



Fitch Downgrades Montepio's Covered Bonds to 'BBB-'; Removes RWN

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Fitch Ratings-London/Paris-24 October 2011: Fitch Ratings has downgraded Caixa Economica Montepio Geral's (Montepio, rated 'BB'/Stable/B') Obrigacoes Hipotecarias (OH, mortgage covered bonds) to 'BBB-' from 'BBB' and removed them from Rating Watch Negative (RWN). Montepio's total outstanding OH amount to EUR2.2bn.

The downgrade was driven by (i) the implementation of Fitch's Covered Bonds Counterparty Criteria published in March 2011, and (ii) Fitch's review of the refinancing cost assumptions for Portuguese residential mortgage loans, due to the continued rise in Portuguese RMBS and government bond yields, which has in turn increased the over-collateralisation (OC) supporting a given rating scenario.

The combination of Montepio's 'BB' Long-term Issuer Default Rating (IDR) and the 70% D-Factor assigned to the OH programme would allow the OH to be rated as high as 'BB+' on a probability-of-default (PD) basis. However, the 35% level of minimum OC that the issuer publicly commits to in the OH's investor reporting only allows for equalisation of the rating of the covered bonds on a PD basis with Montepio's IDR ('BB'). The mortgage covered bonds can be rated two notches higher at 'BBB-' after taking into account recoveries from the cover pool in the event of a covered bonds default.

Fitch believes that Portuguese covered bond programmes are exposed to the risk of time subordination post issuer default (see the report "Analysis of the Portuguese Covered Bonds Framework" dated 3 November 2010, available at www.fitchratings.com). The agency has accordingly deviated from its standard recoveries analysis and has stressed the covered bonds for 100% recoveries in all but the last maturing covered bond series, which was found to provide recoveries sufficient (more than 71%) for a two-notch uplift to 'BBB-', in line with Fitch's criteria.

Montepio's covered bonds benefit from asset and liability swaps with The Royal Bank of Scotland N.V (RBS, rated 'A'/Stable/'F1') to hedge the interest rate mismatches between the cover pool and the covered bonds. The asset swap covers the basis risk of the floating rate mortgages, while the liability swap effectively hedges the interest rate risk between the floating rate received from the asset swap and the coupon due on the bonds.

Based on its counterparty criteria, Fitch assessed the programme's hedging arrangements, including the swaps' market valuations, and found that materiality of the swaps for the programme is overall low. Given that the swap counterparty's rating stands higher than the covered bond rating itself and Fitch's view that the risk of an 'A'/F1' entity proceeding straight into default is rather remote, the swap counterparty exposure and existing collateralisation arrangements are considered commensurate with the current covered bond rating.

Fitch has separately addressed the incremental exposure of the programme to Montepio in its role as account bank. The associated commingling risk has been accounted for in the agency's cash flow analysis, where one-month of asset collections is assumed to be lost upon an issuer event of default. In line with Fitch's criteria, the programme's liquidity reserve, currently funded at EUR21.1m, is deemed sufficient to cover for interest payment due on the covered bonds for at least three months on a rolling basis.

In light of Fitch's updated counterparty criteria, the programme's D-Factor remains unaffected at 70%, mainly driven by the impaired liquidity of Portuguese mortgage assets under a stressed sale scenario.

As of end-September 2011, the cover pool amounted to EUR2.97bn of prime residential mortgage loans originated by the issuer across Portugal, with liquid assets (in the form of highly rated public sector assets) amounting to EUR21.1m, whereas the outstanding covered bonds amounted to EUR2.2bn, resulting in a nominal OC of 35.8%. The cover pool weighted-average life stands at 13 years, compared to 3.8 years for the covered bonds. Fitch applied its increased refinancing cost assumptions when modelling the maturity mismatches between the mortgage

pool and the outstanding bonds.

Montepio intends to maintain a minimum OC of 35.0% going forward. This is in line with the level of OC supporting Montepio's OH's 'BBB-' rating. The OC supporting a given rating will be affected, among others, by the profile of the cover assets relative to outstanding OH, which can change over time, even in the absence of new issuances. It can also change depending on the direction of Portuguese bond yields, which could affect Fitch's refinancing cost assumptions. Therefore it cannot be assumed that the current level of OC supporting the assigned rating will remain stable.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Covered Bonds Rating Criteria', dated 12 August 2011, 'Covered Bonds Counterparty Criteria', dated 14 March 2011, 'Counterparty Criteria for Structured Finance Transactions', dated 14 March 2011, 'Counterparty Criteria for Structured Finance Transactions: Derivative Addendum', dated 14 March 2011 'EMEA Residential Mortgage Loss Criteria' dated 16 August 2011, EMEA Criteria Addendum - Portugal - Mortgage Loss and Cash Flow Assumptions - Amended', dated 11 August 2011 are available on www.fitchratings.com.

Applicable Criteria and Related Research:

[EMEA Criteria Addendum – Portugal - Mortgage Loss and Cash Flow Assumptions - Amended](#)
[Covered Bonds Rating Criteria](#)
[Covered Bonds Counterparty Criteria](#)
[Counterparty Criteria for Structured Finance Transactions](#)
[Counterparty Criteria for Structured Finance Transactions: Derivative Addendum](#)
[EMEA Residential Mortgage Loss Criteria](#)

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