საქართველოს ეროვნული ბანკი
National Bank of Georgia

COVERED BOND FRAMEWORK FOR GEORGIA

July 2021

REFORMS SUPPORTING NEW FINANCIAL INSTRUMENTS

Investment Funds

Legal/Regulatory/Tax framework

Derivatives

Derivatives/Financial collateral Netting and ISDA agreement

Covered Bonds

Securitization

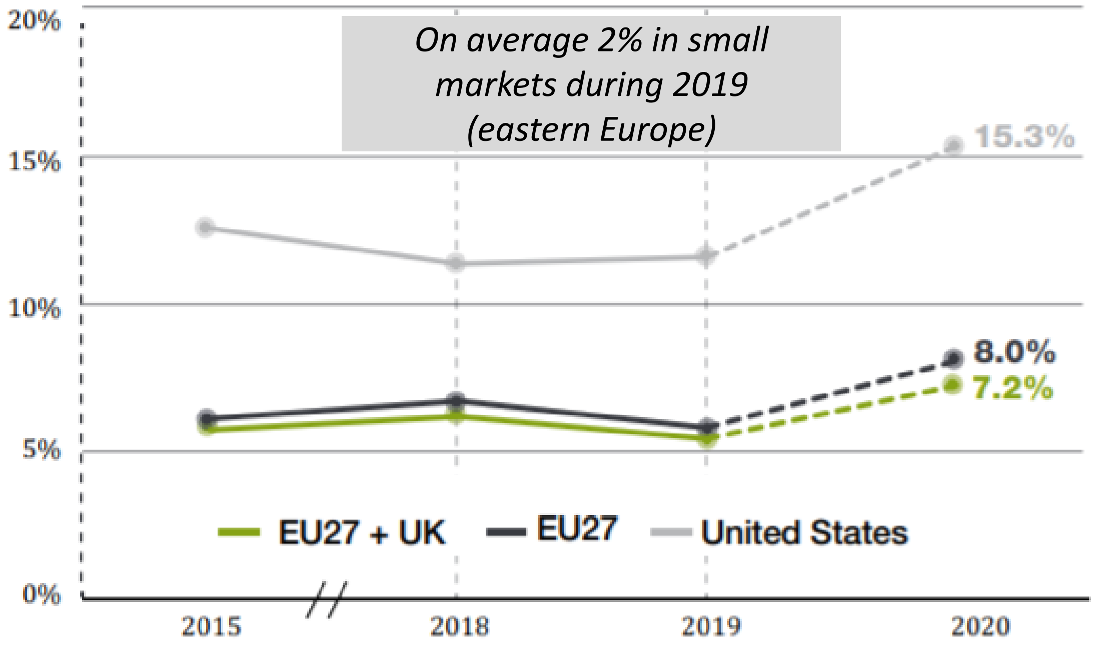
Regulatory/Tax framework: REITS/PE/VC

COVERED BONDS VS. SECURITIZATION

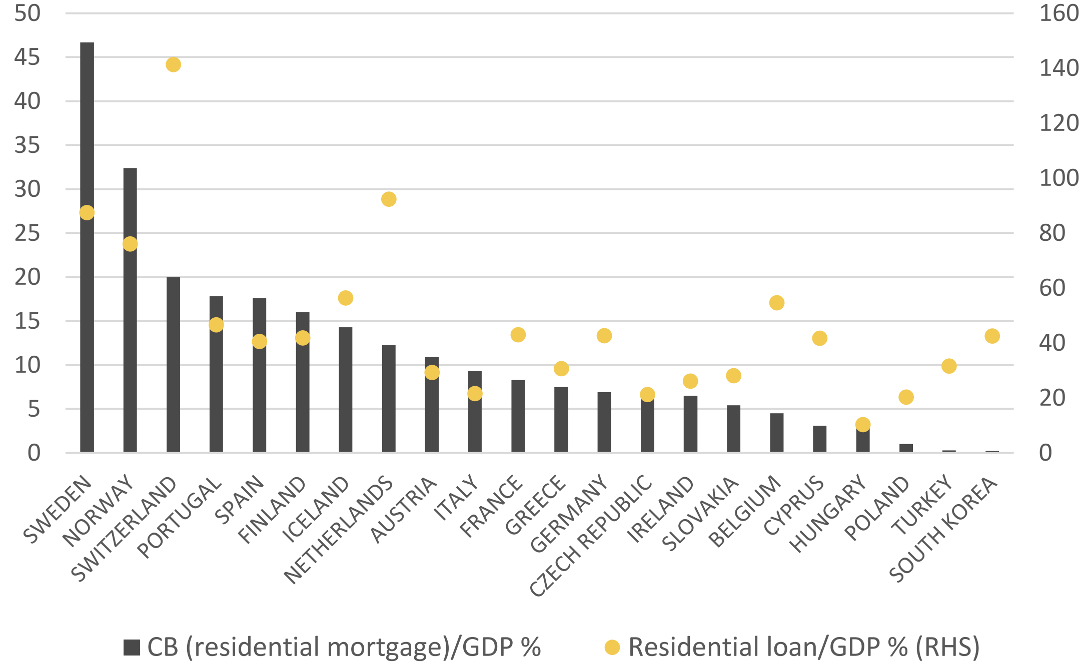
	Covered Bond	Securitization (ABS)
INCENTIVE:	Refinancing	Risk reduction, refinancing
ISSUER:	Generally originator, can be SPV	SPV
RECOURSE TO THE ORIGINATOR:	Yes	No
ON/OFF BALANCE SHEET:	Assets generally remain on balance sheet, but are identified as belonging to cover pool	Assets are transferred to special entity
DEBT REDEMPTIONPROFILE:	Typically bullet	Typically pass-through
ASSET POOL MANAGEMENT:	Mostly dynamic	Typically static pool
TRANCHING:	All bonds rank pari-passu	Senior and subordinated notes
CREDIT RISK:	Generally investment grade (may exceed country ceiling)	Various, depending on tranche
COUPON TYPE:	Predominantly fixed	Predominantly floating

MARKET SIZE: COVERED BONDS AND SECURITIZATION

Annual **flow** of covered bond, securitization and portfolio sales as % of **outstanding loans**



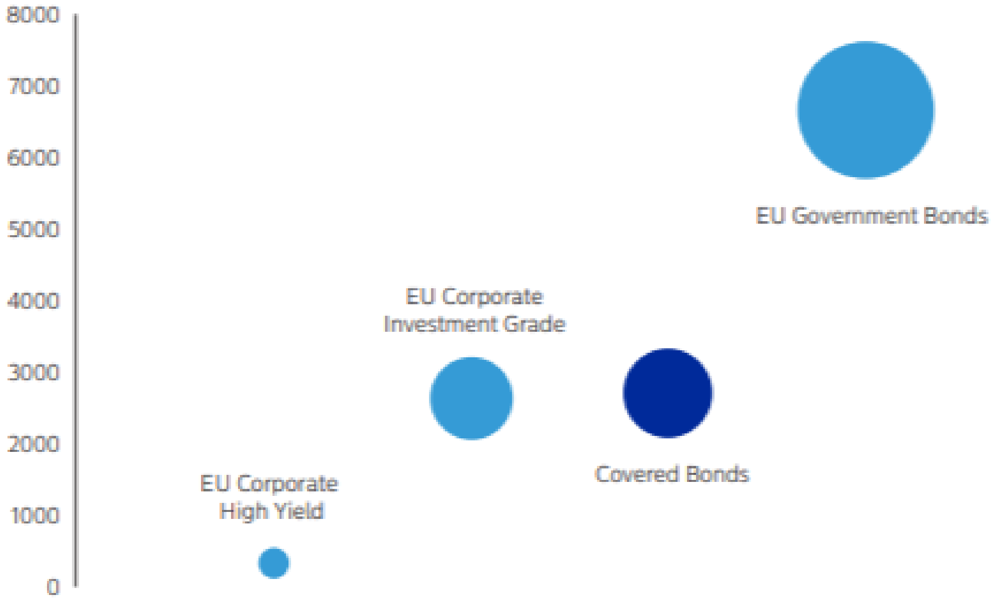
CB (backed by residential mortgage) vs residential loans



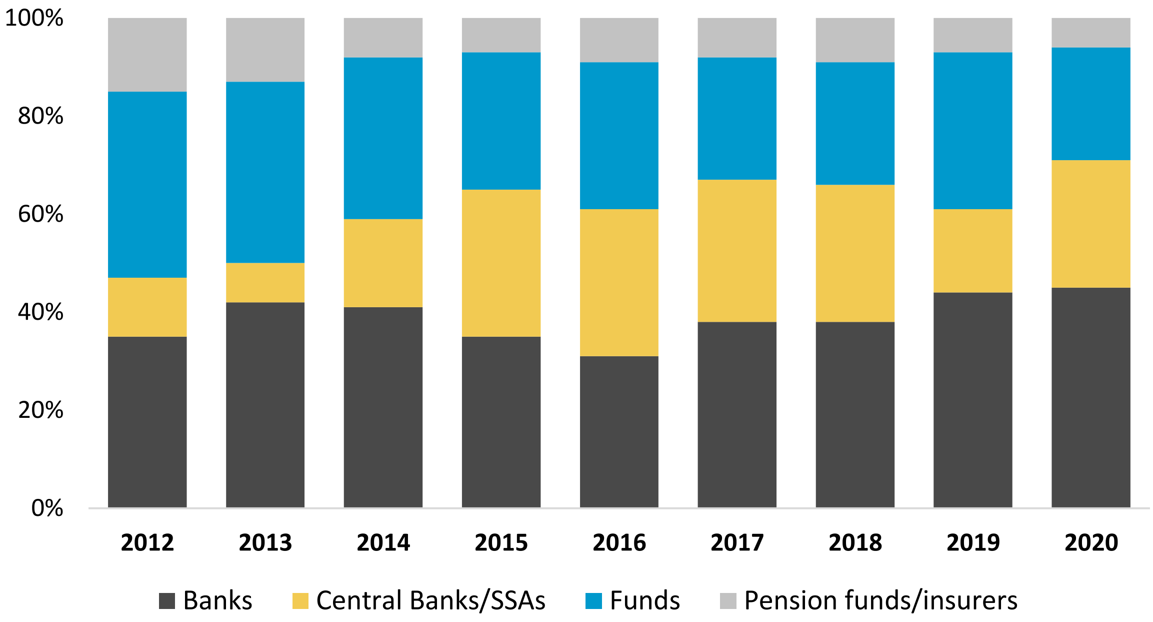
Source: ECBC, ECB, US FED

INVESTOR PERSPECTIVE

EU bond market size (2019**)**



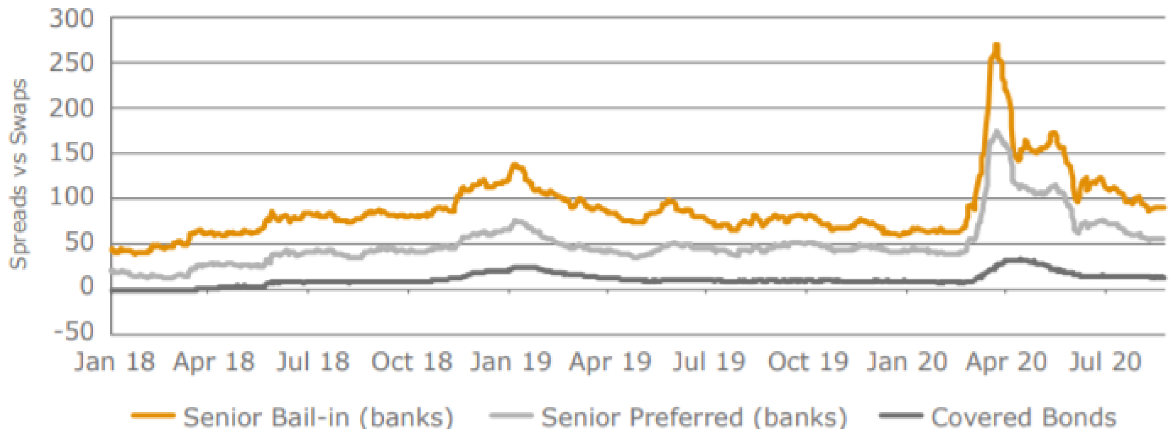
Investor composition of Euro Benchmark Covered Bond Issue – **mostly treasury market investors**



Source: ECBC, ICE

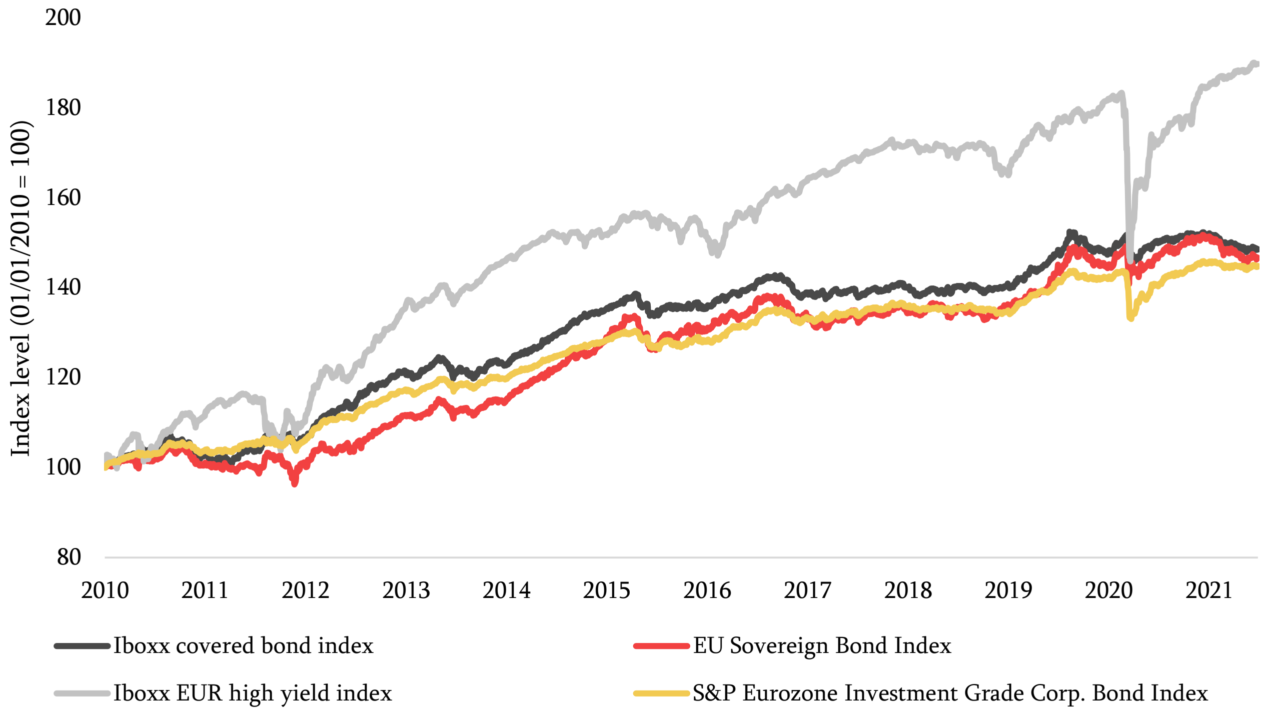
PRICING AND PERFORMANCE

significantly cheaper than other forms of term debt



Source: ECBC Covered Bond Factbook 2020

Covered bond performance Vs. Sovereign and corporate bond indices



Source: Bloomberg

COVERED BOND FRAMEWORK FOR GEORGIA

- Risk management tool to better match bank’s funding profile
- Low cost, stable funding/ funding during more rapid growth rates
- Fixed-to-term pricing for mortgage loans
- Crisis management tool (stability of funding during crisis)

GEO COVERED BOND FRAMEWORK: MAIN FEAUTERS

Covered bond characteristics

Size Limit: up to 4% of total banking assets by individual banks as eligible for covered bond issuance;

Eligible portfolio:

1. Mortgage and SME loans (backed by residential and commercial RE);
2. GEL or foreign currency denominated, however CB and cover assets must be denominated in same CCY;
3. Clearly defined set of assets that secure payment obligations, ring-fenced from other assets held by the commercial bank;
4. Credit quality criteria (e.g. 60/80 –commercial/residential LTV) – must be replaced if criteria is not met

Cover pool: coverage and liquidity

Cover pool composition:

1. Mortgage loans;
2. Substitute assets (liquid assets);
3. Derivatives;

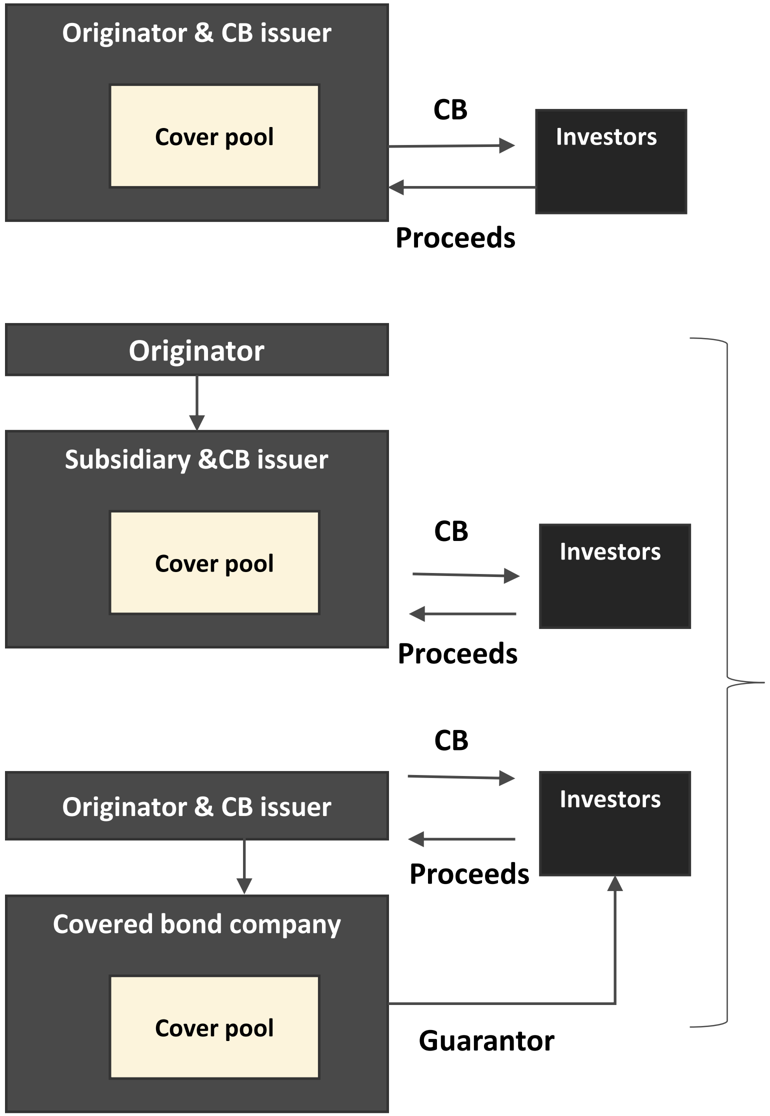
Coverage test: cover assets must be added is test fails

- Cover pool nominal value > CB nominal value by 2%
- Cover pool MV > CB MV by 2%

Liquidity requirement:

Substitute assets > expected net liquidity outflow of the mortgage bond program for the next 180 days

COVERED BOND ISSUE MODEL

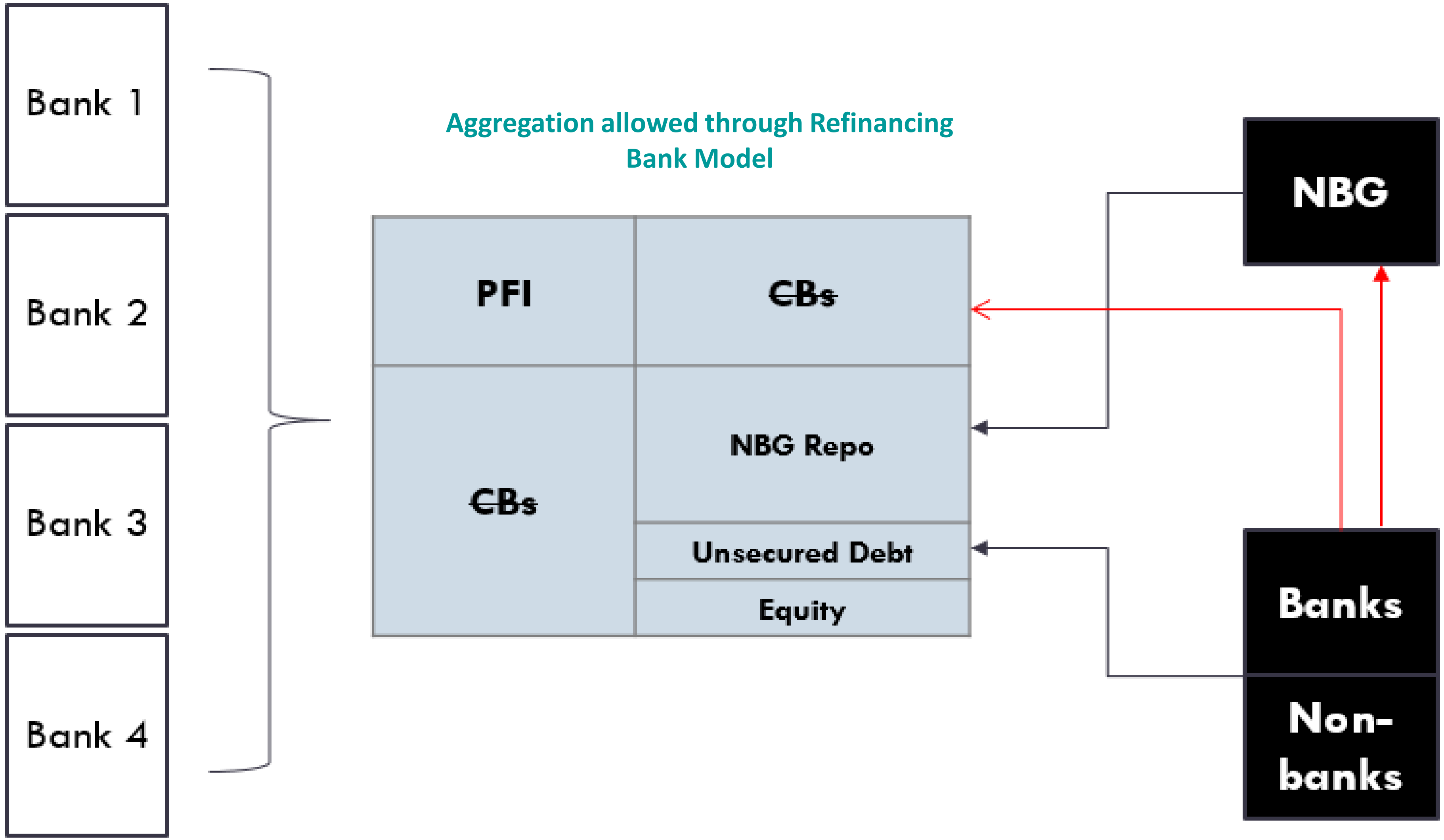


Direct model – segregation achieved on issuers balance sheet (vast majority of EU countries, Georgia)

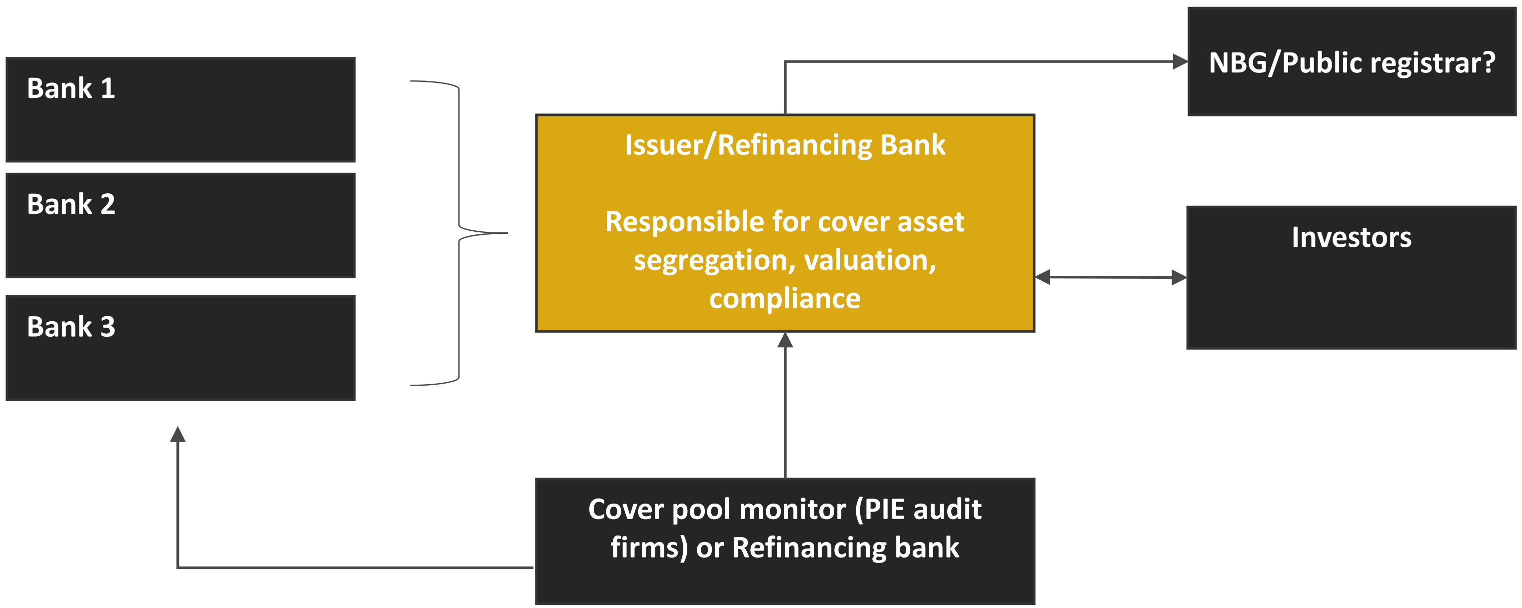
Indirect model – segregation achieved by setting up a distinct subsidiary/special purpose entity to hold the cover pool assets (specialist bank model, guarantor) - mostly common law countries & France, Italy

<< registered legal title to the mortgage collateral typically remains with the issuer

DIRECT/ON-BALANCE ISSUANCE MODEL, BUT WITH SCALE UP POSSIBILITY via REFINANCING BANK



KEY PARTICIPANTS



Responsible for verification of commitments made by issuer

MAIN POLICY FEATURES

Monetary Policy:

Repo Eligibility: Yes

Haircuts: between 7-10%

Gradual phase out of mortgage portfolio

Regulatory Policy:

Basel Principles

Basel III approach

Risk weight table for rated covered bond exposures — Table 8

Issue-specific rating of the covered bond	AAA to AA–	A+ to A–	BBB+ to BBB–	BB+ to B–	Below B–
"Base" risk weight	10%	20%	20%	50%	100%

Risk weight table for unrated covered bond exposures — Table 9

Risk weight of the issuing bank	20%	30%	40%	50%	75%	100%	150%
"Base" risk weight	10%	15%	20%	25%	35%	50%	100%

NBG will introduce new risk exposure class for Covered Bonds in the Regulation on Capital Adequacy Requirements. The approach will be in compliance with Basel III and CRR requirements, i.e. Covered Bonds will be weighted in 50% risk weight, which is preferential treatment compared to FX exposures to Central Governments and Central Banks and long term (more than three months) FX exposures to Commercial Banks.

EU approach – Capital Requirements Regulation (CRR – 575/2013)

Step	Rating	RW of Central Government**	RW of exposures with Banks***	RW of short term exposures with Banks	RW of Covered Bonds
1	AAA to AA-	0%	20%	20%	10%
2	A+ to A-	20%	50%	20%	20%
3	BBB+ to BBB-	50%	50%	20%	20%
4*	BB+ to BB-	100%	100%	50%	50%
5	B+ to B-	100%	100%	50%	50%
6	CCC+ and lower	150%	150%	150%	100%

*Country Rating of Georgia (BB) corresponds to the Step 4 and Commercial Banks are limited to that "country ceiling";
** Exposures in GEL are weighted in 0% risk weight;
*** Exposures in GEL are weighted in 20% risk weight;

LIQUIDITY REQUIREMENTS FOR COVERED BONDS

Covered Bond

Pledgeable at NBG

LCR

Asset:

- *treated as L1 HQLA (w/o haircut defined by the monetary team).*

Liability:

As for secured funding:

- *secured with L1 HQLA: 0% outflow rate;*
- *secured with L2 HQLA: 15% outflow rate for remaining maturity <=30 days, no requirement for longer remaining maturity.;*
- *otherwise: 100% outflow rate for remaining maturity <=30 days, no requirement for longer remaining maturity.*

NSFR

Asset:

- *5% RSF (w/o haircut defined by the monetary team).*

Liability:

- *100% ASF if remaining maturity is >1y;*
- *0%-50% ASF if remaining maturity is <=1y based on counterparty and remaining maturity.*

Non-pledgeable at NBG

LCR

Asset:

- *long-term credit rating at least AA-: treated as L2 HQLA;*
- *lower credit rating: 100% inflow rate for remaining maturity up to 30 days, no inflow rate for longer remaining maturity.*

Liability:

As for secured funding:

- *secured with L1 HQLA: 0% outflow rate;*
- *secured with L2 HQLA: 15% outflow rate for remaining maturity <=30 days, no requirement for longer remaining maturity.;*
- *otherwise: 100% outflow rate for remaining maturity <=30 days, no requirement for longer remaining maturity.*

NSFR

Asset:

- *higher RSF based on counterparty, remaining maturity and type of collateral (beetw. 10%-50% for <=1y, 65%-100% for >1y).*

Liability:

- *100% ASF if remaining maturity is >1y;*
- *0%-50% ASF if remaining maturity is <=1y based on counterparty and remaining maturity.*

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