

### **3.15 GERMANY**

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#### **I. FRAMEWORK**

In Germany, the legal basis for covered bond issuance is the German Pfandbrief Act (PfandBG – Pfandbriefgesetz) dated 22 May 2005 replacing the Mortgage Bank Act from 1900 and other German Pfandbrief laws.

On 15 April 2021 the Deutsche Bundestag and on 7 May 2021 the Bundesrat approved the amendments to the Pfandbrief Act, which implement the CBD into German Pfandbrief law and adapt it to the changes of Art. 129 CRR. These amendments came in force partially on 1 July 2021 and partially on 8 July 2022.

Furthermore, the statutory orders, which are based on the Pfandbrief Act, were adapted in 2022 as well.

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

Since 2005, the issuer of Pfandbriefe is no longer required to be a specialised bank. Instead, Pfandbrief issuers are allowed to exercise all activities of a credit institution, although a special licence for Pfandbrief issuance is required.

Since the EBA outsourcing guidelines do not allow for the outsourcing of important and decision-making sections of the credit institution, the issuer is required to have its own employees. In addition, the PfandBG requires Pfandbrief banks to manage their own risk and take their credit decisions on their own.

The issuer holds the cover assets on his balance sheet. A subsequent transfer of the cover assets to another legal entity does not take place. Given that a direct legal link between single cover assets and Pfandbriefe does not exist, all obligations relating to Pfandbriefe are obligations of the issuing bank as a whole. In the case of insolvency, the cover pool is segregated by law from the general insolvency estate and is reserved for the claims of the Pfandbrief holders. Even then, Pfandbrief holders still have a claim against the general insolvency estate (dual/triple recourse).

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

Cover assets are produced by mortgage lending, public sector lending, ship and aircraft financing activities. ABS/MBS are not eligible. A specific class of covered bonds corresponds to each of these cover asset classes: Hypothekenpfandbriefe, Öffentliche Pfandbriefe, Schiffspfandbriefe and Flugzeugpfandbriefe. The respective Pfandbrief must be fully secured by its specific cover asset class (§ 4 PfandBG).

Up to 15% of the nominal volume of Pfandbriefe outstanding may consist of money claims against the European Central Bank, central banks in the European Union or against suitable credit institutions, which fulfil the requirements of credit quality step 1 according to CRR provisions, have an external rating and do not belong to the same banking group.

The geographical scope of eligible mortgage assets is restricted to EU/EEA countries, to Switzerland, USA, Canada, Japan and explicitly widened to UK due to the Brexit. Public sector loans to these countries are eligible for the cover of Öffentliche Pfandbriefe (§ 20 PfandBG). In 2014, the mortgage asset scope was enlarged to Australia, New-Zealand and Singapore. The total volume of loans granted in non-EU countries where it is not certain that the preferential right of the Pfandbrief creditors extends to the cover assets, may not exceed 10% of the total volume of the cover loans (§§ 13 I 2, 20 III PfandBG) and 20% for ship and aircraft mortgages (§§ 22 V 2, 26b IV 2 PfandBG).

Derivatives are eligible for cover pools under certain conditions (§§ 4b, 19 I PfandBG).

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

Property valuation is regulated in § 16 PfandBG. This provision refers to the mortgage lending value (Beleihungswert) which is, in contrast to the market value, based on sustainable aspects of the property. Details about the valuation process and the qualifications of values are regulated in a specific statutory order on the mortgage lending value (Beleihungswertermittlungsverordnung, BelWertV), § 16 IV PfandBG.

According to § 26 BelWertV both commercial and residential real estate have to be monitored at least annually. In addition, § 27 BelWertV requires a review of the underlying assumptions when the market has declined substantially; a review of property values is also necessary when the loan has defaulted.

The BelWertV requires personal and organisational independence of the valuer (internal or external valuer).

For both commercial and residential property, the LTV limit is 60% of the mortgage lending value of the property. This LTV is a relative limit, i.e. when the loan exceeds the 60% limit, the part of the loan up to 60% LTV remains eligible for the cover pool.

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

§ 4 PfandBG stipulates that the total volume of Pfandbriefe outstanding must be covered at all times by assets of at least the same amount. Thus, the nominal value of the cover assets must permanently be higher than the respective total value of the Pfandbriefe: 2% for Hypothekendarlehen and Öffentliche Pfandbriefe, 5% for Schiffsdarlehen and Flugzeugdarlehen.

In addition, the Pfandbrief Act requires that Pfandbriefe are covered on a net present value basis even in the event of severe interest rate changes or currency fluctuations. The issuer has to provide an npv- "overcollateralization" of at least 2% after stress tests which have to be carried out weekly. This "overcollateralization" is to be regarded as the lump sum for the potential winding-down costs after an issuer's insolvency. Therefore, cover assets that are being used for the npv-"overcollateralization" are not to be taken into account for the calculation of the nominal overcollateralisation. Both the maturity of outstanding Pfandbriefe and the fixed-interest periods of the cover assets are disclosed on a quarterly basis. Details about the calculation are regulated in a special statutory order on Net Present Value (Barwertverordnung).

Furthermore, each day Pfandbrief banks have to calculate the maximum liquidity gap within the next 180 days. This amount has to be covered by liquid assets (§ 4 Ia PfandBG), which are compliant with LCR-Regulation as well as short-term exposures to credit institutions.

Every quarter, the stress-tested NPV of outstanding Pfandbriefe, the cover pool and the overcollateralisation have to be published (§ 28 I PfandBG). The stress tests do not apply to interest rate risks only but also to foreign exchange risks.

#### **VI. TRANSPARENCY**

According to § 28 of the Pfandbrief Act (Pfandbriefgesetz, PfandBG), all Pfandbrief banks are obliged to publish detailed information about their Pfandbriefe outstanding and the pertaining cover pools on a quarterly basis.

Besides these legal requirements, the vdp member banks started the vdp Transparency Initiative in 2010. Within the scope of this initiative, transparency reports of vdp member institutions are published in a uniform format, that can be processed electronically, using a uniform understanding of the legal requirements and on one central website ([www.pfandbrief.de](http://www.pfandbrief.de)).

Each report is available as a reading version in pdf format and, suitable for further direct processing, in xls (Excel), csv and xml-formats as well. Automatic links to investor databases are possible. The website offers sorting possibilities for the reports both by the reporting date and the bank name. All reports are published in English and German language versions. There is a data history available that goes back to 2009.

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

The German federal financial supervisory authority (BaFin) carries out a special supervision on Pfandbrief banks through a dedicated division. The "Pfandbriefkompetenzcenter" is responsible for all fundamental issues regarding the PfandBG and conducts cover pool audits using own staff or external auditors.

### **Cover audits**

The cover pools are subject to a special audit conducted usually every three years by the supervisory authority (§ 3 PfandBG). Cover pool audits are performed either by the appropriate specialist section at BaFin itself or by suitable auditors, who are mandated via contract by public tender.

A cover audit is conducted in respect of individual cover pool assets, the observance of matching cover requirements in terms of the nominal and net present value calculation, the proper keeping of the cover registers, and the systems and processes in place with regard to the cover pools.

Audits of individual cover assets seek to ensure that the respective assets were included in cover in accordance with the relevant rules and regulations or that their continued inclusion is in line with requirements. A system audit entails examining all the Pfandbrief bank's main processes and systems that are directly or indirectly linked to the cover assets and the issued Pfandbriefe. In particular, process documentation, system descriptions and the proper implementation of the relevant methods are scrutinized.

Furthermore, a cover pool monitor (Treuhand) supervises the cover pool. He is appointed by the BaFin and must possess the expertise and experience necessary to fulfil all duties. A qualification as a certified auditor suggests that the necessary expertise is provided. 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, §§ 7, 8 PfandBG. Without his approval, no assets may be removed from the cover pool or new Pfandbriefe been issued. The BaFin has published a specific statutory order on details of the form and the contents of this cover register (Deckungsregisterverordnung – DeckRegV), § 5 III PfandBG.

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

A cover register (Deckungsregister) permits the identification of the cover assets, § 5 PfandBG. The register records the cover assets being used to cover the Pfandbriefe as well as claims under derivatives (§ 5 I 1 PfandBG).

The legal effect of registration is that in the case of insolvency of the issuer, the assets which form part of the cover pool can be identified: all values contained in the register would not be part of the insolvency estate. § 30 I 1 PfandBG now calls them "insolvency-free assets".

While the bank carries out the daily administration of the cover register, it is the cover pool monitor who supervises the required cover and registration in the cover register, § 8 I, II PfandBG. Copies of the cover register shall be transmitted to the supervisory authority on a regular basis.

### **Asset segregation**

The cover pool is part of the general estate of the bank as long as the issuer is solvent. If insolvency proceedings are launched, by operation of law, the assets recorded in the cover registers are excluded from the insolvency estate (§ 30 I 1 PfandBG). Those assets will not be affected by the launching of the insolvency proceedings (§ 30 I 2 PfandBG).

After the launching of the insolvency proceedings, a special cover pool administrator (Sachwalter) carries out the administration of the cover assets (§ 30 II 1 PfandBG). Through the appointment of the cover pool administrator by the court, on proposal of the BaFin (or by BaFin in case of urgency), the right to manage and dispose of the recorded assets will be transferred to him automatically by law (§ 30 II 2 PfandBG). Regarding cover assets and timely payment of Pfandbriefe, the cover pool administrator represents the Pfandbriefbank (§ 30 II 5 PfandBG). He is allowed to use premises and staff of the Pfandbriefbank (§31 VIII PfandBG).

### **Impact of insolvency proceedings on covered bonds and derivatives**

Covered bonds do not automatically accelerate when the issuing institution is insolvent, but will be repaid at the time of their contractual maturity. The same applies to derivatives which are registered in the cover register and form part of the cover pool. Accordingly, the German master agreements for cover derivatives stipulate that the bankruptcy of the Pfandbrief issuer does not signify a termination event. Article 13 N° 6 DeckregV stipulates that the collateral provided by the derivative counterpart or the Pfandbrief bank has to be registered in the cover register. The consequence of such registration is that the collateral belongs to the insolvency-free assets.

The amendments to the Pfandbrief Act introduce a maturity extension as legal option only for the cover pool administrator; but the issuer itself has no discretion to use it. This applies to both Pfandbriefe outstanding at the time of the introduction into law (1 July 2021) and newly issued Pfandbriefe. The extension triggers must be described in the terms and conditions for new Pfandbriefe, outstanding Pfandbriefe are covered by Art. 30 CBD and therefore keep the privileged treatment according to Art. 129 CRR.

The cover pool administrator would be allowed to extend maturities of interest and principal within the first month after his appointment to the end of the period of one month without further requirements.

Additionally, he might extend maturities of principal by a maximum of 12 months, if (1) necessary, (2) not over-indebted and (3) subsequent solvency of the Pfandbriefbank with limited business activities can be assumed; he might do that fully or partially (pro rata) with equal treatment of Pfandbrief holders. However, the cover pool administrator might (prematurely) fulfill the Pfandbriefe within the extension period.

Sequencing will not be inverted, original maturity schedule of Pfandbriefe must be kept. However, this is limited to Pfandbriefe and not extended to new debt, which the cover pool administrator creates in form of liquidity loans or bonds; it also does not apply to derivatives in the cover pool.

During the extension period interest on Pfandbriefe must be paid according to the previous terms, if not regulated otherwise in terms and conditions.

### **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, § 30 I PfandBG.

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.

Only in the case of over-indebtedness or illiquidity of the cover pool, the BaFin may apply for a special insolvency procedure relating to the cover pool and covered bonds (§ 30 VI 2 PfandBG). Insolvency of the cover pool is the only reason, which might trigger acceleration of Pfandbriefe.

The amendments 2021 to the Pfandbrief Act introduce a new provision in § 30 VI 5 and 6 strengthening the dual recourse of Pfandbriefe: The insolvency administrator will have to make reserves for the dual recourse claims of Pfandbrief holders during the insolvency procedure. Furthermore, the final distribution of the insolvency estate to creditors will not be allowed to take place before the amount of potential dual recourse claims of Pfandbrief holders is clarified.

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

Through the appointment of the cover pool administrator, the right to manage and dispose of the recorded assets is transferred to him by law (§ 30 II 2 PfandBG). Thus, the cover pool administrator has first access to the cover assets and collects the cash flows according to their contractual maturity (§ 30 III 2 PfandBG).

No explicit regulation exists with respect to the insolvency remoteness of voluntary overcollateralisation (OC). However, the insolvency administrator may only demand that the overcollateralisation be surrendered to the

insolvency estate, if those amounts will obviously not be necessary as cover for the respective Pfandbrief category (§ 30 IV 1 PfandBG). The burden of proof that OC will never be necessary for the timely payment of the Pfandbriefe, lays with the insolvency administrator.

The cover pool administrator is entitled to contract loans in order to obtain liquidity. According to § 30 II 5 PfandBG, the cover pool administrator may carry out legal transactions with regard to the cover pools in so far as this is necessary for an orderly settlement of the cover pools in the interest of the full and timely payments to the Pfandbrief creditors.

#### **Pfandbriefbank with limited business activities**

The amendment of the PfandBG 2010 was focused on the legal nature of cover pools in the event of a Pfandbrief bank's insolvency and on the access of a cover pool administrator to liquid funds during difficult times. A cover pool would get automatically the status of a non-insolvent part of the bank of the insolvent Pfandbrief bank.

§ 30 I 3 PfandBG uses the term 'Pfandbrief bank with limited business activities'.

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

According to § 32 I PfandBG, the cover pool administrator may transfer all or a part of the assets recorded in the cover register as well as liabilities from Pfandbriefe as a whole to another Pfandbrief bank. This transfer requires the written approval of the supervisory authority.

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

The PfandBG fully complies with Art. 129 Capital Requirements Regulation (CRR), Article 52(4) of the UCITS Directive and the CBD. Aircraft Pfandbriefe only comply with Article 52(4) of the UCITS Directive and the CBD, because Aircraft loans are not eligible cover assets according to Art. 129 CRR.

**Issuers:** There are currently about 80 Pfandbrief banks in Germany, including banks from all three pillars of the German banking industry (private banks, public banks and co-operative banks).



**COVERED BOND LABEL:** UniCredit Bank AG (2 pools), NORD/LB Norddeutsche Landesbank Girozentrale (1 pool), Deutsche Pfandbriefbank AG (2 pools), Münchener Hypothekenbank eG (1 pool), Berlin Hyp AG (1 pool), Landesbank Baden-Württemberg (2 pools), DZ HYP AG (2 pools), Hamburg Commercial Bank (2 pools).

**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 German 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).