a daily basis over the next 180-day period. Following the comparison of the largest calculated difference between the matured liabilities and the matured receivables, the issuer must provide coverage in the form of complementary assets (Covered Bond Act, Article 23).

VI. TRANSPARENCY

The Slovenian banking sector closely follows the developments regarding the ECBC's and its members' initiatives and trends on transparency. It should be noted that there have been no covered bond issuances from the Slovenian market yet. However, the market initiative on the subject and, in particular, on the national transparency templates is currently being contemplated.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

Obligation to keep a cover register

Issuer must keep a cover register and cannot transfer this task to other persons. The cover register includes the individual entries which represent cover assets for the issued mortgage or municipal bonds. The cover register also includes a record of all the mortgage or municipal bonds issued. The cover register reveals at all times the nominal value of cover assets and mortgage or municipal bonds in circulation (Covered Bond Act, Article 37). Only assets approved by the cover register administrator may be recorded in the cover register or struck off the cover register (Covered Bond Act, Article 38(3)).

When issuing mortgage and municipal bonds, the issuer must keep separate cover registers (Covered Bond Act, Article 51(2)).

Cover register administrator

Every issuer must have a cover register administrator[7] who is independent from the issuer and ensures that the cover register is maintained in accordance with Covered Bond Act, as well as the regulations issued on the basis thereof and performs the other tasks provided for by Covered Bond Act. The cover register administrator is appointed by the issuer (Covered Bond Act, Article 39).

The duties of the cover register administrator are: (i) to ensure that the cover assets provide coverage or the total value of the mortgage or municipal bonds in circulation and liabilities from the derivative instruments; (ii) to ensures the assets are registered in this register; (iii) prior to the issuance of mortgage or municipal bonds, the cover register administrator must confirm that the cover assets provide sufficient and adequate coverage for the bonds; (iii) to consider the issuer's requests for a cancellation of a mortgage as a security for the claims entered as coverage in the cover register; (iv) to forthwith notify the Bank of Slovenia when the cover register administrator determines that the cover assets do not sufficiently cover the mortgage or municipal bonds and liabilities from the derivative instruments, or that they are otherwise contrary to the provisions of

7 The cover register administrators shall be a person: (i) a certified public accountant who meets the requirements of the act governing auditing or persons with other professional qualifications; (ii) having previously obtained a licence from the Bank of Slovenia to perform the activities of cover register administrator; (iii) whose previous activity raises no doubt as to that person's suitability for the role of administrator (Covered Bond Act, Article 40).

the Covered Bond Act; (v) to regularly notify the Bank of Slovenia of its findings pursuant to the Covered Bond Act (Covered Bond Act, Article 41).

The responsibilities of the cover register administrator are: (i) to examine the books of account and other documents of the issuer that are in any way associated with the mortgage or municipal bonds and cover assets; (ii) to require from the issuer to keep the cover register administrator regularly informed of the performance of the cover asset-related repayments and any other changes associated with these assets (Covered Bond Act, Article 42).

Replacement of inadequate assets

The cover register administrator must require from the issuer to replace the inadequate mortgage loans if: (i) during the term of the mortgage loan, the value of real property declines to such an extent that the value of the outstanding mortgage loan exceeds the mortgage lending value or the real property's general market value level; or (ii) the borrower falls behind in meeting its payment obligations under the loan agreement for over 90 days; or (iii) the issuer receives the cover register administrator's written request related to the expiration of the time limit for entering the mortgage in the land register. In case of a decline in the real property value referred to in item (i), the issuer may supplement the existing receivables from mortgage loans by receivables from other mortgage loans or other suitable assets to the extent of the deficit in the cover assets resulting from a decline in the real property value (Covered Bond Act, Article 31).

Role of the Bank of Slovenia

The Bank of Slovenia supervises the implementation of the Covered Bond Act, grants authorisation to the bank prior to the issuance of the covered bond and grants license to the cover register administrator. In case of the issuer's insolvency, the Bank of Slovenia proposes to the court a cover assets trustee and is authorised to file a request to institute separate bankruptcy proceedings against the cover assets. The issuer and covered bond administrator have to regularly report to the Bank of Slovenia.

VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

Segregation of cover assets

The cover assets that comprise the cover pool are evidenced by way of entry in the cover register; while they remain the property of the issuer, they are intended primarily for the payment of obligations under the covered bonds and the derivative instruments that are included in the cover pool (Covered Bond Act, Article 3(1)). Cover assets and complementary assets may not be used or pledged for any other purpose (Covered Bond Act, Articles 19(4) and 20(4)).

The issuer must ensure that the activities in connection with the covered bonds and cover assets are conducted separately from its other business activities (Covered Bond Act, Article 10).

Only the obligations of the issuer under the covered bonds and the derivative instruments can be enforced against the cover assets (Covered Bond Act, Article 37(5)). The law also sets limitations to the set-off rights of the debtors whose liabilities are included in the cover pool (Covered Bond Act, Article 37(6)).

Impact of the issuer's insolvency proceedings and the preferential treatment of the covered bond holders

Upon the issuer's insolvency, the cover pool is separated from the issuer's insolvency estate and the payment of obligations under the covered bonds and the derivative instruments, including the costs, from the cover assets is given priority over all other claims against the issuer (Covered Bond Act, Articles 45(1) and 44(1)). The consequences of the insolvency proceedings do not affect the issuer's obligations under the covered bonds and the derivative instruments (Covered Bond Act, Article 45(2)).

The court designates a cover assets trustee (who is not the same person as the issuer's insolvency administrator) entrusted with the management and disposal of cover assets to the extent necessary for the continuous payment of obligations under the covered bonds and the derivative instruments, for which no approval of the court is required (Covered Bond Act, Articles 46 and 47(1)). The court approval is required for the cover asset trustee's disposal of the cover pool and redemption of the covered bonds prior to their maturity, which is granted if such redemption increases the possibility of repayment of the issuer's obligations under the covered bonds and the derivative instruments (Covered Bond Act, Article 47(3)) – this is the only possible means of acceleration before the maturity of the covered bonds, they do not automatically accelerate in case of insolvency of the issuer nor can they be accelerated at the option of the holders (Covered Bond Act, Article 18).

The issuer's insolvency administrator may request the cover asset trustee to transfer to the issuer's insolvency estate such part of the cover assets that will, beyond any doubt, not be required for the payment of obligations under the covered bonds and the derivative instruments included in the cover pool; the decision on transfer vests with the court (Covered Bond Act, Articles 47(5) and (6). Once all the obligations under the covered bonds and the derivative instruments have been paid, the cover asset trustee transfers the remaining cover assets to the issuer's insolvency estate (Covered Bond Act, Article 47(7)).

Should the cover assets prove insufficient to ensure the continuous payment of obligations under the covered bonds and the derivative instruments, a separate insolvency proceedings are initiated against the cover assets at the request of the Bank of Slovenia; the cover asset trustee can give the initiative to the Bank of Slovenia (Covered Bond Act, Articles 49(1) and (2)). If such separate insolvency proceedings still do not result in full payment of the obligations under the covered bonds and the derivative instruments, the holders of the covered bonds and the creditors under the derivative instruments are entitled to file a claim for the outstanding part of their receivables in the issuer's general insolvency proceedings (Covered Bond Act, Article 49(3)).

Access to liquidity in case of insolvency

The cover asset trustee is entitled to borrow money if this is required to ensure continuous compliance with the payment obligations under the covered bonds and the derivative instruments (Covered Bond Act, Article 47(2)).

Sale and transfer of cover assets to other issuers

Once appointed, the cover asset trustee may transfer the entire cover pool and all obligations arising under the issued covered bonds to a substitute issuer who is willing to assume such rights and liabilities, subject to the prior approval of the Bank of Slovenia (Covered Bond Act, Article 48).

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

The risk-weighting of covered bonds is regulated by two regulations adopted by the Bank of Slovenia, (Regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks and the Regulation on the calculation of capital requirements for credit risk under the internal ratings based approach for banks and savings banks, both published in the Official Gazette of the Republic of Slovenia, No. 135/06, as amended). The banks using the standardised approach assign the risk-weightings to their covered bond exposures based on the risk weighting of the issuer (e.g. covered bonds of the credit institution with a 20% risk-weighting are assigned a 10% risk-weighting). Under the internal ratings based approach the loss given default (LGD) for covered bonds is set at 11.25%.

The legislation when taken together with the practices, processes and procedures across the industry should fall within the criteria of Article 129 of the Capital Requirements Regulation (CRR). The provisions of the Covered Bond Act fall within the criteria of Article 129(1) CRR as well as the criteria of Article 52(4) of the UCITS Directive.[8]

ECBC Covered Bond Comparative Database: http://www.ecbc.eu/framework/110/Slovenian_Covered_Bonds

8 Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): http://ecbc.hypo.org/Content/default.asp?PageID=504#position.

3.31 SOUTH KOREA

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I. FRAMEWORK

Efforts to create a covered bond market in Korea

Korea did not have legislation for covered bonds until recently when the Covered Bond Act ("Covered Bond Act") was passed by the National Assembly on December 19, 2013 and came into effect on April 15, 2014. Until now, domestic banks in Korea had been looking at covered bonds as an alternative source of funding and the Korea Federation of Banks, a major association of banks in Korea, set up a task force team in 2008 to pursue the introduction of covered bonds in Korea, including by way of a dedicated covered bond statute. Even prior to the Korea Federation of Banks task force team, market participants were looking into alternative structured covered bond structures utilizing Korea's Act on Asset-Backed Securitization (the "ABS Act").

Such efforts eventually led to Kookmin Bank's offshore covered bond issuance in May 2009 (the "KB Covered Bonds"). Kookmin Bank developed a structure on the basis of the securitization techniques under the ABS Act and the Trust Act that enabled the relevant asset pool to be "ring fenced" and effectively granted dual-recourse to its investors through contractual arrangements. The KB Covered Bonds were the first covered bonds issued out of Korea and the Asia-Pacific region.

Many Korean banks looked into possible issuance of similar structured covered bonds after Kookmin Bank's inaugural transaction. Due to the complex structure and favorable market conditions allowing banks to procure funding at acceptable rates, Korean banks did not follow through with covered bond issuance under the Kookmin Bank structured covered bond model.

Separately, in July 2010, the Korea Housing Finance Corporation ("KHFC") issued the second covered bond out of Korea and the first statutory covered bond transaction out of Asia. KHFC utilized the "mortgaged-backed bonds" (the "KHFC Covered Bonds") under the Korea Housing Corporation Act (the "KHFC Act") in issuing the covered bonds. The KHFC Act contemplates various financing options for KHFC and to issue mortgage-backed bonds is one of these options. Mortgaged-backed bonds are economically similar to covered bonds because the bond holders have a statutory priority right over a pool of assets segregated from the other assets of KHFC.

The successful issuance of the KHFC Covered Bonds in 2010 stimulated new interest for covered bonds in Korea, with KHFC Covered Bonds being considered as a potential alternative to traditional residential mortgage backed securities (RMBS) transactions as a funding source for Korean mortgage lenders. Several follow-on transactions have been completed that utilize KHFC as the issuer and the dual recourse feature of mortgage-backed bonds under the KHFC Act.

II. STRUCTURE OF THE ISSUER

1. KHFC Act

Eligible issuer

KHFC, which is wholly owned by the Korean government and the Bank of Korea, is the only eligible issuer of KHFC Covered Bonds. Pursuant to Article 31 of the KHFC Act, the holders of KHFC Covered Bonds have a statutory priority right of payment from a separately managed pool of mortgage loans designated as the underlying collateral for KHFC Covered Bonds (the "KHFC Cover Pool"). In addition, if principal and interest on a KHFC Covered Bond are not fully paid out of the KHFC Cover Pool, it can be paid from the general assets of KHFC. KHFC issues these bonds without transferring the cover assets to a separate legal entity and the bankruptcy remote cover assets are left on KHFC's balance sheet.

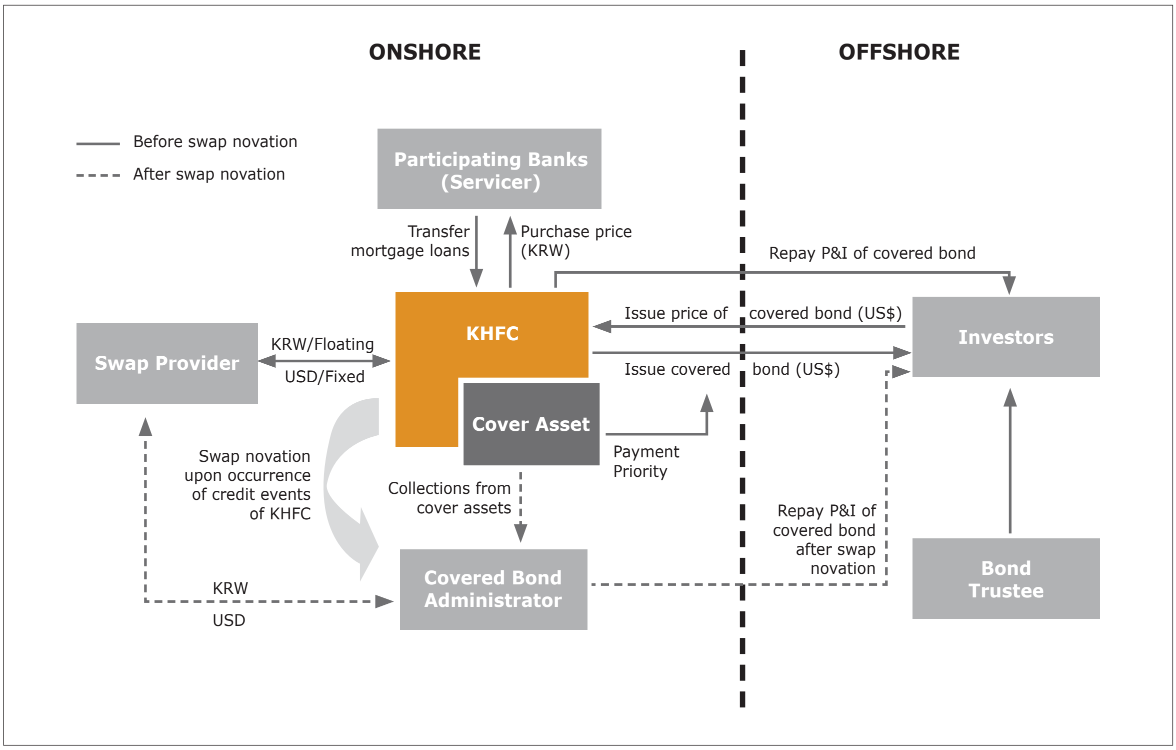
A bond trustee is typically appointed to act on behalf of the investors and an onshore covered bond administrator is appointed for the purpose of the automatic swap novation described below. The investors have dual recourse in respect of the KHFC Covered Bonds: (a) a senior unsecured claim to KHFC upon the occurrence of an issuer event of default or at maturity; and (b) a statutory priority right of payment over the KHFC Cover Pool.

In the case of KHFC Covered Bonds issued offshore, KHFC enters into a cross currency swap agreement and an interest rate swap agreement with the swap providers, pursuant to which KHFC will deliver KRW interest periodically and principal at maturity to the swap providers in exchange for U.S. dollar currency payments. The swap providers pay U.S. dollar interest periodically and principal at maturity. The swap agreement is subject to an automatic swap novation mechanism (the "Swap Novation") in which the swap providers, KHFC, and the covered bond administrator entered into a tripartite automatic novation agreement, which states that the swap agreement will be automatically terminated with KHFC and novated to the covered bond administrator upon the occurrence of certain events of default regarding KHFC, and that the mark-to-market valuation of the swap agreement as of the novation date will not be exchanged between KHFC and the swap providers or between KHFC and the covered bond administrator.

Subsequent to such events of default, the covered bond administrator will pay KRW generated from the KHFC Cover Pool to the swap providers in exchange for the U.S. dollar denominated payments, and the swap providers will pay the U.S. dollar denominated interest periodically and principal at maturity.

The following diagram illustrates the structure of the KHFC Covered Bonds transaction.

Figure 1: KHFC Covered Bonds Transaction Structure



Source: Kim & Chang