

### **3.2 AUSTRIA**

By Bernhard Freudenthaler, Hypothekenverband (Austrian Pfandbrief-Forum Secretary)  
 Martin Schweitzer, Erste Group Bank (Austrian Pfandbrief-Forum Speaker)

#### **I. FRAMEWORK**

Austria has three different frameworks under which Covered Bonds can be issued. These are:

1. Hypothekbankengesetz: Mortgage Banking Act (Law of 7/13/1899, last amended 2005) "Pfandbriefe"
2. Gesetz betreffend fundierte Bankschuldverschreibungen: Law on Secured Bank Bonds (Law of 12/27/1905, last amended 2005) „FBS“
3. Pfandbriefgesetz: Mortgage Bond Act (Law of 12/21/1927, last amended June 1, 2005) "Pfandbriefe"

Under these laws banks can issue two kinds of Covered Bonds, Pfandbriefe which are issued under the Mortgage Banking and Mortgage Bond Act, and Fundierte Bankschuldverschreibungen (FBS) issued under the Law on Secured Bank Bonds.

Amendments of all three laws have been brought forward in during 2010 with the aim of further harmonizing/unifying Austrian Pfandbrief legislation.

#### **II. STRUCTURE OF THE ISSUER**

The Mortgage Banking Act does stipulate a specialist banking provision and this would apply to any new mortgage bank. In practice, due to grandfathering of bonds issued before the law was implemented, exceptions are allowed and, in practice, all types of commercial banking activity are allowed. The Mortgage Bond Act applies to public-sector banks. And the Law on FBS is applicable for all other issuers.

Under all frameworks, the issuer holds the assets on the balance sheet and the assets are not transferred to a separate legal entity. This means that the Covered Bonds are an unconditional obligation of the issuer, rather than a direct claim on the cover assets. In the case of insolvency of the issuer, the cover assets will be separated from the rest of the assets and a special cover pool administrator will be appointed. The Covered Bond holders have a preferential claim on the cover assets.

#### **III. COVER ASSETS**

The cover pools have either mortgage-backed or public-sector assets. ABS/MBS are not eligible.

A Pfandbrief or Fundierte Bankschuldverschreibung (FBS) issue always corresponds to one asset class.

The geographical scope of eligible mortgage assets is restricted to EU / EEA countries, to Switzerland; USA, Canada and Japan are not eligible. For EEA countries that do not recognise a preferential claim, a 10% limit is in place. For öffentliche Pfandbriefe, the geographic scope of assets is the same.

The limits for FBS are similar. In addition also bonds that have the status of "Mündelgelder" are eligible (such as other local public bonds, or Austrian Pfandbriefe).

Derivative contracts are allowed in the cover pool and the Austrian legislation allows for interest rate currency and credit derivatives. Derivatives are only allowed for hedging and there is no limit in place on the volume of derivatives in the cover pool.

Substitute cover assets are limited to 15% and can consist of cash, bank deposits and bonds from public issuers from EEA countries and Switzerland.

#### **IV. VALUATION AND LTV CRITERIA**

The Mortgage Bank Act stipulates conditions for property valuation and the value of mortgage lending and the valuation method must be approved by the regulator. One condition is a 60% LTV (loan to value) for residential and commercial mortgages based on the mortgage lending value.

There is no provision for property valuation for FBS. In practice, issuers have incorporated an LTV provision into their articles of association which is 60% LTV.

In practice, monitoring of the property value is done by the issuer and a regular audit of the cover register is undertaken. The valuation of the property used in the calculations cannot exceed the resale value of the property, and valuation guidelines are approved by the regulator in line with general Mortgage Business valuation approvals (i.e. in IRB approval).

#### **V. ASSET - LIABILITY MANAGEMENT**

All Austrian Covered Bond laws enshrine the matching principle whereby the total volume of assets in the cover pool must at least cover the total nominal amount of Covered Bonds in issuance. The cover pool assets must also cover the outstanding bonds in terms of interest income. In addition, a mandatory overcollateralisation level of 2% is in place, which must be held in highly liquid substitute cover assets.

As well as these rules, banks can make additional voluntary provision in their articles of association which can strengthen the overcollateralization or asset- and liability management. An example of this would be to extend the matching principle to a net present value instead of nominal value and apply interest rate shocks, which is used by many of the international benchmark issuers.

The legislation also contains some maturity matching requirements to the extent that bonds cannot be issued if their maturity is considerably greater than the maturity of assets in the cover pool.

#### **VI. COVER POOL MONITOR AND BANKING SUPERVISION**

The cover pool is monitored by a trustee ("Treuhänder"), who is appointed by the Minister of Finance, on suggestion of the issuer. The trustee is liable according to the Austrian civil code and has formal functions only. The monitor has to ensure that the prescribed cover for the Pfandbriefe exists at all times and that the cover assets are recorded correctly in the cover register. Without his approval, no assets may be removed from the cover pool.

For FBS the pool is monitored monthly by the government commissioner ("Regierungskommissar"), who works for the ministry of finance on behalf of the Banking Supervisory Authority (FMA).

Any disputes between the issuer and the trustee would be settled by the regulator. For FBS if the government commissioner is concerned that the rights of the Covered Bond holders are being infringed then he can apply to the courts to appoint a joint special representative of the creditors.

#### **VII. SEGREGATION OF COVER ASSES AND BANKRUPTCY REMOTENESS OF COVERED BONDS?**

A cover register (Deckungsregister) permits the identification of the cover assets. All mortgages, public-sector loans, substitute cover assets and derivative contracts need to be registered in the cover register. Austrian Banks need to inform customers that loans will be introduced into the cover pool and state that loans in the cover pool are not subject to compensation. Set-off statements for derivative counterparties are admissible when they refer to claims and liabilities from the same Master Agreement.

The legal effect of registration is that in the case of insolvency of the issuer, the assets which form part of the separate legal estate (the so called "Sondervermögen") can be identified: All values contained in the register would be qualified as part of the separate legal estate.

While the bank carries out the daily administration of the cover register, it is the cover pool monitor who supervises the required cover und registration in the cover register.

### **Asset segregation**

If the issuer becomes insolvent then the cover assets will be segregated from the remainder of the assets as a direct consequence of the insolvency proceedings. These assets shall form what is known as a 'Sondervermögen' and are earmarked for the claims of the Covered Bond holders. Any voluntary overcollateralisation is also bankruptcy-remote but cover assets that are not needed to satisfy the claims of the Covered Bond holders are passed back to the insolvent issuer.

The cover assets will be managed by a special administrator, who is appointed by the bankruptcy court, after consultation with the FMA. The special administrator has the right to manage and dispose of the recorded assets.

### **Impact of insolvency proceedings on Covered Bonds and derivatives**

Covered Bonds do not automatically accelerate in case of insolvency of the issuer, but will be repaid at the time of their contractual maturity. The cover assets are administered in favour of the bond holders and any claims of the Covered Bond holders in respect of interest or principal repayments are to be paid from the assets. Consequently, in respect of derivatives, there is no legal consequence of insolvency and the counterparty claims as derivative transactions rank pari passu with the claims of the Covered Bond holders.

### **Preferential treatment of Covered Bond holders**

Covered Bond holders enjoy preferential treatment as the law stipulates the separation of the cover assets on the one hand and the insolvency estate. The satisfaction of the Pfandbrief creditors is not limited to the cover assets. On the contrary, these creditors also participate in the insolvency proceedings with respect to the Pfandbrief bank's remaining assets. As long as the separate legal estate has sufficient liquidity, a moratorium on the insolvency estate cannot delay the cash flows from the cover assets and, therefore, endanger the timely payment of Covered Bond holders.

Only in the case of over-indebtedness or insolvency of the cover assets may trigger an acceleration of Covered Bonds.

### **Access to liquidity in case of insolvency**

Once appointed, the special administrator for the cover pool has the right to manage the cover pool in order to satisfy the claims of the Covered Bond holders. The administrator can, for example, sell assets in the cover pool or enter into a bridging loan in order to create liquidity to service the bonds in issue.

The administrator also has access to any voluntary over collateralisation, which is also considered bankruptcy-remote. Any voluntary overcollateralisation that is not necessary to cover the claims of the Covered Bond holders can be transferred back to the insolvency estate.

### **Sale and transfer of mortgage assets to other issuers**

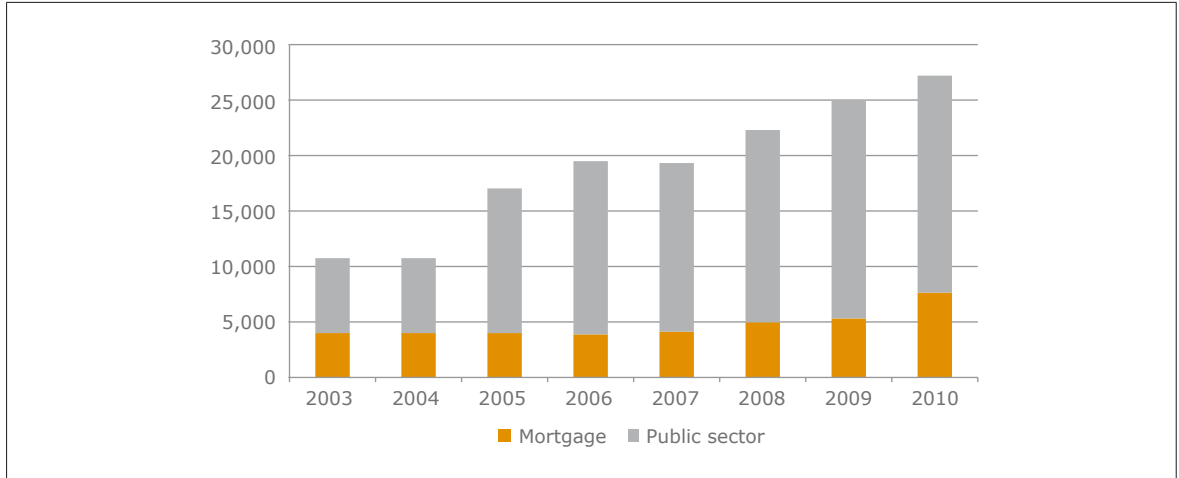
The Covered Bond administrator can also sell the assets collectively to a separate credit institution. This institution must then take over all liabilities with regard to the Covered Bonds. In fact, one of the tasks of the special administrator is to find a suitable credit institution that will buy the assets collectively.

### **VIII. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION**

Austrian Pfandbriefe as well as Austrian Covered Bonds (FBS) fulfil the criteria of the UCITS 52(4) directive, as well as those of the CRD Directive, Annex VI, Part I, Paragraph 68 a) to f). This results in a 10% risk weighting in Austria and other European jurisdictions where a 10% risk weighting is allowed.

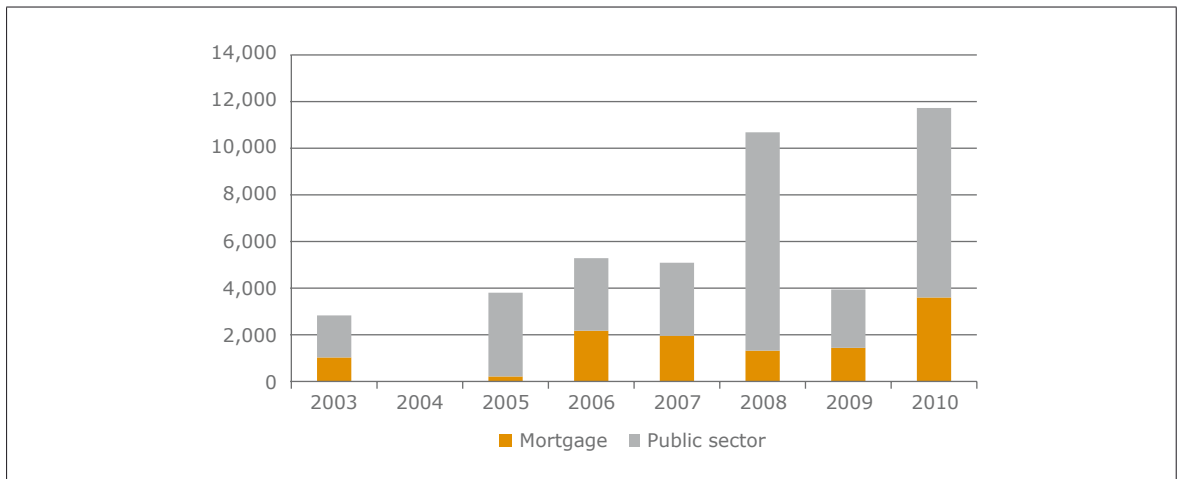
Austrian Covered Bonds are eligible in repo transactions with the national central bank.

> FIGURE 1: COVERED BONDS OUTSTANDING, 2003-2010, EUR M



Source: EMF/ECBC

> FIGURE 2: COVERED BONDS ISSUANCE, 2003-2010, EUR M



Source: EMF/ECBC