

Covered Bonds: Credit & Market Risk Workshop

Identify critical factors in evaluating Covered Bonds, improve your market knowledge and learn how Covered Bonds differ from RMBS and other bank issued instruments.

TARGET AUDIENCE

Investors, credit risk managers, issuers, regulators, bankers and other professionals who need to understand the key risks and features of covered bonds.

COURSE OBJECTIVES

The overall goal of this two-day workshop is to equip participants with the analytic skills and understanding to assess the risk and rewards inherent in Covered Bonds backed by mortgages and public sector assets.

- Specifically, participants will be equipped to:
 - Use a structured analytic approach to evaluate the risk profile of covered bonds
 - Understand the legal framework used to issue covered bonds in key jurisdictions
 - Identify risks to continued payments should an issuer default
 - Distinguish the credit quality of cover pools
 - Assess the impact of programme features on ratings
 - Evaluate the relative risks and rewards of covered bonds vs. other funding instruments (e.g. RMBS, CMBS, unsecured debt).

CONTENT

INTRODUCTION

Section aims: highlight motivations of issuers and investors in the covered bond market and to establish a framework of analysis for covered bonds.

Industry overview

- Features of covered bonds
- Motivations for issuance and Investor concerns
- Covered bonds vs. unsecured financings vs. securitisations.

Analytic approach to credit evaluation

- A structured approach: purpose, payback, risks and structure
- Application to different types of covered bonds.

Exercise: examining variations in two covered bond programmes

RISKS TO REPAYMENT

Section aims: consider, from a rating agency and investor perspective, risks related to the different sources of covered bond payments and to continuity of payments should an issuer default.

Issuer risk

- Credit quality of the issuer: Issuer Default Rating (IDR)
- The link between IDR and rating of the covered bond
- Evaluating the issuer's business organisation: origination practices, client base and IT systems
- Implications of covered bond issuance on bank ratings.

Cover pool risk

- Characteristics of eligible assets
- Static analysis: residential mortgages, commercial mortgages and public sector pools
- Drivers of PD's based on specific asset pools
- Recovery assumptions: based on collateral and jurisdiction
- Calculation of expected defaults and losses
- Portfolio realisation analysis
- Impact of dynamic pools on creditworthiness
- Cover pool credit quality under various stress scenarios.

Exercise: calculating expected loss on residential loans

Exercise: collateral in public sector covered bonds

Operational risk

- Scope of asset monitor's role and relevance to performance
- Appointing a substitute manager and providing back-up servicing

Continuity risk

- Considering asset segregation, liquidity gaps, alternative management and covered bond oversight
- Cash-flow analysis.

Exercise: impact of issuer ratings, collateral analysis and continuity factors on covered bond ratings

STRUCTURE

Section aim: to understand how the legal frameworks governing covered bonds and terms and conditions address repayment risk.

Legal framework

- Understanding the differences between regulatory (special-law) and contractual (general-law) framework
- Segregation of cover assets
- Ranking of covered bondholder claims in a bankruptcy scenario
- Likelihood of interruption of payments
- Role of supervisory authority.

Debt profile

- Priority of payment
- Bullet terms: hard vs. soft, extension risk and call options.

Exercise: assessing changes to cover pool and payment priorities based on the stage of the covered bond

Programme features

- Asset / liability mismatches: maturity, interest rate and currency
- Addressing potential liquidity gaps
- Substitute assets
- Hedging and associated counterparty risk
- Overcollateralisation: asset coverage tests (ACT), enforceability
- Selected Assets Required Amount (SARA) provisions.

Exercise: analysing how a covered bond legal framework and programme features mitigate investor risk

Pricing

- Activities of the central banks
- Credit tiering and sovereign debt impact
- Basel II and III implications for investors
- Current market conditions: impact on spreads across the sector

Case Study

The goal of this case study is for course participants to apply the covered bond analytic framework to analyse a covered bond programme.

MONITORING PERFORMANCE

The goal of this section is to examine how market conditions affect the performance of covered bonds.

- Availability of information
- Comparing exposure to credit and market risks
- The need for vigilance in turbulent times.

Exercise: monitoring performance of a covered bond programme which has experienced credit issues.