

CDOs
Spain
Performance Report

Multi-Issuer Cédulas Hipotecarias OC Tracker

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Related Research

Applicable Criteria

- *Multi-Issuer Cédulas Hipotecarias OC Tracker (Excel File)* (March 2011)
- *Rating Criteria for Multi-Issuer Cédulas Hipotecarias* (December 2009)
- *Fitch Reviews Liquidity Risk and Cost of Refinancing for European Covered Bond Programmes* (December 2010)
- *Covered Bonds Rating Criteria* (August 2010)
- *Covered Bonds Counterparty Criteria* (March 2011)
- *Assessment of Liquidity Risks in Covered Bonds* (August 2010)
- *More Stringent Capital Requirements for Spanish Banks* (March 2011)
- *Counterparty Criteria for Structured Finance Transactions* (March 2011)
- *Counterparty Criteria for Structured Finance Transactions: Derivative Addendum* (March 2011)

Summary

- The Spanish multi-issuer cédulas hipotecarias (MICH) sector rated by Fitch comprises 46 live transactions with an aggregate value of securities of EUR105bn.
- Prior to the current Spanish financial entity consolidation process, over 50 different entities were sellers of mortgage cover bonds (cédulas hipotecarias or CH) into the securitisation vehicles. Currently the sector comprises 26 participants, including stand alone entities and groups.
- Transactions in this sector had been rated 'AAAsf' from inception until the most recent rating action in March 2011 (see "*Fitch Downgrades 51 Classes of Multi-Issuer Cédulas Hipotecarias*", available at www.fitchratings.com). The sector's credit quality has deteriorated and consequently Fitch updated its overall rating analysis and downgraded the vast majority of the notes to the 'AAAsf' category with a Negative Outlook.
- The agency's analysis is based on a four-stage review of key risk drivers, namely:
 - overcollateralisation (OC);
 - liquidity support;
 - CH participant concentration; and
 - counterparty criteria compliance.
- Fitch has identified OC as being the major driver for the downgrades. Its MICH rating methodology is based on the "first dollar loss" principle, and the notes are not cross-collateralised against the cover pools of all participating entities. As a consequence, the failure by the weakest link in the CDO to survive a particular stress scenario, regardless of its participation in the overall transaction, would imply a default of the rated note under such a rating stress.
- Within this performance report, up-to-date OC ratios are disclosed for all participants in Fitch rated MICH transactions. Additionally, the Fitch supporting over collateralisation rate (SOC) commensurate with various rating categories is disclosed.
- As a result of the continued issuance of CHs and the limited growth of financial entities' cover pools, weighted-average (WA) OC ratios have decreased from 177% to 165% since the last version of this report in June 2010.
- Fitch expects OC ratios to further decline in the future.
- When comparing data presented in this report to that of previous ones, readers should note that in order to align the vocabulary to that used in Fitch covered bond analysis, collateralisation rates (CR) have been transposed into OC percentages. For the purposes of this and future MICH reports, OC is calculated as (Cover Pool minus Outstanding CH)/Outstanding CH), whereby the cover pool corresponds to the entire mortgage book of the issuer, excluding securitised loans and loans backing bonos hipotecarios (BH).

Performance and Analytical Highlights

Banking system consolidation: In 2010, the Spanish banking system embarked on a significant consolidation process; consequently, the system is expected to remain under pressure, with the possibility of additional downgrades. This is due to its high exposure to real estate, particularly developer loans, which on a WA basis make up more than 25% of the sector's mortgage portfolio. Additionally, the current limited access to wholesale funding markets and the still rising funding costs put further pressure on the sector.

Heightened activity in mergers and institutional protection schemes (Sistema Integral de Protección or SIP) and the high likelihood of further consolidation, may result in further uncertainty in the short term. However, recent initiatives by the Spanish government and regulators are expected to have positive effects in the medium term, and ease some of the pressure as regards the creditworthiness of the banking system. In its analysis, Fitch has relied on its public ratings and credit opinions. In cases where an entity or group of entities do not have a public rating, or they are involved in an ongoing merger or SIP process, Fitch has made conservative estimates for the resulting credit profile.

Key Credit Considerations

OC ratios continue to decline: OC across CH issuers continued to decline in 2010. This is due to increasing CH and securitisation issuance, together with the decline in mortgage originations, which in many cases is resulting in decreasing mortgage books. Based on year-end 2010 data, the WA OC of entities participating in Fitch-rated MICH deals was 165%, compared to a WA OC of 177% in the last version of this report. Considering limited portfolio growth prospects and the current liquidity challenges faced by Spanish financial institutions, Fitch expects OC to continue to fall.

OC is a key driver in the agency's MICH analysis. In its ultimate principal redemption analysis, Fitch assesses the credit risk losses of a cover pool by determining the cumulative default and recovery expectations, and then applies a market value risk component to the remaining cover pool to determine the SOC for each rating scenario. The lower a financial entity's OC, the less collateralisation cushion it will have to absorb credit and market value losses and still provide 100% principal recoveries on CH assumed to be in default.

Concentration risk increases: As a result of the recent mergers and the constitution of SIPs, the universe of participants in Fitch-rated MICH deals has reduced from 53 entities to 26 (grouping all SIP participants in one entity). Consolidation has resulted in higher individual issuer concentrations in existing transactions. Under Fitch's current MICH criteria, transactions with more than 30% exposure to one entity are analysed using a combination of MICH and covered bond (CB) methodologies.

The agency has identified the transactions with high concentration risk to individual participants or groups and has applied the lower of the MICH or CB methodology rating (taking into account the additional structural protection of MICH compared to single CH issuance). Details on the current merger/SIP status of MICH-participating entities are presented in *Appendix 1*.

Liquidity support is not a key rating driver in existing deals: Liquidity support is an important element in Fitch's MICH analysis as it addresses the timely payment of interest on the rated notes. Recent downgrades and issuer concentration (arising from mergers and the grouping of MICH participants into SIPs) have resulted in an increase in the portfolio default risk, which is used to assess whether a transaction's liquidity facility can provide for interest payments for at least one year. While liquidity support requirements have increased, they are not the main driver of MICH ratings for existing deals. In all cases where a transaction's liquidity facility shortfall would have warranted a rating action, the rating action resulting from insufficient OC was at least as severe.

Counterparty issues in compliance: As for all structured finance products, MICH transactions rely on counterparties as part of their structure. Currently, all Fitch-rated MICH transaction counterparties are considered eligible under the agency's counterparty criteria or are being changed to eligible counterparties.

SIP cover pool analytical assumptions: In its cover pool analysis, for merged entities Fitch has considered the merged entity cover pool data as provided by the entity, and when not provided, the merged entity cover pool and its breakdown was calculated by the agency. Based on conversations with participants and on the agency's opinion, Fitch has assumed that all SIPs will ultimately result in the merger of assets and liabilities at the parent bank level, implying the full merger of the individual participants' cover pools.

OC commitments for 'F3' or below rated entities: In its analysis, for entities rated 'F3' or below, Fitch does not give full credit to the current available OC. If there is a public OC commitment in place, Fitch will give credit up to the OC commitment level in its analysis. In the absence of such an undertaking, the agency will take into account that the unencumbered assets could be reduced at short notice (at worst down to a level corresponding to the mandatory minimum OC of 25% compared to the eligible mortgage book according to the Spanish legislation). In line with its criteria, the agency has relied on its public ratings and credit opinions, as well as the public ratings of other NRSROs. In cases where an entity or group of entities do not have a public rating and they are involved in an ongoing merger or SIP process, the analysis is based on a conservative estimate of the expected resulting rating, giving full or partial credit to its cover pool.

Cover pool market value risk: Market value risk stems from the assumption that in the event of a CH default, the insolvency administrator may be forced to sell cover pool assets at a distressed price to meet payments on CHs. This is addressed by applying a refinancing spread that accounts for the cost of funding of a potential buyer plus a profit margin. Fitch has updated the components of the market value discount considering current market conditions and future expectations. To reflect the re-pricing trend on mortgage portfolios – as evidenced within the data received by Fitch – the agency also increased the margin component of its stressed refinancing costs. These changes have significantly increased the market value discount which Fitch applies to the post credit risk cover pool when calculating the SOC for each rating scenario.

Updated SOCs: Fitch has updated its SOCs based on September and December 2010 cover pool data. The average 'AAAsf' SOC was 133%, an increase from the close 2009 average of 102%. This rise is due to a combination of the updated market value risk assumptions and changes in the participating entities' cover pools.

The effect of weakest link approach: The absence of cross-collateralisation in MICH transactions implies that the entire structure is vulnerable to the weakest participant's ability to maintain sufficient OC to pass a 'AAAsf' scenario. From a OC perspective, MICH deals will only reach the highest rating reached by the weakest participant. Considering the latest OC and SOC rates, not all existing MICH participants reach a 'AAAsf' rating. As a result of the granularity of the MICH deals, and the participation of the "weakest links" in most of them, most transactions in the sector have been downgraded to 'AAsf'. This is detailed in *Appendix 2*.

Improving reporting quality: While data reporting remains an area with significant room for improvement, the agency recognises the efforts made by participating entities in providing data in the current Fitch format. Additionally, merged entities have in most cases provided merged cover pools and, on the whole, data quality and integrity issues have improved since the last OC Tracker report.

The Road Ahead

Fitch acknowledges that the consolidation of the Spanish financial system has been moving ahead with an important momentum and the blessing of the Spanish government and regulators. There is uncertainty however as to how far further consolidation will go, its magnitude and participating entities, and the effects it may have on their ratings. The agency will analyse any developments and their effect on MICH transactions and take them into consideration in its analysis as and when they occur.

Fitch expects that OC ratios will continue to decline. However, many of the resulting mergers and SIPs are having a positive effect on the overall OC of the merged entities compared to some of their participants.

Future MICH deals will probably involve the selection of participants in line with their OC and the transaction desired rating level. More complex structures will also possibly come to the market, providing additional credit enhancement in the form of reserve funds or other structural mechanics. Additionally, market players may also consider the issuance of BH as an alternative to CH.

Sector outlook: 46 of the 51 Fitch-rated MICH classes have been placed on Negative Outlook. This is because a few institutions have very little extra OC cushion to support the current rating of their participated deals. Should these institutions issue more CHs, securitisations or any BH, which after scheduled or early amortisations reduce their OCs, there could be further negative rating action on the sector.

Appendix 1

Financial Entity Participation in Fitch-Rated MICH

Issuer Name	Issuer Short Name	Comments	Amount in Fitch Rated multi-CH (EURm)	# deals	LT IDR	ST IDR	Outlook
Caja de Ahorros y Monte de Piedad de Gipuzkoa y San Sebastian	Kutxa		1,800	8	A-	F2	OutN
Bilbao Bizkaia Kutxa	BBK		2,100	13	A	F1	OutN
BBK Bank CajaSur, S.A.U.	BBK Bank CajaSur	Subsidiary of BBK	2,910	19			
Monte de Piedad y Caja de Ahorros de Ronda, Cadiz, Almeria, Malaga, Antequera y Jaen	Unicaja	Merger of Unicaja and Caja Jaen	6,449	36	A	F1	
Caja de Ahorros y Monte de Piedad de Zaragoza, Aragon y Rioja	Ibercaja		4,500	24			
Caja de Ahorros y Monte de Piedad de Ontinyent	Caixa Ontinyent		170	10			
Caja de Ahorros de Vitoria y Alava	Caja Vital		800	10	A-	F2	OutN
Cajamar Caja Rural, Sociedad Cooperativa de Credito	Cajamar		800	2	A	F1	OutN
Banca March, S.A.	Banca March		1,000	4			
Caja Laboral Popular	Caja Laboral		2,025	6	A+	F1	
Ipar Kutxa Rural, Sociedad Cooperativa de Credito	Ipar Kutxa		100	1			
banco Gallego, S.A.	Banco Gallego		460	7			
Banco Espirito Santo, S.A. Sucursal en España	Banco Espirito Santo		225	2			
Banco Guipuzcoano, S.A.	Banco Guipuzcoano	Subsidiary of Banco de Sabadell	200	1	A	F1	
Banco de Valencia, S.A.	Banco de Valencia		1,200	3	BBB-	F3	RWN
Caixa d'Estalvis Unio de Caixes Mantlleu, Sabadell i Terrassa	UNNIM	Merger of Caixa Sabadell, Caixa Mantlleu and Caixa Terrassa	6,000	37	BBB-	F3	
Caja España de Inversiones, Salamanca y Soria, Caja de Ahorros y Monte de Piedad	Caja España-Duero (Espiga)	Merger of Caja España and Caja Duero	5,395	30			
Caixa d'Estavis de Catalunya, Tarragona i Manresa	Catalunya Caixa	Merger of Caixa Catalunya, Caixa Tarragona and Caixa Manresa	3,861	21			
Banco Popular Espanol, S.A.	Banco Popular Espanol	Merger of Banco Popular Espanol and Banco Popular Hipotecario	2,000	1	A	F1	
Caixa de Aforros de Galicia, Vigo, Ourense e Pontevedra	NovaCaixaGalicia	Merger of Caixa Galicia and Caixa Nova	6,830	33	BBB-	F3	OutN
Caja de Ahorros y Pensiones de Barcelona	La Caixa	Merger of La Caixa and Caixa Girona	1,375	20	A+	F1	RWN
Banco Base Group	BASE SIP	SIP comprising of Caja de Ahorros del Mediterraneo (CAM), Caja Asturias, Banco de Castilla La Mancha, Caja Cantabria and Caja Extremadura	16,145	45			
Banco Financiero y de Ahorros Group (Bankia)	BFA SIP	SIP comprising of Bancaja, Caixa Laietana, Caja Avila, Caja Insular de Canarias, Caja Madrid, Caja Rioja and Caja Segovia	11,714	45	A-	F2	
Banca Civica Group	Banca Civica SIP	SIP comprising of Caja Municipal de Burgos, Caja General de Canarias, Caja Navarra and Caja Sol (merged with Caja Guadalajara)	12,286	37.00	A-	F2	RWN
Caja Tres Group	Caja Tres SIP	SIP comprising of Caja Circulo Catolico de Burgos, Caja de Ahorros de la Inmaculada and Caja Badajoz	2,325	25	BBB	F3	
Banco Mare Nostrum Group	MareNostrum SIP	SIP comprising of Caixa Penedes, Caja Granada, Caja Murcia and SaNostra	12,201	41	BBB+	F2	

Appendix 2

Issuer Cover Pool Breakdown, OC and SOC

Issuer Short Name	Total Cover Pool (EUR)*	Eligible Cover Pool (EUR)*	Outstanding CH (EUR)*	Total Over Collateralisation Rate (OC)*	Eligible OC Rate*	Residential % of Pool**	Commercial % of Pool**	Developers, Land and Others % of pool**	AAA SOC***	AA SOC***	A SOC***	BBB SOC***	Current OC Commitment
Kutxa	8,626.51	5,606	2,500	245%	124%	76%	7%	17%	94%	72%	55%	41%	
BBK	13,687.55	8,774	4,438	208%	98%	81%	4%	15%	104%	79%	60%	45%	
BBK Bank CajaSur	10,554.60	6,667	4,824	119%	38%	48%	30%	22%	119%	91%	67%	50%	
Unicaja	17,310.85	13,185	9,159	89%	44%	71%	8%	21%	99%	75%	56%	42%	
Ibercaja	22,313.92	15,642	6,175	261%	153%	68%	4%	29%	122%	92%	68%	50%	
Caixa Ontinyent	571.66	401	195	193%	105%	55%	11%	34%	143%	106%	76%	56%	
Caja Vital	4,885.39	2,215	1,372	256%	61%	60%	8%	32%	117%	88%	64%	47%	
Cajamar	13,219.90	7,751	3,683	259%	110%	53%	21%	26%	127%	94%	70%	52%	
Banca March	4,383.30	2,867	1,675	162%	71%	32%	14%	54%	180%	128%	88%	62%	
Caja Laboral	12,102.40	7,351	4,725	156%	56%	76%	3%	21%	106%	81%	60%	45%	
Ipar Kutxa	2,194.30	1,556	650	238%	139%	62%	4%	34%	155%	115%	83%	61%	
Banco Gallego	2,163.00	1,465	875	147%	67%	51%	4%	45%	149%	109%	76%	55%	120%
Banco Espirito Santo	1,502.40	479	305	393%	57%	30%	12%	58%	183%	129%	87%	61%	
Banco Guipuzcoano	3,759.10	1,713	940	300%	82%	37%	7%	56%	179%	127%	86%	60%	
Banco de Valencia	7,939.40	5,591	3,350	137%	67%	42%	15%	43%	160%	116%	82%	60%	132%
UNNIM	14,285.83	9,976	6,905	107%	44%	62%	7%	31%	135%	90%	73%	54%	90%
Caja España-Duero (Espiga)	20,880.30	12,861	8,822	137%	46%	54%	5%	42%	154%	114%	81%	59%	120%
Catalunya Caixa	28,580.34	17,878	11,975	139%	49%	46%	8%	46%	166%	121%	85%	61%	130%
Banco Popular Espanol	36,048.74	24,832	19,458	85%	28%	38%	34%	28%	95%	71%	52%	38%	
NovaCaixaGalicia	25,896.06	16,609	10,260	152%	62%	65%	9%	26%	115%	87%	64%	48%	
La Caixa	106,177.82	51,892	38,714	174%	34%	68%	11%	22%	115%	86%	63%	46%	
BASE SIP	58,031.06	38,729	21,820	176%	86%	54%	11%	35%	136%	101%	73%	53%	
BFA SIP	117,907.06	75,781	50,831	162%	55%	63%	7%	30%	129%	96%	69%	51%	
Banca Civica SIP	39,521.78	26,034	14,572	174%	80%	62%	8%	30%	126%	93%	68%	50%	
Caja Tres SIP	9,713.72	6,322	2,626	283%	150%	51%	8%	41%	140%	102%	72%	52%	
MareNostrum SIP	37,733.46	27,670	15,686	144%	80%	64%	8%	28%	111%	84%	62%	46%	

* Based on end December 2010 and January 2011 data

** Fitch Calculation based on end September, December and January data

*** Based on end September, December and January Data

Over Collateralisation Rate = (Cover Pool - Outstanding CH) / Outstanding CH

Cover Pool under Spanish legislation represents the entire mortgage book of financial institutions, except for securitised pools and loans individually pledged to investors in the form of bonos hipotecarios.

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