FitchRatings

NON-RATING ACTION COMMENTARY

German Pfandbriefe Benefit from Six Notches of PCU following Law Amendment

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Fitch Ratings-Frankfurt-01 July 2021: Fitch Ratings has granted six notches of Payment Continuity Uplift (PCU) to all Pfandbrief programmes it rates following the first set of amendments to the Pfandbrief Act (PfandBG), which introduced a 12-month maturity extension feature. The PCU was increased from five and four notches for public-sector and mortgage Pfandbrief programmes, respectively.

The PfandBG changes came into force on 1 July 2021 and are in line with our previous publication"Soft-Bullet Maturities to Improve German Pfandbriefe Payment Continuity". However, the uplift excludes the guaranteed Pfandbriefe issued by three Landesbanken and NRW.BANK's Pfandbrief, to which no PCUs are granted as the ratings are solely based on the respective guarantees.

Feedback

The six notches of PCU are in line with Fitch's covered bonds rating criteria for programmes secured by standard asset types if they benefit from a 12-month liquidity protection for principal payments and at least three months for interest payments.

For Pfandbriefe already at the maximum 'AAA' rating, the higher PCU leads to an increased buffer against a possible issuer downgrade. This supports a greater stability for Fitch's Pfandbriefe ratings in case of issuer rating downgrades.

For Pfandbriefe rated under the limited rating uplift approach, the PCU does not serve as buffer against issuer downgrade as the Pfandbrief rating is directly linked to that of the issuer.

The introduction of a 12-month maturity extension feature also lead to improved cash flow model results for two of Fitch's rated Pfandbrief programmes: The 'AAA' break-even overcollateralisation (OC) for Santander Consumer Bank AG's mortgage Pfandbriefe decreases to 4% from previously 8.5% and that of Bayerische Landesbank's public sector Pfandbriefe decreases to 7.5% from previously 12%.

The reduced levels of break-even OC for the ratings are driven by lower modelled asset and liability mismatches. The possibility to extend bond maturities for 12 months in combination with the 180-day liquidity buffer in the PfandBG reduces the amount of assets that may need to be sold under stressed conditions to enable timely payment of the covered bonds. In particular, programmes with large or concentrated covered bond maturities benefit.

We also expect the modelled break-even OC for assigned ratings to be less volatile in future should assets or liabilities change.

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