

### **3.3 AUSTRIA**

By Jochen Deiss, Raiffeisen-Landesbank Steiermark AG, and Heiko Langer, Erste Group Bank AG

#### **I. FRAMEWORK**

Based on the EU Covered Bond Directive<sup>1</sup>, the Austrian legislator sets into force a new Mortgage Bond Act "Pfandbriefgesetz – PfandBG<sup>2</sup>" by July 8<sup>th</sup>, 2022. This law finally brings together the existing frameworks of:

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

These laws had already converged toward each other in recent years such that the foundation to unify them in just one Covered Bond Act was laid out. The new Mortgage Bond Act ensures with its transitional regulations that every Cover Pool and its associated Covered Bonds can be perpetuated safely. In the case of a continuing Cover Pool with both legacy bonds and new issued bonds, existing investors (i.e. those holding covered bonds issued before July 8<sup>th</sup>, 2022) also benefit from the new features, such as the introduced risk management system, improved supervision by national authorities or a standardised reporting that is geared to the ECBC Harmonised Transparency Template.

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

In continuation of the three former laws, only duly authorised credit institutions, with a special license to such effect, have the right to issue covered bonds. Credit institutions that already issued covered bonds will keep their concession for issuing under the new Mortgage Bond Act. Under the new framework, the issuer either holds the cover assets on its balance sheet or uses another bank's eligible claims as cover assets, which is permitted under joint funding rules that already existed in the previous laws. The assets are not transferred to a separate legal entity anyway. The following well-established principles will continue to apply from July 8<sup>th</sup>, 2022, onwards:

1. Dual recourse, meaning that covered bond investors have both a claim against the issuer and, in case of insolvency or resolution of the issuer, a priority claim against the principal and any accrued and future interest on covered bonds,
2. Bankruptcy remoteness, meaning that covered bonds are not subject to automatic acceleration upon insolvency or resolution of the issuer, and
3. Special administrator, meaning a person or entity appointed to administrate a covered bond programme in the event of the insolvency of the issuer.

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

The new Mortgage Bond Act defines two different qualities of eligible cover pool assets:

- 1) Assets subject to CRR<sup>3</sup> Art 129 (1) that conform to CRR Art 129 (1a) – (3), e.g. risk positions vis-à-vis or guaranteed by public sector entities (central governments, central banks, regional governments or local authorities), loans secured by residential or commercial property and loans secured by ship liens or
- 2) high-quality cover assets that constitute a claim for payment which is secured by physical collateral assets recorded in a public register.

1 Directive (EU) 2019/2162 on the issue of covered bonds and covered bond public supervision

2 Austrian Federal Law Gazette 2021/I/199

3 Directive (EU) 575/2013 as amended by December 2019 and legally effective as of July 8<sup>th</sup>, 2022

Only Covered Bonds covered by assets of the first quality category (CRR Art 129 compliant) qualify themselves to be labelled as “European Covered Bond (Premium)” and can hereby be seen as the legitimate successor of all legacy Austrian Covered Bonds. However, both quality types may only be used in separated cover pools.

The Mortgage Bond Act also defines three distinct types of covered bonds, depending on the cover assets used as collateral. Covered bonds backed by mortgage loans are referred to as “Hypothekendarfandbriefe”, while covered bonds backed by public sector or public sector guaranteed assets are referred to as “öffentliche Darfandbriefe”. Covered bonds backed by loans secured by ship liens are referred to as “Schiffsdarfandbriefe”. For each of these types, the issuer has to form at least one separate cover pool. However, an issuer has the possibility to form more than one cover pool within a certain covered bond type and hereby create distinct pools for sub-categories (e.g. just retail mortgage loans).

The quoted primary cover assets for each type (i.e. public sector debt, mortgage loans or ship liens) have to represent at least 85% of the collateral required to secure the outstanding covered bonds. The remaining 15% can consist of substitute cover assets that meet the requirements of Art. 129 par. 1 of the CRR.

The geographical scope of eligible mortgage assets is restricted to EU / EEA countries, Switzerland and the United Kingdom.

Derivative contracts are allowed in the cover pool if they are entered to hedge interest rate, currency and credit default risks. Derivatives are only allowed for hedging and there is no limit in place on the volume of derivatives in the cover pool. However, the volume of derivatives in the cover pool has to be adjusted or eliminated if the underlying risk decreases or ceases to exist.

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

The Mortgage Bond Act stipulates conditions for physical property valuation that are modelled on CRR Art 229. It determines that the valuation must be carried out by an appraiser with necessary qualifications who is independent from the lending process. He may not take into account speculative elements in the assessment of the mortgage lending value and has to document that value in a transparent and clear manner. At the time of inclusion of the cover assets in the cover pool, the (reviewed) property value may not be older than one year, in compliance with CRR Art 129 (3).

LTV (loan to value) limits are not explicitly addressed by the Mortgage Bond Act, but deduced from CRR Art 129 (1) lit d, f and g. For residential mortgages, an 80% LTV limit applies. The LTV limit for commercial mortgage loans is set at 60%. The same 60% limit applies to ship liens.

Issuing banks may legally commit themselves to lower LTV limits for their covered bond programmes by recording in the statutes of the issuing institution.

#### **V. ASSET – LIABILITY MANAGEMENT**

Austrian covered bonds are subject to a matching principle whereby the total volume of assets in the cover pool must at least cover the total nominal amount of outstanding covered bonds as well as net interest liabilities from the covered bonds, net liabilities from derivatives and expected costs related to maintenance and administration for the winding-down of the covered bond programme. In addition, nominal overcollateralization of 2% of the outstanding amount of covered bonds must be maintained. The excess cover can be provided by primary cover, substitute cover, liquid funds eligible for the liquidity buffer or derivative claims. Issuers can voluntarily commit themselves to net present value cover calculations by statute. This also includes a minimum overcollateralization of 2%. The requirements of the nominal cover calculation and overcollateralization must also be met in this case.

The Mortgage Bond Act contains an obligation for issuers to maintain a liquidity buffer. The liquidity buffer is intended to cover the net liquidity outflows of the programme (related to cover pool and outstanding covered

bonds) for the next 180 days. Assets that meet the requirements of Level 1, 2a or 2b of the EU Liquidity Coverage Requirement (LCR) Regulation can be used to fill the buffer. Unsecured exposures to credit institutions that also meet the criteria for substitute cover are also permitted. However, these may account only for a maximum of 15% of the liquidity buffer. To prevent a double burden for issuing banks caused by overlapping liquidity buffer requirements (Covered Bond Directive vs. LCR-DelReg<sup>4</sup>), the EU Commission amended the LCR-DelReg (legally effective as of July 8th, 2022) such that the required liquidity buffer assets held in the cover pool shall be deemed to be unencumbered during the 30 calendar day LCR stress period.

Issuers can opt to issue covered bonds that provide for a potential 12-months maturity extension in the event of an insolvency of the issuer (soft bullet). The postponement may not be at the discretion of the issuer. In the event of insolvency, the special administrator may trigger the postponement if he is convinced that the liabilities can be serviced in full at the extended maturity date.

If an institution issues covered bonds with a possible maturity extension, the following information must be provided in the bond terms and conditions:

- > Trigger event of the maturity extension;
- > Maximum period of maturity extension of the covered bond;
- > Possible effects of the insolvency of the issuer;
- > Role of the supervisory authority and the special administrator

## **VI. TRANSPARENCY**

Issuers are legally required to publish information about their programmes on their websites on a quarterly basis. The following information must be published according to the Mortgage Bond Act:

- > Amount of cover pool and outstanding bonds;
- > Listing of ISIN numbers of all issues made;
- > Geographic distribution and type of cover assets, size of loans, and valuation method;
- > Information on market risk, including interest rate risk and currency risk, as well as credit and liquidity risks;
- > Maturity structure of cover assets and outstanding bonds; overview of maturity extension triggers, if applicable;
- > Amount of required and available coverage, including amount of statutory, contractual and voluntary overcollateralization;
- > Share of loans defaulted in accordance with CRR Art 178 and in any case share of non-performing loans in the cover pool.

Quarterly cover pool reports published by the Austrian issuers organized in the Austrian Covered Bond Forum can be found at the forum's website: <http://www.pfandbriefforum.at/downloads.html>.

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

The cover pool is monitored by a trustee ("Treuhänder"), who is appointed by the credit institution and is notified to the Austrian Finance Market Authority. The trustee is liable according to the Austrian Civil Code. The trustee has to ensure that the prescribed cover for the covered bonds exists at all times and that the cover assets are recorded correctly in the cover register. Without his or her approval, no assets may be removed

<sup>4</sup> Commission Delegated Regulation (EU) 2015/61

from the cover pool. Before the issuance of a Covered Bond, the trustee has to certify that both sufficient coverage and correct recording in the cover register exist. Any disputes between the issuer and the trustee would be settled by the regulator.

In case of insolvency proceedings, the Bankruptcy Court must appoint a joint special representative of the covered bond creditors ("Kurator") according to the Austrian insolvency regime.

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

The Cover Register ("Deckungsregister") in which all cover assets are entered permits the identification of the cover assets. All mortgages, public-sector loans, substitute cover assets and derivative contracts which form part of the cover must be registered in the cover register.

The issuers must not include a loan (or derivative contract) in the cover pool before the debtor (or the counterparties of derivative contracts) has agreed with this. The issuer must also notify the debtor of his intention to include a loan in the cover pool before doing so and that it is not allowed to discharge his debt through any set-off. An exemption from the general prohibition of set-off applies to derivative contracts, when the set-off (or netting) occurs in respect of receivables arising under one and the same Master Agreement (i.e. pertaining to the cover assets).

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 "Sondermasse") 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**

Cover assets may only be enforced by the covered bond creditors (or counterparties of derivative contracts which form part of the cover pool).

If the issuer becomes insolvent, the cover assets are segregated from the remainder of its assets. The cover assets form what is known as "Sondermasse" (pool of special assets) and are earmarked for the claims of the covered bond holders. Any voluntary overcollateralization is also bankruptcy-remote. Only cover assets that are evidently not needed to satisfy the claims of the covered bond holders are passed back to the issuer's general insolvency estate.

The cover assets are managed by a special administrator ("besonderer Verwalter"), who is appointed by the bankruptcy court after consultation with the Austrian regulator (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 are not automatically accelerated 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 (primarily) from the cover assets. Equally, in respect of derivatives which belong to the pool, there is no (immediate) 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 on the other hand. To the extent that they are not satisfied from the

cover assets, the covered bond holders may also participate in the issuer's general insolvency proceedings. Only if the cover assets do not suffice to satisfy the covered bond creditors are the covered bonds accelerated.

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

Once appointed, the special administrator for the cover pool has the duty to manage the cover pool in order to satisfy the claims of the covered bond holders. The administrator may, for example, sell assets in the cover pool or enter into a bridge loan in order to create liquidity to service the bonds in issue.

The administrator also has access to any voluntary overcollateralization, which is considered bankruptcy-remote. Any surplus collateral may only be transferred back to the insolvency estate to the extent that it is evident that it will not be needed to cover the claims of the covered bond holders.

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

By virtue of his or her appointment, the special administrator has the right to manage and dispose of the cover assets. In particular, the special administrator must collect the cover assets according to their contractual maturity.

The special administrator is also entitled to 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. If a sale is not feasible, the cover pool administrator has to continue the servicing of the cover pool and the outstanding covered bonds.

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

The legislation, when taken together with the practices, processes and procedures across the industry should fall within the criteria of Article 129 of the CRR. Austrian covered bonds fulfil the criteria of Article 52(4) of the UCITS Directive as well as those of Article 129 of the CRR. 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.

**Issuers:** BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse AG, Erste Group Bank AG, Allgemeine Sparkasse Oberösterreich Bank, Bausparkasse der österreichischen Sparkassen Aktiengesellschaft, Volksbank Wien AG, Kommunalkredit Austria AG, Raiffeisen Bank International AG, Raiffeisenlandesbank Oberösterreich AG, Raiffeisenlandesbank Niederösterreich-Wien AG, Raiffeisen-Landesbank Steiermark AG, Raiffeisen-Landesbank Tirol AG, UniCredit Bank Austria AG, HYPO NOE Gruppe, HYPO NOE Landesbank, HYPO Tirol Bank AG, Vorarlberger Landes- und Hypothekenbank Aktiengesellschaft, HYPO Bank Burgenland AG, Austrian Anadi Bank AG, Hypo Oberösterreich, Hypo Salzburg, BKS Bank AG, Oberbank AG, BTV-Bank für Tirol und Vorarlberg AG, Sparkasse Schwaz.



COVERED BOND : UniCredit Bank Austria AG (2 pools).  
- LABEL -

**For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website [www.coveredbondlabel.com](http://www.coveredbondlabel.com).**

In the context of the transposition of the Covered Bond Directive (the final deadline for which was 8 July 2022), the ECBC has undertaken a full review and update of the Covered Bond Comparative Database to take account of the latest regulatory developments. This unique reference tool can be accessed via the link hosted on the Covered Bond Label website ([www.coveredbondlabel.com/legislation/comparative\\_database](http://www.coveredbondlabel.com/legislation/comparative_database)).

For further national information on the Austrian market, please see [compare.coveredbondlabel.com/frameworks](http://compare.coveredbondlabel.com/frameworks). To access the "Country Comparison" feature of the database, please see [compare.coveredbondlabel.com/compare/select/frameworks](http://compare.coveredbondlabel.com/compare/select/frameworks).