



**Fritz Engelhard**  
+49 69 7161 1725  
fritz.engelhard@barclays.com  
Barclays, UK

**Jussi Harju, CFA**  
+49 69 7161 1781  
jussi.harju@barclays.com  
Barclays, UK

# Central European Covered Bond Conference 2015

Panel 2: Secondary insolvency procedure versus pass-through

October 2015

# Key questions in a post-issuer default environment (I)

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## Who is in charge?

- Can the issuer or sponsor bank still influence covered bond features?
- How does the application of resolution tools influence covered bonds?
- Is a special administrator entitled to manage the cover pool and related liabilities as long as the cover pool is solvent?
- In case of specialist issuers, is administration geared towards representing the interests of covered bond holders?

## How is refinancing risk addressed?

- Is a specific liquidity buffer stipulated?
- Can cover pool assets be sold/transferred and/or new covered bonds be issued/transferred?
- Is the remaining cover pool operation an eligible counterparty for central bank repo?
- Can the remaining cover pool operation enter into central bank repo operations?

## What happens in case of illiquidity?

- Is maturity extension applicable? If “yes” how is it triggered?
- Will a cover pool insolvency procedure start and covered bonds accelerate?
- What powers have supervisory authorities over this process?

## Key questions in a post issuer default environment (II)

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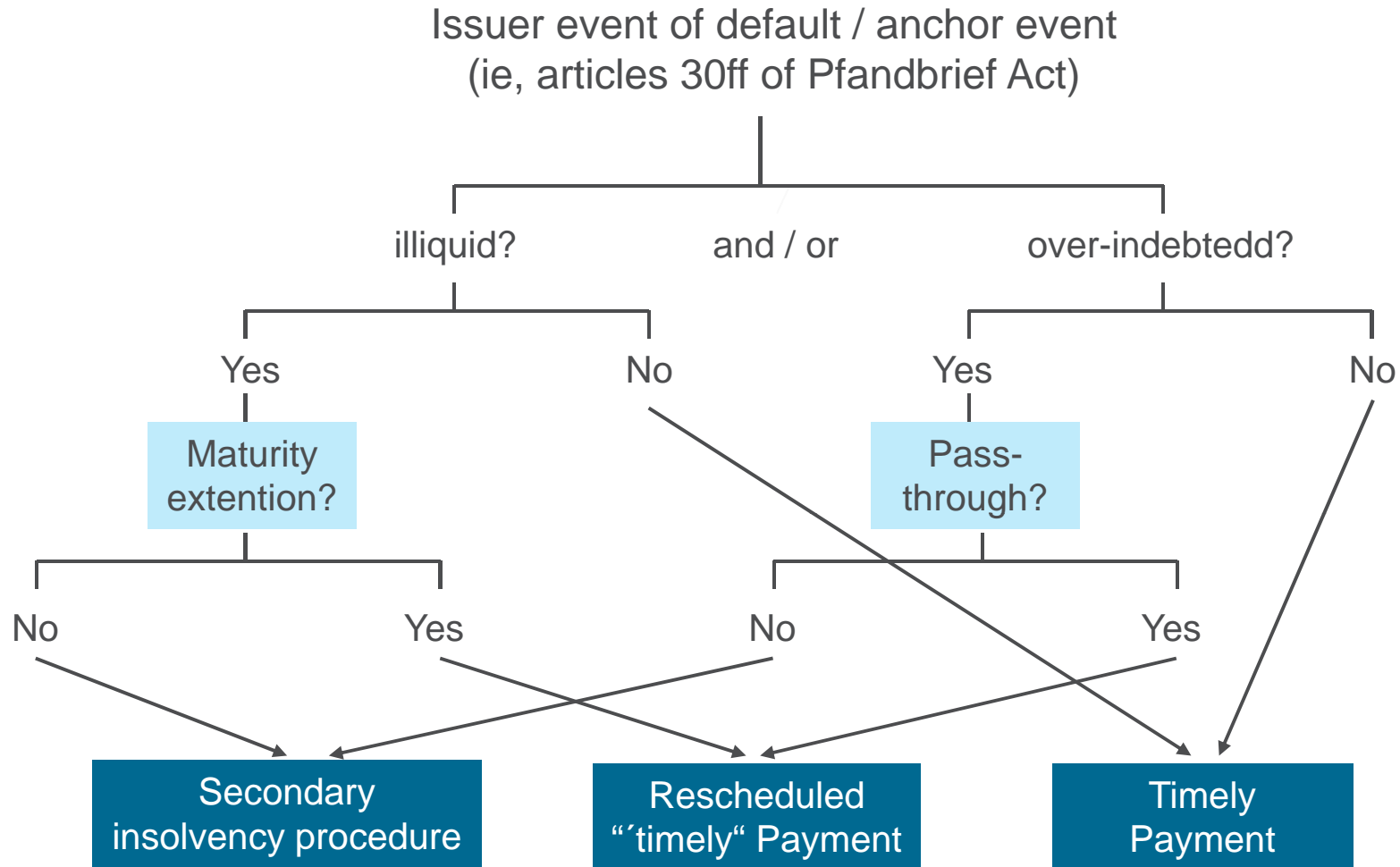
### When is a covered bond over-indebted?

- Under what conditions is a covered bond over-indebted? In particular, what valuation rules should apply?
- Who makes the final decision on whether a covered bond is over-indebted and how are the legal consequences enforced?

### What happens in case of over-indebtedness?

- Is pass-through applicable? If “yes” how is it triggered?
- Can bail-in of covered bond holders according to articles 44(2) or 45(3) be applied? On what basis will the loss rate be calculated?
- Will a cover pool insolvency procedure start and covered bonds accelerate?
- What powers have supervisory authorities over this process?

# Covered bond scenarios post issuer default



Source: vdp, Barclays Research

# EBA recommendation from July 2014

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## **Best practice 7 - C: Duties and powers of the national authority in a scenario of issuer's insolvency**

- The legal/regulatory covered bond framework should provide a sufficiently detailed description of what the duties and powers of the competent authority are on the covered bond programme, ***as well as its administration, in a scenario of issuer's default.***

## **Recommendation EU COM 1 - C: Role of the competent authority:**

- The EBA considers that requirements relating to the role of the special public supervision of the covered bonds should be considered for inclusion among the qualifying criteria determining preferential risk weight treatment. The requirements considered for inclusion may cover: i) supervision prior to the issuance of covered bonds; ii) ongoing supervision; and iii) ***supervision post-default/resolution of the issuer.***

Source: EBA report on EU covered bond frameworks and capital treatment. (July 2014)

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# Powers of the national authority in the event of issuer default

Country	Role of the competent authority
Germany	<ul style="list-style-type: none"> <li>Proposes to court special administrator upon issuer default.</li> <li>Can propose removal of special administrator.</li> <li>Can undertake ad hoc audits of cover pool which operates as a stand-alone limited activity bank.</li> <li>Supervises the covered bond programme as limited activity bank against covered bond legislation/regulation.</li> </ul>
Denmark	<ul style="list-style-type: none"> <li>Proposes to court administrator upon issuer default (mortgage banks).</li> <li>May appoint special administrator upon issuer default (universal banks).</li> </ul>
Spain	<ul style="list-style-type: none"> <li>The judge will appoint the insolvency administrator amongst those suggested by the deposit guarantee fund (the management committee of the deposit guarantee fund is currently composed of 12 members, six of them designated by the Bank of Spain).</li> </ul>
France	<ul style="list-style-type: none"> <li>Appoints the special administrator to run the issuer and the (independent) covered bond vehicle;</li> <li>Can impose extra data collection – random audits.</li> </ul>
Ireland	<ul style="list-style-type: none"> <li>May request the national treasury management agency 73 (“NTMA”) to identify a suitably qualified person to manage the asset covered securities business or appoint the NTMA if such a suitably qualified person cannot be identified upon issuer default (and other special circumstances).</li> <li>May confer special powers to this administrator.</li> </ul>
Italy	<ul style="list-style-type: none"> <li>Supervises in accordance with the powers conferred to the supervisory authority in banking crisis by primary law.</li> </ul>
Netherlands	<ul style="list-style-type: none"> <li>Supervises in accordance with the powers conferred to the supervisory authority in banking crisis by primary law.</li> </ul>
Poland	<ul style="list-style-type: none"> <li>Implements recovery programme.</li> </ul>
Portugal	<ul style="list-style-type: none"> <li>Appoints, in certain cases, the credit institution that will manage the covered bond programme upon an issuer’s default.</li> <li>It has to be notified by the issuer, in other cases, on the identity of the credit institution chosen by the issuer as manager of the CB programme upon default of the issuer.</li> <li>Determines the fees paid to the appointed managing institution to be paid out of the cover pool resources.</li> <li>In case of default of the covered bond programme issuer, it initiates with the representative of the CB investors the procedure to grant the investors access to the cover pool.</li> </ul>
Sweden	<ul style="list-style-type: none"> <li>If the license is revoked, FI may determine the resolution process of the business.</li> </ul>
UK	<ul style="list-style-type: none"> <li>Supervises the special administrator in accordance with the same principles of the ongoing supervision.</li> </ul>

Source: EBA

# Overview on conditional pass-through programmes

Issuer	F. Van Lanschot Bankiers N.V.	NIBC Bank N.V.	Banca Monte dei Paschi di Siena S.p.A.	UniCredit S.p.a.
Ticker	LANSNA	NIBCAP*	MONTE	UCGIM
Guarantor	Van Lanschot Covered Bond Company	NIBC Conditional Pass-Through Covered Bond Company B.V.	MPS Covered Bond S.r.l.	UniCredit OBG S.r.l.
Conditions for conditional pass through	<ol style="list-style-type: none"> <li>1) Issuer event of default</li> <li>2) CBC has received notice to pay</li> <li>3) Insufficient proceeds from partial asset sale to redeem relevant CB</li> </ol>	<ol style="list-style-type: none"> <li>1) Issuer event of default</li> <li>2) CBC has received notice to pay</li> <li>3) Insufficient proceeds from partial asset sale to redeem relevant CB</li> </ol>	<ol style="list-style-type: none"> <li>1) Failure to pay OBG series on maturity date</li> <li>2) OBG Guarantor has received notice to pay</li> <li>3) Insufficient proceeds from partial asset sale</li> </ol>	<ol style="list-style-type: none"> <li>1) Failure to pay OBG series on maturity date</li> <li>2) OBG Guarantor has received notice to pay</li> <li>3) Insufficient proceeds from partial asset sale</li> </ol>
Issuer event of default	<ol style="list-style-type: none"> <li>1) Failure to pay principal (7 days) or interest (14 days)</li> <li>2) Issuer defaults on material obligations</li> <li>3) Issuer is subject to dissolution or wind up</li> <li>4) Appointment of liquidator or start of bankruptcy proceedings</li> <li>5) Issuer is adjudged bankrupt or emergency regulations are applied</li> </ol>	<ol style="list-style-type: none"> <li>1) Failure to pay principal (7 days) or interest (14 days)</li> <li>2) Issuer defaults on material obligations</li> <li>3) Issuer is subject to dissolution or wind up</li> <li>4) Appointment of liquidator or start of bankruptcy proceedings</li> <li>5) Issuer is adjudged bankrupt or emergency regulations are applied</li> </ol>	<ol style="list-style-type: none"> <li>1) Failure to pay principal (7 days) or interest (15 days)</li> <li>2) Issuer materially defaults on its obligations in respect of OBGs</li> <li>3) Issuer is subject to an insolvency procedure</li> <li>4) Breach of mandatory tests or OC test not cured within one month</li> <li>5) Temporary payment suspension pursuant to article 74 Banking Law</li> <li>6) Issuer ceases to carry on its primary business</li> </ol>	<ol style="list-style-type: none"> <li>1) Failure to pay principal (7 days) or interest (14 days)</li> <li>2) Issuer materially defaults on its obligations in respect of OBGs</li> <li>3) Issuer is subject to an insolvency procedure</li> <li>4) Breach of mandatory tests or OC test not cured within one month</li> <li>5) Temporary payment suspension pursuant to article 74 Banking Law</li> </ol>
Amortisation test minimum OC level	115.0%	115.0%	1+75% of the OC level based on the asset percentage applicable on the last OC calculation date prior to the service of a notice to pay	1+75% of the OC level based on the asset percentage applicable on the last OC calculation date prior to the service of a notice to pay
Breach of amortisation test triggers CB guarantor event of default?	No	No	No	Yes
Extended due for payment date	32 years after maturity date	32 years after maturity date	38 years after maturity date	38 years after maturity date
Asset monitoring	CBC must undertake best efforts to sell assets every 6 months	CBC must undertake best efforts to sell assets every 6 months	OBG guarantor must undertake best efforts to sell assets every 6 months	OBG guarantor must undertake best efforts to sell assets every 6 months
CB redemption only possible to the extent that amortisation test OC level is not decreasing?	Yes	Yes	Yes	Yes
Bondholder quorum for extraordinary resolution in respect of CB series	75%	75%	75%	75%
Bondholder quorum for extraordinary resolution in respect of CB programme	75%	75%	75%	75%

Source: Programme documents

# When is a covered bond over-indebted?

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## What valuation rules should apply?

- Valuation based on legal coverage principles pre issuer default
- Valuation based on resolution and recovery rules stipulated under BRRD
- Valuation based on wind-down rules stipulated in insolvency law

## What valuation purpose should guide the selection of valuation rules?

- Take a decision on the resolution requirement (covered bonds versus other operations!)
- Calculate bail-in amount
- Evaluate the results of the resolution procedure against insolvency scenario

Source: EBA report on EU covered bond frameworks and capital treatment. (July 2014)

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