

# Legislation Public Sector Bonds

## Summary of German Covered Bond Act (Pfandbriefgesetz)

The German Pfandbrief legislation<sup>1</sup> has a history which spans over a century and was most recently amended on 26th March 2009. This amendment ensures that the Pfandbrief legislation is now CRD compliant. Some of the highlights of the legislation relating to Public Sector Pfandbriefe include:

- ▶ **Strict requirements for Pfandbrief issuing institutions:** Issuers need a specific Pfandbrief licence and a professional risk management process as well as enhanced cover pool transparency in accordance with §28 of the Pfandbrief Act
- ▶ **Pool eligible assets:** Pool may have unlimited exposure to sovereign and sub-sovereign entities in EU and EEA member countries as well as restricted exposure to Switzerland, the USA, Canada and Japan. Exposure to Multilateral Banks and International Organisations as defined in Appendix IV of the Directive 2006/48/EC is permitted, as is exposure to export credit insurers based in the EU or EEA.
- ▶ **Mandatory over-collateralisation:** The present value of the assets must exceed that of the liabilities at all times by a minimum of 2%, this minimum over-collateralisation must also be maintained in weekly stress testing scenarios
- ▶ **Liquidity risk:** In order to reduce liquidity risk in the cover pool, from November 1st, 2009 on Pfandbrief issuers will be obliged to maintain a liquidity buffer amounting to the net cash flows in the cover pool for the following 180 days
- ▶ **Preferential claims and bankruptcy remoteness:** Pfandbrief holders rank senior and have a preferred claim to the assets in the pool. The cover pool is excluded from other creditors' claims (including the German tax authorities) in the event of insolvency until all the claims of the priority creditors (i.e. Pfandbrief holders) have been satisfied.
- ▶ **Strong monitoring:** A qualified independent trustee (Treuhänder) is responsible for the monitoring of the cover pool and reports to BaFin

## Public Sector cover pool

### Process and documentation

- ▶ All public sector cover pool assets are monitored by the Treuhänder (trustee appointed by BaFin) on the basis of a vdp<sup>1</sup> – checklist and the legal requirements for the cover pool
- ▶ The Deutsche Pfandbriefbank AG maintains a register of all cover assets
- ▶ To facilitate direct access to details of assets in the cover pool and to ensure a smooth audit process, the Pfandbrief Collateral Department maintains a mirror credit documentation.
- ▶ Special legal knowledge base for international cover pool material which is constantly updated following vdp seminars for key jurisdictions and cover pool relevant changes in regulatory frameworks
- ▶ In case of new business: involvement of PfandBG<sup>2</sup> specialists at origination stage to ensure cover pool eligibility

1 vdp = Verband Deutscher Pfandbriefbanken (Association of German Covered Bond Issuers)

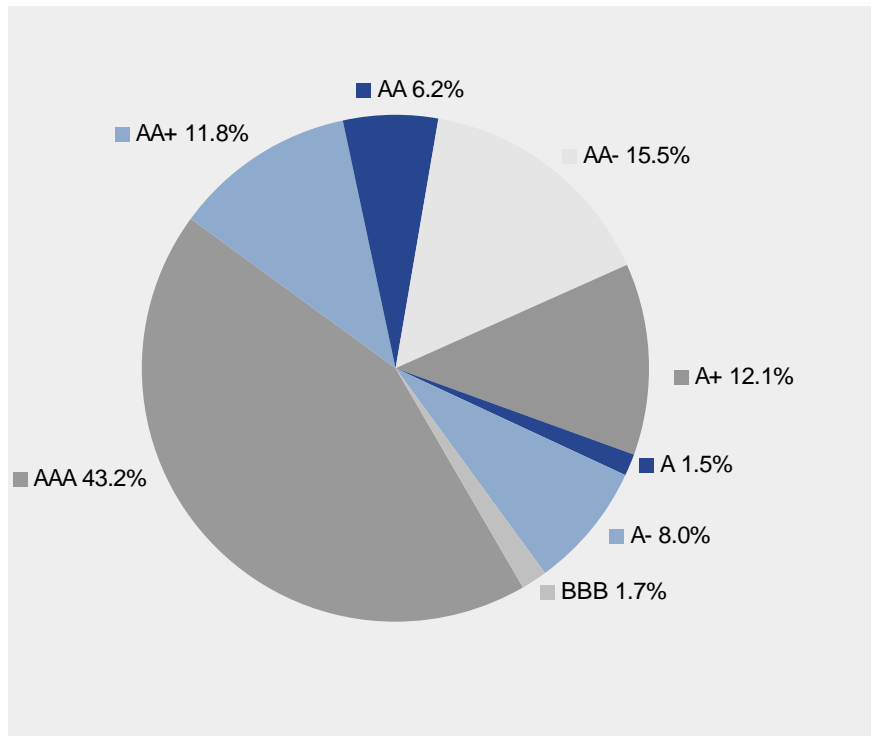
2 PfandBG = Pfandbrief Gesetz of 2005 (Covered Bond legislation)

# Combined Public Sector cover pool

## Overview cover pool by rating & country

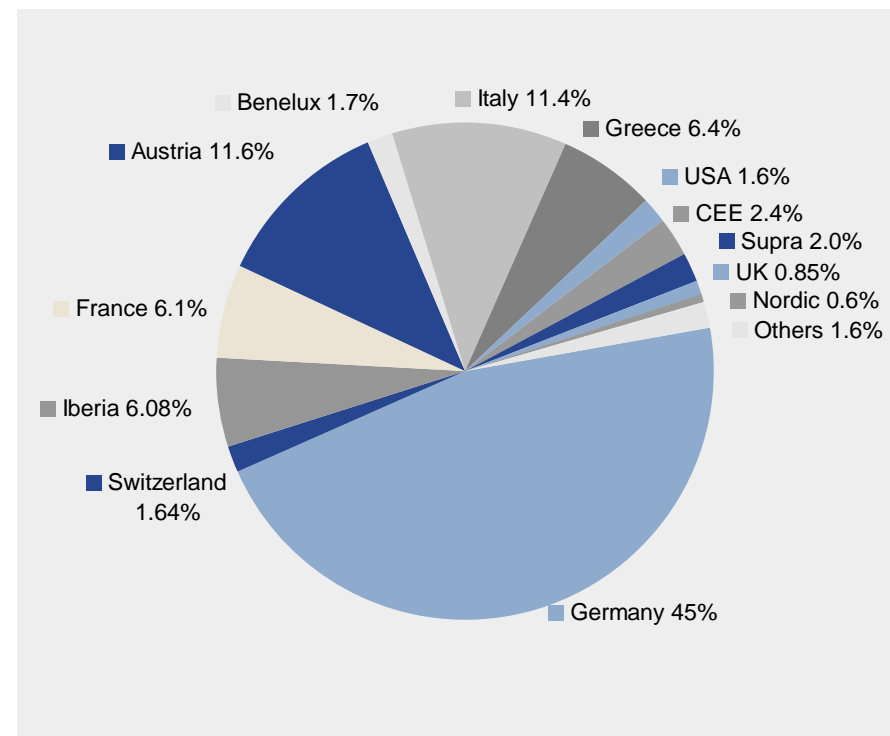
INTERNAL UNAUDITED FIGURES

**EUR 60.0 bn Combined post-merger Public Sector Pfandbrief Pool**  
Distribution by rating in % (06/2009)



- ▶ High asset quality in the cover pool
- ▶ 77% with rating AA- and above (43% AAA rated)
- ▶ Lowest rating BBB (1.7% of total cover pool)<sup>1</sup>

**EUR 60.0 bn Combined post-merger Public Sector Pfandbrief Pool**  
Geographical distribution in % (06/2009)



- ▶ Cover pool with majority of exposures in western European countries
- ▶ Germany by far the largest with 45% exposure and broadly diversified within the country

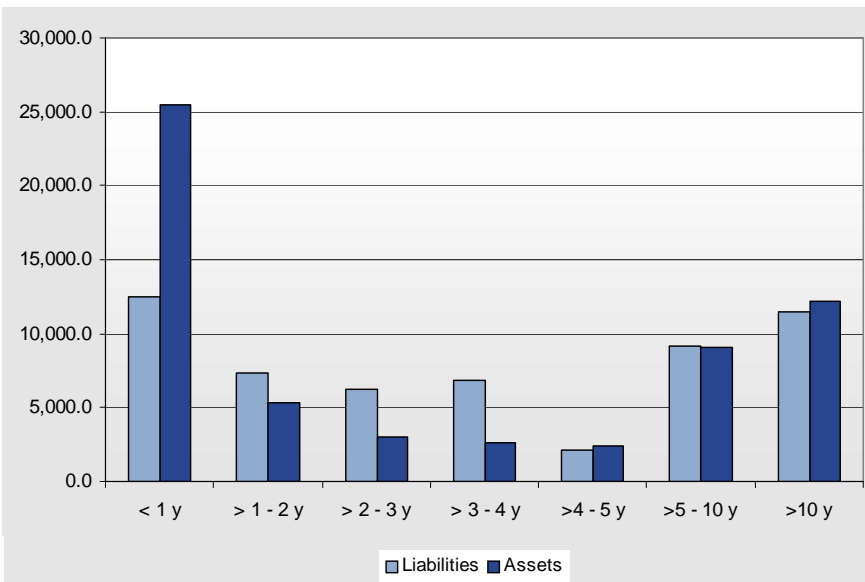
# Combined Public Sector cover pool

## Maturity profile of assets and liabilities on nominal basis in the cover pool

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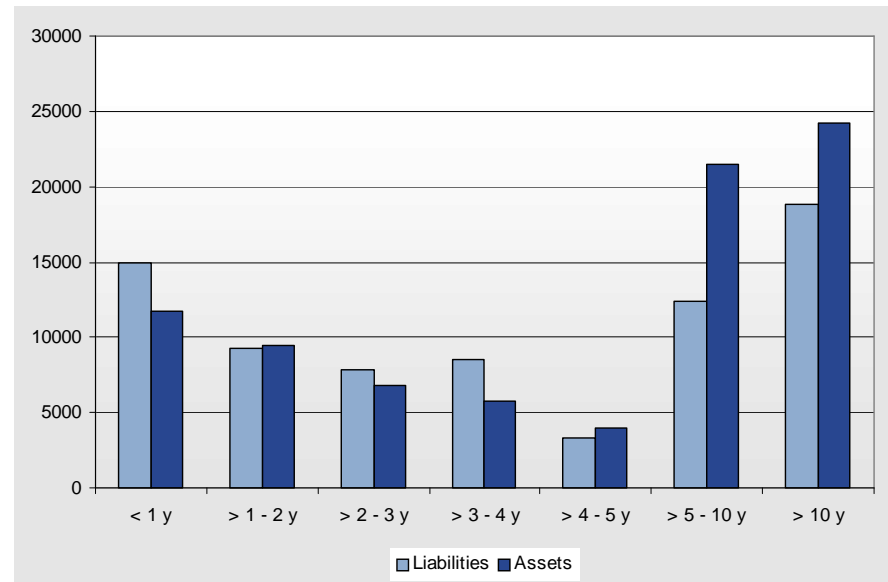
### EUR 60.0 bn Combined post-merger Public Sector Pfandbrief Pool

Maturity profile<sup>1</sup> acc. to § 28 Pfandbriefgesetz (06/2009)



### EUR 60.0 bn Combined post-merger Public Sector Pfandbrief Pool

Maturity profile<sup>2</sup> on cash-flow basis (06/2009)



- ▶ The maturity profile on a cash-flow basis gives a more realistic insight in the actual liquidity position of the cover pool
- ▶ According to § 30 part 2 of the amended German Covered Bond Act (Pfandbriefgesetz 2005) that became effective as of March 26th 2009, the trustee will have the possibility to use over-collateralisation for repo-transactions with the ECB and/or Central Banks of EEA countries in order to ensure full and timely payments of Pfandbrief liabilities.

1 Assets to interest maturity; liabilities to legal maturity

2 Assets and liabilities to legal maturity; amortization taken into account

# Combined Public Sector cover pool

## Paragraph 28 Pfandbriefgesetz Cover Pool Transparency Requirements

INTERNAL UNAUDITED FIGURES

- ▶ “Total volume of Public Pfandbriefe outstanding as well as of the corresponding cover pool in the amount of the nominal value, the net present value and the risk adjusted net present value stipulated in the statutory order in accordance with § 4 par. 6”

EUR millions (06/2009)	Nominal Value (NV)	Net Present Value (NPV)	Risk adjusted NPV <sup>1</sup>
Liabilities (Pfandbriefe)	55,715.40	59,385.80	
Public Sector Cover Pool Assets	60,012.00	65,325.30	
Over-collateralisation (+)/ Under-collateralisation (-)	4,296.60	5,939.50	4,812.00
In % of NV	7.71%		
In % of NPV		10.00%	8.10%

<sup>1</sup> Dynamic stress-testing approach: Interest risk tested with 100 bp upward and downward shift; FX risk EU currencies 10%, EOCED countries 15%, USD 25% up- and down shift

- ▶ “The share of derivatives included in the cover pools in accordance with § 19 par. 1 no. 4 sent. 3, also in conjunction with § 20 par. 2 no. 3 and § 26 par. 1 no. 4”

EUR millions (06/2009)	NPV <sup>2</sup>	%
Ratio of derivatives with a negative NPV in % of the Pfandbrief Liabilities	-220.80	0.37%
Ratio of derivatives with a positive NPV in % of the Public Sector Cover Pool Assets	354.00	0.54%

<sup>2</sup> Value of currency and interest rate derivatives in cover pool

- ▶ “The total amount of payments on these claims that are at least 90 days in arrears and their regional distribution”

90 days overdue (06/2009)	EUR millions	%
Germany	0.7	
<b>Total</b>	<b>0.7</b>	<b>0.002%</b>