FitchRatings

Fitch Affirms Eurohypo Lux's Lettres de Gage Publiques at 'AAA' Ratings

02 Sep 2010 6:47 AM (EDT)

Fitch Ratings-London/Frankfurt-02 September 2010: Fitch Ratings has today affirmed EUROHYPO Europaeische Hypothekenbank S.A.'s (Eurohypo Lux, 'A'/Rating Watch Negative/'F1') outstanding Lettres de Gage Publiques (LdGP) at 'AAA' following an annual review.

For this programme, Fitch has taken the view that an overcollateralisation (OC) of 16.5% between the cover assets and the covered bonds is sufficient to avoid a default under the covered bonds in a 'AA' stress scenarios. In line with its criteria, Fitch additionally modelled the recoveries expected from the cover pool in case of a default of the covered bonds and subject to 'AAA' stress scenarios. In all scenario runs the recovery rate exceeded 91%. This allows a rating uplift for the LdGP of up to two notches to 'AAA'.

The programme's Discontinuity Factor remains unchanged at 13.8%. Combined with Eurohypo Lux's Long-term Issuer Default Rating (IDR) of 'A', it enables the public sector covered bonds to be rated as high as 'AA+' on a probability of default (PD) basis. However, the OC level which Eurohypo Lux targets to reach by end September 2010 constrains the LdGP's rating to 'AA' on a PD basis. All else being equal, Eurohypo Lux's covered bond rating could be maintained at 'AAA' if the issuer is rated at least 'BBB'.

The percentage of OC supporting a 'AA' rating on a PD basis has increased to 16.5% from 12.0% previously. This is mainly driven by an increase of the unhedged FX positions over the course of the last year. As of June, the programme's OC stood at around 12.8%, which is below the OC supporting the current rating. Eurohypo Lux has informed Fitch that covered bonds maturing before 30 September 2010 will not be replaced which will lead to an OC of at least 16.5% by this date. Due to the issuer's current IDR, the agency deems this period of time to be short enough and still compatible with a 'AAA' rating on the LdGP. However, Fitch will monitor the programme on a higher frequency to continue to assess the impact of changes in the cash flow structure going forward.

The OC supporting a given rating is affected, among other factors, by the profile of the cover assets relative to outstanding LdGP, which can change over time, even in the absence of new issuances.

As of March, Eurohypo Lux's EUR14.7bn LdGP were secured by a cover pool worth EUR16.6bn. The cover pool consists of around 840 assets from more than 300 debtors. However, a considerable portion of the pool relates to U.S. student loan exposure which is ultimately guaranteed by the U.S. federal government. Combining all U.S. exposure, the total number of obligors equals 280 with the U.S. sovereign representing 23% of the outstanding portfolio. As such, there is a strong linkage between the rating of the U.S. and the credit quality of the collateral pool. The biggest country concentration including the sub-national level is in the U.S. with 32%, followed by the U.K. and Canada (14% each).

Interest rate mismatches are hedged to a large extent by interest rate swaps with several counterparties. The cover pool also contains cross currency swaps hedging a substantial proportion of FX risks, although there are remaining open positions on the asset side, particularly in USD (equivalent to EUR 1.2bn) and GBP (equivalent to EUR 0.6bn). Assets have a maturity which is about 1.4 times longer than liabilities. Namely within 2011 a substantial gap between the expected collections and scheduled redemptions of the LdGP is observable. In the second quarter 2011, LdGP in an amount of EUR2.4bn will mature while the expected collection in this quarter will amount to EUR0.34bn. Nevertheless, Fitch is of the view that sufficient liquid assets of a high quality are available to raise funds even via forced sales if necessary.

Contact:

Primary Analyst
Oliver Issl
Analyst
+49 69 768076 122
Taunusanlage 17, 60325 Frankfurt am Main, Germany

Secondary Analyst
Jan Seemann
Associate Director
+49 69 768076 112

Committee Chairperson
Michael Hoelter
Senior Director
+49 69 768076 236

Media Relations: Christian Giesen, Frankfurt am Main, Tel: + 49 (0) 69 7680 762 32, Email: christian.giesen@fitchratings.com.

Additional information is available at www.fitchratings.com.

Applicable criteria, 'Covered Bonds Rating Criteria', dated 13 August 2010, 'Assessment of Liquidity Risks in Covered Bonds', dated 16 August 2010, 'Assessment of Liquidity Risks in Covered Bonds- Spread Assumption Addendum', dated 16 August 2010, are available at www.fitchratings.com.

Related Research:
Covered Bonds Rating Criteria
Assessment of Liquidity Risks in Covered Bonds
Assessment of Liquidity Risks in Covered Bonds – Spread Assumption Addendum