



The rating of mortgage bonds A challenge for issuers

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The importance of rating

- Rating has become one of the **most important pricing factors** for covered bonds
- The **widening rating-span** within several markets has led to less homogeneity
- A rating is still an important **pre-condition** for international distribution of mortgage bonds
- The applicable **rating method** has a significant impact on degree of credit differentiation within a market



Rating approaches for covered bonds are ...

Fundamental Rating Approach

- Link to unsecured rating
- Link to rating of parent company
- **No** acknowledgement of over-collateral
- Notching up

Well-Secured Debt Rating Approach

- Link to unsecured rating
- Link to rating of parent company
- Acknowledgement of over-collateral
- Notching up

Structured Finance Rating Approach

- Independent rating of collateral pool
- Acknowledgement of over-collateral
- Quality of collateral and cashflow match determine over-collateral



... determined by the degree of bankruptcy remoteness

Bankruptcy Remoteness:

How immune is the cover pool to a possible insolvency of the issuer?

How likely is a delay / default of payment of covered bonds if the issuer defaults?

Low

High

Fundamental rating approach

Well-Secured Debt rating approach

Structured Finance rating approach



Moody's notching policy for covered bonds ...

Country	S&P Rating Approach	Notching	Moody's Rating Approach	Notching
D	Structured Finance	n.a.	Fundamental	Up to 3 - 4 notches
DK	Structured Finance	n.a.	Fundamental	Up to 3 notches
F	Structured Finance	n.a.	Fundamental	Up to 3 notches
ES	Well-Secured	Up to 2 notches (no AAA)	Fundamental	Up to 2 notches
EIR	Structured Finance	n.a.	Fundamental	Up to 3 notches
LUX	Structured Finance	n.a.	Fundamental	Up to 2 notches
LAT	n.a.	n.a.	Fundamental	Up to 1 notch

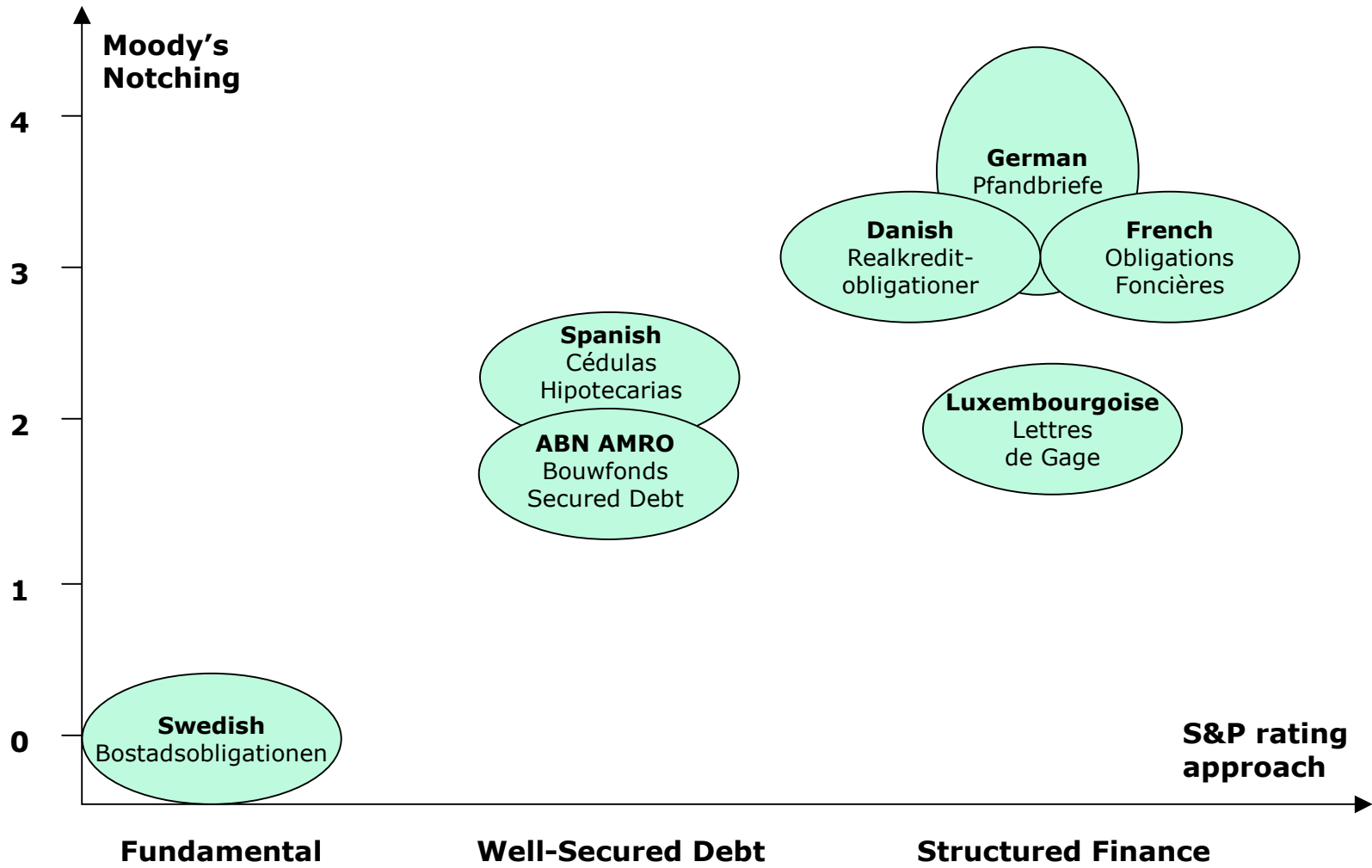


... is driven by various parameter ...

- Geographical range of eligible assets
 - LTV restrictions
 - Matching requirements (interest rate, currency risk) set out in the applicable law
- Market risk profile
- Post bankruptcy regulations/proceedings
 - Level of supervision by public authorities
 - Trustee
- Institutional aspects
- Track record and strategic importance of the respective mortgage bond market for the financial system

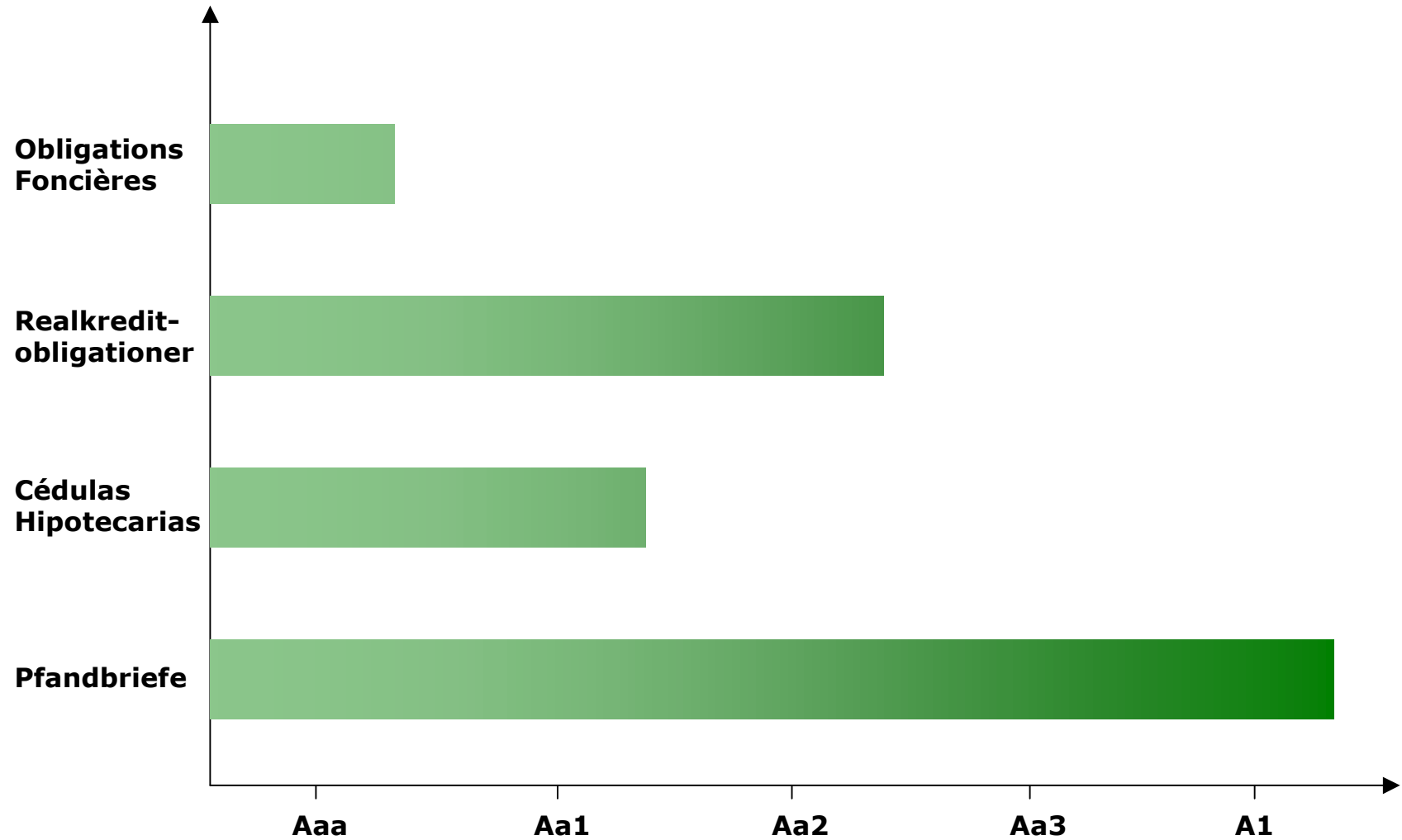


... leading to a different positioning of various covered bond systems





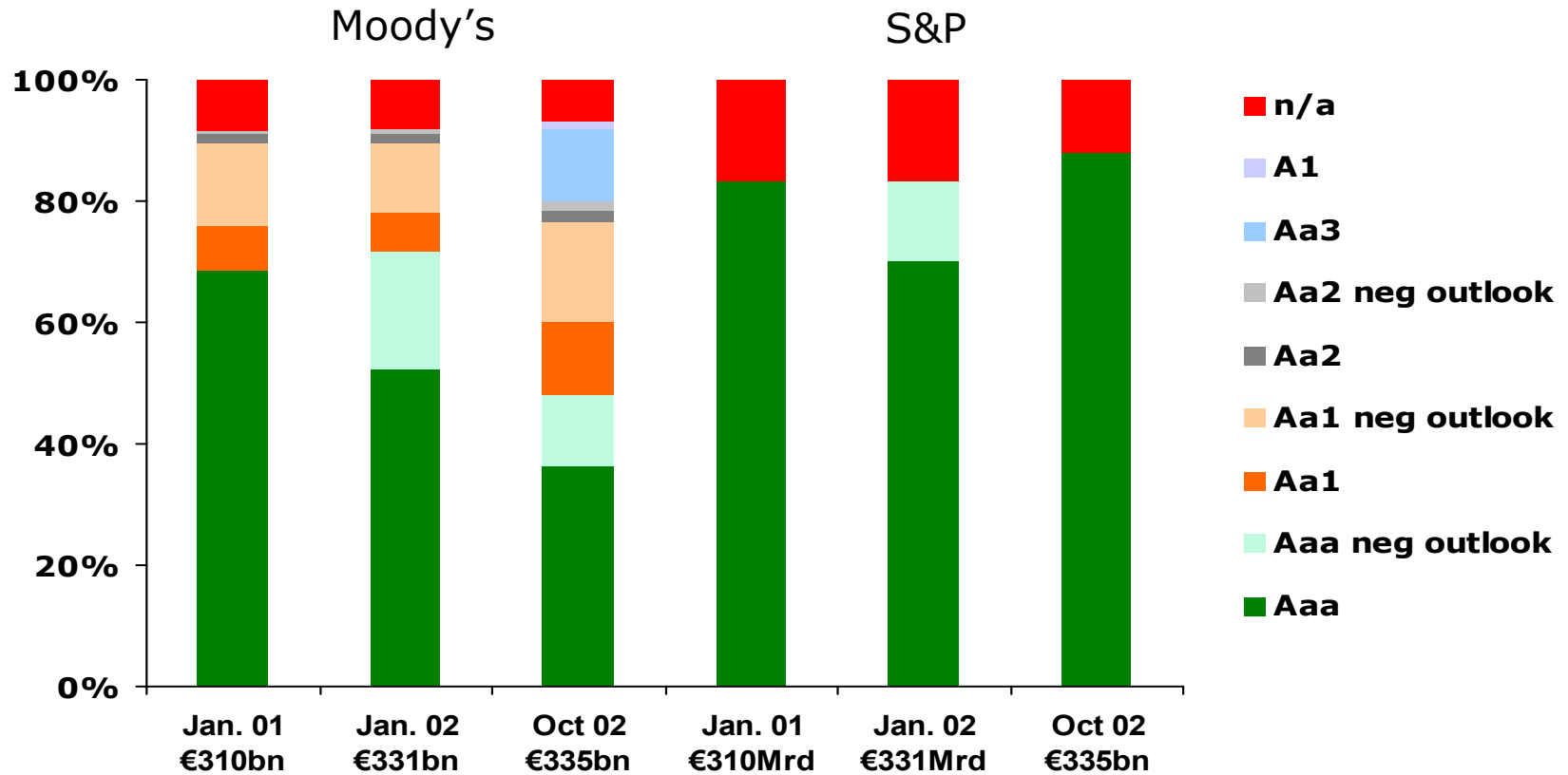
Moody's Rating Span reached a new peak ...





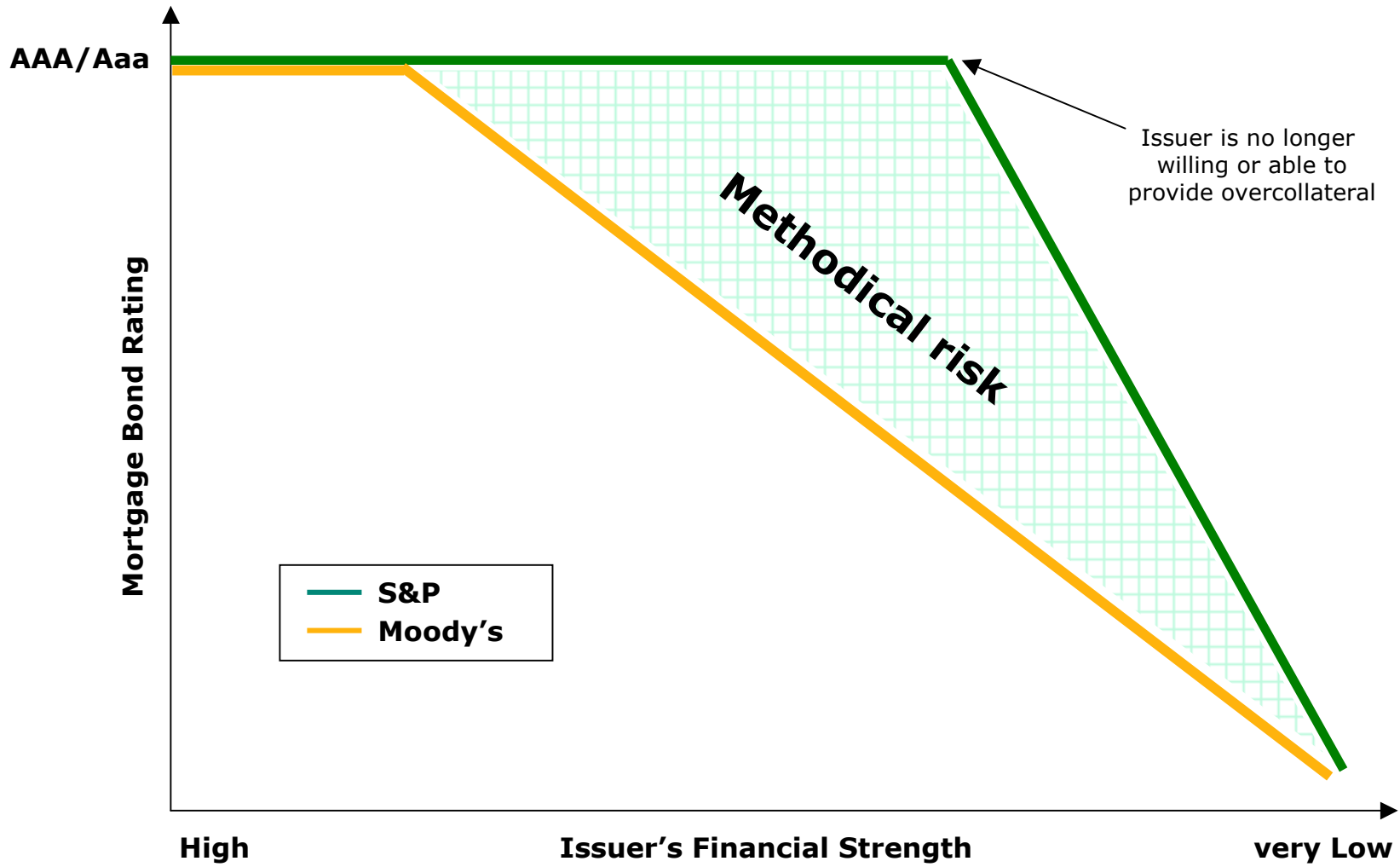
... while the gap to S&P is the largest in Germany ...

private mortgage bank Jumbo Pfandbriefe outstanding





... indicating a serious rating deterioration schemes of Moody's and S&P





The issuers' scope to directly influence the rating ...

Fundamental Rating Approach

- Increasing capital base
- Increasing profitability
- Lowering total / avg risk of full balance sheet / loan portfolio

Structured Finance Rating Approach

- Providing overcollateral
- Increasing credit quality of collateral pool
- Improving cash flow matching of collateral and mortgage bonds
- Credit enhancement



... due to the rating's impact on pricing

In the 5y to 10y area asset swap spreads of Jumbo Pfandbriefe are driven by (Oct 17):

- *+1.2 bp per year in remaining maturity*
 - **+2.7 bp between public and mortgage Pfandbriefe**
 - **+2.7 bp for issuers with Aaa/Aa1 Jumbo ratings**
 - **+7.5 bp for issuers with Aa1/Aa2 Jumbo ratings**
 - **+10.9 bp for issuers with Aa2/Aa3 Jumbo ratings**
 - **+17.2 bp for issuers with Aa3/A1 Jumbo ratings**
- In relation to Aaa/AAA rated and Landesbank Jumbos