Moody's Investors Service

Global Credit Research
Rating Action
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Rating Action: UniCredit Mortgage Bank Covered Bonds

Moody's downgrades three Hungarian Covered Bond programmes

London, 08 April 2009 -- Moody's Investors Service has today downgraded the following Hungarian covered bond programmes:

- Mortgage Covered Bonds issued by FHB Mortgage Bank:

Downgraded to A3 from Aa3 and placed on review for possible downgrade; previously on 1 April 2008, downgraded to Aa3 from Aa2 on review for possible downgrade. The TPI for this programme has been lowered to Probable;

- Mortgage Covered Bonds issued by OTP Mortgage Bank:

Downgraded to Aa2 from Aa1 and placed on review for possible downgrade; previously on 11 April 2007, downgraded to Aa1 from Aaa; and

- Mortgage Covered Bonds issued by Unicredit Mortgage Bank:

Downgraded to A1 from Aa3 and placed on review for possible downgrade; previously on 27 January 2009, assigned a long-term rating of Aa3.

Moody's says that the downgrades were prompted by a combination of the weakening economic environment in Hungary and the exposure of Covered Bondholders to both significant refinancing risk and foreign denominated liabilities. The ratings have also been placed on review for possible further downgrade as Moody's is reviewing the underlying issuers for possible downgrade.

The difficulties for the Hungarian economy have been highlighted by rating actions and opinions issued by Moody's sovereign rating group. On 6 April 2009, Moody's published a special comment "European Sovereigns Face Differentiated Refinancing Risk" in which Moody's identified Hungary as a country with "elevated" refinancing risk. The report identifies Hungary as having significant" risks when it comes to "GRRI+" -- Government Refinancing Risk. Since November 2008, Moody's has downgraded the Hungarian government to Baa1 with negative outlook from A2.

Against this backdrop, and given the exposure of the covered bonds to both refinancing and foreign exchange risk Moody's believe any recovery against the cover pool following an Issuer Default could be severely distressed.

The three covered bond programmes are all exposed to both refinancing risk and foreign exchange rate risk. Specifically:

- Refinancing risk. The covered bonds issued are "bullet" bonds, and so, following an Issuer Default, the natural amortisation of the assets in the cover pool cannot be relied on to fully repay the covered bonds in a timely manner. This means that funds may need to be raised against the assets backing the covered bonds, possibly through the firesale of the assets in the cover pool. In the current volatile environment, Moody's expects that recoveries from such a sale would be highly stressed. The high level of the potential refinancing risk faced in Hungary is reflected by both the widening of government yield by approximately 3% over the past year and the current CDS premium of around 450 bps for Hungarian government debt.

- Foreign exchange risk. All of the three impacted programmes suffer from a certain amount of unhedged foreign exchange rate risk. As at December 2008, approximately i) 50% of the covered bonds and 50% of assets in the FHB programme; ii)55% of the covered bonds and 40% of assets in the OTP programme; and iii) 5% of the covered bonds and 30% of assets in the Unicredit programme were denominated in foreign currency (mainly euros and/or Swiss francs). Moody's notes that the issuers may have swaps hedging these risks outside the cover pool; however, Moody's has not currently given value to these in our analysis. The level of depreciation of the Hungarian forint against the euro has been almost 20% over the past year. Two potential risks in a weakened economy include: i) whether borrowers would continue to be able to make payments if the currency depreciates further; and ii) covered bondholders' exposure to material unhedged foreign exchange rate risks should parts of the assets be redenominated into domestic currency.

Moody's initially analysed and monitors these transactions using the rating methodology for EMEA Covered Bond transactions as described in the Rating Methodology reports "Moody's Rating Approach to European Covered Bond", published in June 2005, "Timely Payment in Covered Bonds following Sponsor Bank Default", published in March 2008 and "Assessing Swaps as Hedges in the Covered Bond Market", published in September 2008.

The rating assigned by Moody's addresses the expected loss posed to investors. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.

Headquartered in Budapest, Hungary, FHB Mortgage Bank reported IFRS net income of HUF3.5 billion (EUR14.7 million) in H1 2008 and total assets of HUF631 billion (EUR2.68 billion).

Headquartered in Budapest, Hungary, OTP Mortgage Bank reported IFRS net income of HUF8 billion (EUR34 million) in H1 2008 and total assets of HUF1.404 trillion (EUR5.97 billion).

Headquartered in Budapest, Hungary, Unicredit Mortgage Bank reported IFRS net income of HUF1.9 billion in 2008 and total assets of HUF143.9 billion.

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