



Obrigações Hipotecárias
Obrigações Sector Público

Structure of the issuer

Obrigações Hipotecárias and *Obrigações Sector Público* can have two types of issuers, both being Credit Institutions :

- **Universal Banks** - credit institution legally authorized to grant credits (direct issuance);
- **A dedicated issuer** – the Mortgage Credit Institution (MCI).

If the issuer is an **Universal Bank**, there are no restrictions to its business activities.

If the issuer is a **MCI**, its authorized business activities are:

- Granting and/or acquiring credits guaranteed by a mortgage or on the central administration, regional or local authorities, or credits guaranteed by these entities;
- Management of the asset pool;
- Management of assets that have been repossessed from defaulted credits;
- Any necessary dealings to obtain additional liquidity.



Legal Framework

In March 2006, The Portuguese Council of Minister approved a new Decree-Law governing Portuguese Covered Bonds (Decree Law n. 59/06) that regulates the issuance of mortgages bonds - Obrigações Hipotecárias – and public sector loan bonds - Obrigações Sector Público.

On the 11th of October, the Bank of Portugal published its Avisos (Notices) in the Official Gazette (Avisos numbers 5/2006 through 8/2006) regulating:

- Valuation of real estate of mortgage loans assigned to a cover pool;
- Asset-liability management principles;
- Reporting requirements;
- Risk-weighting, and;
- Post-bankruptcy procedures.

The legal framework of Portuguese covered bonds supersedes the general bankruptcy law since it allows for a segregation of cover pool assets from the insolvency estate.



Cover Assets

Obrigações Hipotecárias (mortgage covered bonds)

- Loans secured by first ranking residential or commercial mortgages backed by real estate located in a Member State of European Union;
- Loan-to-value:
 - ✓ 80% for residential mortgages
 - ✓ 60% for commercial mortgages
- Credits no more than 90 days overdue;
- Property damage insurance compulsory (fire and floods).

Obrigações Sector Público (public sector loans covered bonds)

- Credits to central governments, regional or local authorities of a EU member state or guaranteed by these entities.



Cover Assets

Substitution assets (up to a limit of 20%):

- Deposit with the Bank of Portugal in cash, government bonds or other ECB Tier 1;
- Deposits at credit institutions with rating equal to or greater than “A-”;
- Other assets of low risk and high liquidity (to be defined by the Bank of Portugal on a case by case basis).

Other assets (for asset-liability management purposes)

- Derivatives contracts are permitted in the cover pool for hedging purposes, namely interest rate, exchange rate and liquidity risks.



Risk management provisions

Overcollateralisation for mortgage covered bonds (5.26%) resulting from the provision that outstanding mortgage bonds must be less than or equal to 95% of outstanding mortgage loans;

Average maturity of mortgage bonds cannot exceed the average life of the mortgage pool;

Total amount of interest due from the bonds cannot exceed the amount of interest to be received from assigned mortgage pool;

Exchange rate matching between issues and mortgage credits compulsory through the use of derivatives.

If these limits are exceeded, the issuer must:

- Assign new mortgage credits;
- Purchase bonds in the secondary market;
- Deposit with the Bank of Portugal eligible assets (cash, government bonds or other ECB Tier 1).



Preferential claim

Preferential claim:

The segregated credits in the pool do not account for any other debts of the issuer until full payment to covered bondholders has been made;

Covered bond holders benefit from a preferential claim on assets in the pool until all payments of interest and capital on the covered bond have been met;

They also rank *pari passu* with senior unsecured debtors, in case the pool does not meet all their payments.

Preferential claim applies as well to counterparties of derivatives



Mortgage Valuation

The valuation is based on the commercial value, taking into account the sustained long term characteristics of the property. The value can't be higher than the market value.

By using statistical methods, the issuer should update, annually the value of commercial mortgage and every three years the value of residential mortgages.

A new valuation is done every time there a substantial decrease in the property value – an independent appraiser should value the underlying property.



Asset Liability Management

Issuers should have adequate risk management systems.

Interest rate risks and liquidity gaps are to be reported to the Central Bank;

Stress test - on a net present value basis the coverage has to valid for a 200 bps parallel shift of the yield curve;

Risk positions with credit institutions with a maturity greater than 100 days (including derivatives) limited to 15%.



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Reporting Requirements

Asset-liability guidelines and pool characteristics to be reported to the Central Bank before the issue and also on an ongoing basis.

Risk Weighting

10% - compliance with CRD and UCITS

Post Bankruptcy Procedures

In case of insolvency of the issuer, a credit institution will be appointed to manage the pool and continue to make timely payments of interest and capital to bondholders.



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Segregation of assets

All the assets in the cover pool are to be registered, including derivatives, and the registry is held by the Bank of Portugal to be used in case of insolvency.

Separate pools will be formed for mortgage bonds and public sector loan bonds.

Cover pool monitor (cover pool auditor)

Appointed by the Board of Directors of the issuer and registered with CMVM (Portuguese Securities Commission).

Presents annual report on legal and regulatory compliance of the covered bond issues.

Common representative of bondholders

Appointed the Board of Directors of the issuer; bondholders may replace him at a Bondholder's Assembly.

Represents bondholders' interests and decisions.

