

# Erste Bank der oesterreichischen Sparkassen AG Public-Sector Covered Bonds

## Covered Bonds / Austria

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### Contacts

Jörg Homey  
+49 69 70730-740  
Joerg.Homey@moodys.com

José de León  
+34 91 702-6697  
jose.deleon@moodys.com

### Client Service Desk

Frankfurt: +49 69 70730-776  
London: +44 20 7772-5454  
csdlondon@moodys.com  
New York: +1 212 553-1653

### Monitoring

monitor.cb@moodys.com

### Website

www.moodys.com

## DEFINITIVE RATINGS

Cover Pool (€ million)	Ordinary Cover Assets	Covered Bonds (€ million)	Rating
1,454.7	Public-Sector Assets	966.3	Aaa

The ratings address 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.

## OPINION

### Strengths of the Transaction

- **Sponsor Bank:** The Public-Sector Covered Bonds or *Kommunalpfandbriefe* are full recourse to Erste Bank der österreichischen Sparkassen AG (Erste Bank) (rated **Aa3/Prime-1**).
- **The Austrian Mortgage Bank Act:** The Public-Sector Covered Bonds (Covered Bonds) are issued in accordance with the Austrian Mortgage Bank Act (*Hypothekbankengesetz*), which explicitly protects the status of the Covered Bondholders. The Austrian covered bond legislation boasts a number of strengths, including *inter alia* the following:
  - Pursuant to the terms of the Austrian legislation, the Sponsor Bank is regulated and supervised by the Financial Supervisory Authority of Austria (*Österreichische Finanzmarktaufsicht* or FMA).
  - Covered Bonds are secured by a separated pool of assets (Cover Pool), which are subject to conservative eligibility criteria. In general, only debt of public-sector entities located in Austria or other member states of the European Economic Area (EEA) and Switzerland are eligible assets.
  - In the event of a declaration of bankruptcy of Erste Bank, the Cover Pool will be segregated from Erste Bank's general insolvency estate.
  - A special cover pool administrator appointed by a court will undertake the necessary administrative measures to satisfy those claims of the creditors of the Covered Bonds.
  - A cover pool monitor (*Treuhänder*) will monitor various operations with respect to the Cover Pool on a day-to-day basis.
- **Credit Quality of the Cover Pool:**
  - The Covered Bonds are supported by a Cover Pool backed by high-quality assets. The majority of the claims are against local governments in Austria or debt related to Austrian central, regional or local governments, which have on average very good credit quality.



- A minimum nominal over-collateralisation of 2% has to be maintained at all times. Erste Bank has elected under the Austrian Mortgage Bank Act to include in its articles of association a requirement to match the Cover Pool and Covered Bonds in accordance with a net present value (NPV) test.
  - The quality of the collateral is seen in its Collateral Score of currently just below 5%.
- **Refinancing Risk:**
    - In general, the more liquid nature of public-sector debt.
    - Ability of the cover pool administrator to raise funds against the cover pool assets, for example bridge loans. Moody's understanding from legal and industry advisors is that the party providing bridge financing to the Cover Pool (upon the segregation of the Cover Pool) would enjoy senior status with respect to the Covered Bondholders.
  - **Market Risks:** On an NPV basis, the value of the Cover Pool assets has to match the value of the outstanding Covered Bonds. This has also to be maintained in stressed market conditions. Erste Bank opted for a "stressed" NPV calculation under its articles of association. This internal approach stresses interest rates by applying ten basis points key rate shocks of every term point extrapolated to a 100-basis-point shock.
  - **De-Linkage:** Following Sponsor Bank Default,<sup>1</sup> the Covered Bondholders will benefit from an administrator that acts independently from the insolvency administrator of Erste Bank.

## Weaknesses with Mitigants

- **Sponsor Bank:** As with most covered bonds, until Sponsor Bank Default the Sponsor Bank has the ability to materially change the nature of the programme. For example, new assets may be added to the Cover Pool, new Covered Bonds issued with varying promises and new hedging arrangements entered into. These changes could impact the credit quality of the Cover Pool as well as the overall refinancing risk and market risks. **Mitigant:** (i) the fact that the Covered Bondholders have a direct claim on the Sponsor Bank, rated **Aa3** and (ii) the controls imposed by the Austrian legislation.
- **Credit Quality of the Cover Pool:**
  - As of March 2008, the Cover Pool was concentrated with respect to the following aspects: (i) geographical concentration: around 84% of the claims are against public-sector entities situated in Austria; and (ii) obligor concentration: the 10 largest obligors account for around 69% of the total loan balance of the public-sector loans of the Cover Pool. These facts increase the probability of significant defaults. **Mitigants:** The generally high credit quality of the obligors. Furthermore, Moody's collateral score model takes into account the impact of concentration on borrower, regional and country levels.
  - As with most covered bonds in Europe, there are few restrictions on the future composition of the Cover Pool; hence substitution risk exists. **Mitigants:** The quality of the Cover Pool, over time, will be protected by, among others, the requirements of the Austrian Mortgage Bank Act. This act sets out rules detailing which assets qualify as cover assets for Public-Sector Covered Bonds in Austria. In addition, Moody's will monitor the Cover Pool. If the quality of the collateral were to deteriorate below a certain threshold, the Sponsor Bank would have the ability, but not the obligation, to increase the over-collateralisation in the Cover Pool. Failure to increase the level of over-collateralisation following a deterioration of the Cover Pool could lead to negative rating actions.
- **Refinancing Risk:** Following a Sponsor Bank Default, to achieve timely principal payment, Covered Bondholders may need to rely on proceeds being raised through the sale of, or borrowing against, assets in the Cover Pool. Following a Sponsor Bank Default, the market value of these assets may be subject to certain volatility.

<sup>1</sup> Sponsor Bank Default is defined in Moody's rating methodology for European Covered Bonds as removal from the Cover Pool of (i) support provided by entities within the Sponsor Bank, (ii) ancillary activities of the Sponsor Bank (i.e. those not related to the Cover Pool) and (iii) usually, management functions of the Sponsor Bank.

**Mitigants:** 1) the high rating of the Sponsor Bank (**Aa3**): the higher the rating of the Sponsor Bank, the lower the chances of being exposed to this risk; 2) Moody's has applied stressed refinancing margins.

- **Market Risk:** As with the majority of European covered bonds, there is potential for market risks. For example, following a Sponsor Bank Default, Covered Bondholders may be exposed to interest risk, which could arise from the different payment promises and durations made on the Cover Pool and the Covered Bonds. Moreover, in this transaction, there was a currency mismatch of around 16% as of March 2008. **Mitigant:** the requirement that the value of the Cover Pool has to exceed the NPV of the total of outstanding Covered Bonds issued, also in stressed market conditions.
- **Liquidity:** The programme does not benefit from any designated source of liquidity if cash flow collections are interrupted. **Mitigants:** (1) the strengths of the Austrian Mortgage Bank Act, which include the alternatives given to the cover pool administrator for raising funds against the Cover Pool; (2) the minimum 2% over-collateralisation on a nominal basis.
- **Time Subordination:** After a Sponsor Bank Default, later-maturing Covered Bonds are subject to time subordination. Principal cash collections may be used on a first-come-first-served basis, paying earlier-maturing Covered Bonds prior to later-maturing Covered Bonds. This could lead to over-collateralisation being eroded away before any payments are made to later-paying Covered Bonds.

## STRUCTURE SUMMARY

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Issuer:	Erste Bank der österreichischen Sparkassen AG ( <b>Aa3/Prime-1</b> )
Sponsor Bank:	Erste Bank der österreichischen Sparkassen AG ( <b>Aa3/Prime-1</b> )
Structure Type:	Public-Sector Covered Bonds ( <i>Kommunalfandbriefe</i> )
Issued under Covered Bond Law:	Yes (Austrian Mortgage Bank Act)
Country Applicable Law:	Austria
Main Originator:	Erste Bank der österreichischen Sparkassen AG
Main Servicer:	Erste Bank der österreichischen Sparkassen AG
Intra Group Swap Provider:	n.a.
Monitoring of Cover Pool:	Cover pool monitor ( <i>Treuhänder</i> ), mandatory by operation of the Austrian Mortgage Bank Act
Trustee:	n.a.
Timely Payment Indicator (TPI):	High

## COVERED BONDS SUMMARY

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Total amount of Covered Bond issuance outstanding:	€ 966,282,193
Currency of the Covered Bonds:	Euros (84%), Swiss francs (16%)
Extended Refinance Period:	No
Principal Payment Type:	Bullet
Interest Rate Type:	Fixed-rate bonds (75%), variable-rate bonds (25%)

## COLLATERAL SUMMARY

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Size of Cover Pool:	€ 1,454,749,518
Main collateral type in Cover Pool:	Public-Sector assets (100%)
Main Asset Location:	Austria
Loans Count:	963
Currencies:	Euros (99.7%), Swiss francs (0.3%)
Concentration of 10 biggest loans:	69%
WA Remaining Term:	7 years
Interest Rate Type:	Fixed rate assets (35%), variable rate assets (65%)
Current Over-Collateralisation (nominal basis):	50.6%
Current Over-Collateralisation (NPV basis):	56.8%
“Committed” Over-Collateralisation:	2% on a nominal basis
Collateral Score:	4.8%
Further details:	Appendix 1
Pool Cut-Off Date:	31 March 2008

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## TRANSACTION SUMMARY

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Moody's has assigned definitive long-term ratings of **Aaa** to the Public-Sector Covered Bonds (Covered Bonds) issued by Erste Bank der österreichischen Sparkassen AG (Erste Bank or the Sponsor Bank) according to the provisions of the Austrian Mortgage Bank Act. Amongst others, the rating takes into account the following factors:

1. The credit strength of Erste Bank (rated **Aa3/Prime-1**).
2. The Austrian legal framework. Pursuant to the terms of the Austrian Mortgage Bank Act, the Sponsor Bank is regulated and supervised by the Austrian Financial Supervisory Authority. Investors will – on a *pari-passu* basis – have the benefit of a priority right in respect of a pool of assets (Cover Pool). In addition, according to the law, the nominal value of the cover pool assets has to exceed the nominal value of all outstanding Covered Bonds by 2% at all times.
3. The Cover Pool. The Covered Bonds are backed by the Cover Pool, which comprises public-sector debt from Austrian local and regional governments as well as the central government of Austria and other member states of the European Union or debt guaranteed by these public-sector entities.

As is the case with other covered bonds, Moody's considers the credit strength of the transaction to be linked to that of certain parties, in particular the Sponsor Bank. Should such credit strength deteriorate, all other things being equal, the rating of the Covered Bonds might be negatively affected. However, the Sponsor Bank has the ability, but not the obligation, to commit voluntary enhancements to the transaction such as further over-collateralisation in order to increase the level of de-linkage to its credit strength.

## STRUCTURAL AND LEGAL ASPECTS

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### ***Public-Sector Covered Bonds are governed by the Austrian Mortgage Bank Act***

Erste Bank's Public-Sector Covered Bonds are governed by the Austrian Mortgage Bank Act (*Hypothekbankgesetz*). No structural feature outside the Austrian Mortgage Bank Act is envisaged by Erste Bank's Covered Bond Programme. It is worth noting that Erste Bank set up a pooling structure for Austrian Savings Banks (Sparkassen) and other financial institutions of the Austrian S-Group under the Austrian Mortgage Bank Act, which aims to bring together public-sector debt from *inter alia* Savings Banks (following Trust Receivables) and assets from Erste Bank itself as cover assets for Erste Bank's Public-Sector Covered Bonds (Pooling Structure).

### ***Pooling of Trust Receivables***

The Pooling Structure is based on the Austrian Mortgage Bank Act. According to §6(1a) of the Austrian Mortgage Bank Act, Erste Bank may use public-sector debt of another credit institution for its Cover Pool for Public-Sector Covered Bonds. Such Trust Receivables are held in trust for Erste Bank by for example an Austrian Savings Banks pursuant to a bilateral contract between these institutions. The Savings Banks have the obligation to ensure that the Trust Receivables are compliant with the Austrian Mortgage Bank Act.

A description of the general legal framework as well as the Pooling Structure for Public-Sector Covered Bonds governed by the Austrian Mortgage Bank Act is contained in Appendix 2.

## MOODY'S RATING METHODOLOGY

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The approach used by Moody's for rating covered bond transactions is detailed in our Rating Methodology.<sup>2</sup> The impact of the credit strength of the Sponsor Bank, quality of the collateral, refinancing and market risks are considered below.

### Credit Strength of the Sponsor Bank

*The Covered Bondholders benefit from a direct claim against the Sponsor Bank, rated Aa3/Prime 1*

The Public-Sector Covered Bonds are full recourse to Erste Bank (**Aa3/Prime-1**). The ratings derives from the bank's strong retail franchises throughout Austria and the more mature economies in Central & Eastern Europe (CEE), as well as its still satisfactory financial fundamentals. Moody's believes that the probability of both sector and systemic support for Erste Bank is very high.

For more information on the fundamental credit quality of the Sponsor Bank, please see Related Research: Moody's latest Credit Opinion on Erste Bank, published in March 2008.

In December 2006, Erste Bank's Supervisory Board approved a restructuring of its organisational structure. It is Moody's understanding that during 2008 Erste Bank will be converted to the legal structure of a holding company, with the Austrian banking business as a separate legal entity. The holding company Erste Bank will provide centralised control and steering functions for the group and provide the infrastructure for local retail activities. Moody's understands that the holding company Erste Bank will be the issuer for both the Public-Sector Covered Bonds and the Mortgage Covered Bonds, when the restructuring will be completed and that the vast majority of Cover Pool assets for both covered bond programmes will be transferred from other financial institutions of the group as Trust Receivables via the Pooling Structure set-up under the Austrian Mortgage Bank Act (for further details on the Pooling Structure please refer to the Appendix 2 of this report).

### The Credit Quality of the Cover Pool

*Total Cover Pool volume amounts to €1,454 million*

As of the end of March 2008, the Cover Pool comprised 963 loans or bonds to 322 public-sector entities or loans guaranteed by public-sector entities. These claims add up to a volume of €1,454.7 million. Around 43% of these assets are Trust Receivables from Austrian Savings Banks or other financial institutions of the Austrian S-Group.

The nominal value of Erste Bank's currently outstanding Public-Sector Covered Bonds amounts to €966.3 million; therefore, on a nominal basis these numbers translate into an over-collateralisation of 50.5% as of the end of March 2008.

*Majority of the Cover Pool assets are loans originated in Austria*

The majority of the Cover Pool assets are claims against Austrian public-sector entities or claims guaranteed by those entities. Within Austria the geographical focus of the assets is claims against the central government or claims against public-sector entities located in Vienna. Claims against entities in Lower Austria – the second-largest region behind Vienna – account for around 12% of the claims against Austrian public-sector entities.

The assets relating to borrowers outside Austria are currently claims against sovereigns from five different countries: Germany (rated **Aaa**), Greece (rated **A1**), Poland (rated **A2**), Portugal (rated **Aa2**) and Romania (rated **Baa3**). The total amount of debt to borrowers outside Austria accounts for around 16% of the Cover Pool.

Moody's was provided with good-quality information on the Cover Pool assets. Where possible, the current ratings for Moody's-rated public-sector entities were utilised. However, not every borrower is rated by Moody's as the Cover Pool is also supported by a high number of claims, for example, against relatively small local governments across Austria. Therefore, Moody's uses what we see as conservative rating estimates for these entities. For more detailed information on the composition of the Cover Pool, please refer to Appendix 1 of this report.

<sup>2</sup> "Moody's Rating Approach to European Covered Bonds", published in June 2005 (see Related Research).

***Average credit quality of Cover Pool assets is very good***

From a credit perspective, Moody's sees the following characteristics of the Cover Pool as positive:

- In general, public-sector loans can be associated with a low expected loss in the event of a payment disruption on the loan. This is reflected in the credit ratings of Erste Bank's Cover Pool assets.
- The claims against public-sector entities are spread across 322 different borrowers.

From a credit perspective, Moody's regards the following portfolio characteristics as negative:

***Some borrower concentration***

- Borrower concentration: the ten largest obligors account for around 69% of the Cover Pool assets.
- Country concentration: the majority of the public-sector entities are located in Austria. These entities account for around 84% of the volume of the Cover Pool assets.

These facts increase the probability of significant defaults.

The above-mentioned factors have been incorporated into Moody's analysis. The result of the Cover Pool analysis is the Collateral Score.<sup>3</sup> Moody's calculates a Collateral Score based on the credit quality of the public-sector debt pool using a Monte Carlo simulation. For this transaction, the Collateral Score is around just under 5%, based on the current pool.

***Substitution risks are mitigated by the Austrian Mortgage Bank Act***

As with most covered bonds in Europe, there are few restrictions or limitations on the future composition of the Cover Pool. This may have the effect of creating substitution risk. Mitigants to substitution risk, which should protect the quality of the Cover Pool over time, include:

- Requirements of the Austrian Mortgage Bank Act: The Austrian Mortgage Bank Act limits the eligible cover pool assets to (i) direct claims against public-sector entities located in Austria and member states of the European Economic Area or Switzerland or local and regional governments located in these countries, or (ii) debt guaranteed by the aforementioned public-sector entities.
- The Cover Pool composition will be monitored. If the quality of the collateral were to deteriorate below a certain threshold, the Sponsor Bank would have the ability, but not the obligation, to increase the over-collateralisation in the Cover Pool in order to support the current rating. If additional over-collateralisation was not added following a marked deterioration of the collateral, this could lead to a negative rating action.

## **Refinancing the Cover Pool**

Following a Sponsor Bank Default, when the "natural" amortisation of the Cover Pool assets alone cannot be relied on to repay principal, Moody's assumes that funds must be raised against the Cover Pool at a discount if Covered Bondholders are to receive timely principal payment. After a Sponsor Bank Default, the market value of these assets may be subject to certain volatility. Examples of the stressed refinancing margins used by Moody's for different types of prime-quality assets are published in Moody's method piece (please see Related Research: "Moody's Rating Approach to European Covered Bonds", published in June 2005).

***The refinance margin stress used for public-sector assets is much lower than that for commercial and residential assets***

Aspects specific to this programme that are refinancing positive include:

- Austrian Mortgage Bank Act: The cover pool administrator has the ability to transfer the Cover Pool together with the Covered Bonds or sell the cover pool assets and to raise funds against the cover pool assets, for example bridge loans.
- The credit quality of the Cover Pool, which is reflected in a relatively low Collateral Score. The higher credit quality of the Cover Pool will lead to a lower write-off for losses and lower refinancing margins applied.
- Public-sector assets are in general terms a more liquid type of collateral, which should improve the sales value of the Cover Pool. Public-sector assets (repo-eligible) are expected to trade at lower refinancing margins than other asset classes.

<sup>3</sup> The Collateral Score can be seen as the amount of risk-free enhancement required to protect a **Aaa** rating from otherwise unsupported assets – so the stronger the credit quality of the collateral, the lower the Collateral Score. This only considers the credit deterioration of the assets and ignores any risk from refinancing and market risk (see Rating Methodology "Moody's Rating Approach to European Covered Bonds").

**All notes issued under this programme are bullet**

Aspects specific to this programme that are refinancing negative include:

- All Covered Bonds issued under the programme are bullet. Furthermore, the programme does not benefit from any contractual provisions to allow for an extension of a principal refinancing period.
- During the entire life of the loan, an administrator of the Cover Pool may not be able to change the rate charged to the underlying borrowers.

### Market Risk

As with the majority of European covered bonds, there is potential for market risks. For example, following a Sponsor Bank Default, Covered Bondholders may be exposed to interest risk, which could arise from the different payment promises and durations made on the Cover Pool and the Covered Bonds. Following a Sponsor Bank Default, the Moody's Covered Bond Model looks separately at the impact of increasing and decreasing interest rates on the expected loss of the Covered Bonds, taking the path of interest rates that leads to the worst result. The interest and currency stressed rates used over different time horizons are published in Moody's Rating Methodology (please see Related Research: "Moody's Rating Approach to European Covered Bonds", published in June 2005).

Table 1:

	Assets (%)	Liabilities (%)	WAL assets (years)	WAL liabilities (years)
Fixed rate	34.8	75.5	2.4	7.9
Variable rate	65.2	24.5	9.5	2.1

WAL = weighted average life (time to reset)

**Cover test on NPV basis, including stress tests**

Aspects specific to this programme that are market risk positive include:

- The exposure to market risk is mitigated by the cover test on an NPV basis, taking stressed interest rate scenarios into consideration.  
Interest rate risk is mitigated by the "stressed" net present value calculation opted for by Erste Bank under its articles of association (NPV test). This internal approach stresses interest rates by applying ten basis points key rate shocks of every term point extrapolated to a 100-basis-point shock. As of March 2008, Erste Bank had not entered any swaps into the Cover Pool register of its Public-Sector Covered Bonds.
- The portion of variable-rate assets is around 65% and therefore quite high compared to other European public-sector debt-based cover pools.

**Currency mismatch of around 16% as of March 2008**

Aspects specific to this programme that are market risk negative include:

- The vast majority of Erste Bank's outstanding Public-Sector Covered Bonds and majority of the cover pool assets are denominated in euros. However, there is a currency risk, which remains unhedged. In its analysis, Moody's has assumed a 16% currency mismatch across this programme.
- Some interest rate risk exists, around 35% of the Cover Pool assets have a fixed rate (see also Table 1). However, this number is low compared to other public-sector covered bond programmes and the weighted average life of the fixed-rate assets is also lower than in other European public-sector debt-based cover pools.

**The exposure to interest rates risk is mitigated by the NPV test, taking stressed interest rates scenarios into consideration**

The result of Moody's calculations was that the more stressful scenario is currently one of increasing interest rates, as a potential sale of fixed-rate assets would lead to a crystallisation of interest rate losses. Interest rate risk is partially mitigated by the over-collateralisation based on the NPV test. The NPV test applied by the Sponsor Bank does partially immunise the assets against interest rate movements. However, the stresses applied by Moody's approach when modelling interest rate shifts exceed this level.

In the case of an insolvency of the Sponsor Bank, Moody's does not currently assume that the special cover pool administrator would always be able to efficiently manage any natural hedge between the Cover Pool and the Covered Bonds.



## LINKAGE

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### **All Covered Bonds are linked to the Sponsor Bank**

All Covered Bonds are linked to the Sponsor Bank. As a result, the Covered Bonds will come under increasing rating stress as the Sponsor Bank's credit strength deteriorates. Reasons for this include:

- Refinancing risk: following a Sponsor Bank Default, if principal receipts from collections of the Cover Pool are not sufficient to meet the principal payment on a Covered Bond, funds may need to be raised against the Cover Pool. However, the fact that the Sponsor Bank has defaulted may negatively impact the ability to raise funds against the Cover Pool.
- The exposure of the programme to the choices of the Sponsor Bank. For example, prior to a Sponsor Bank Default, the Sponsor Bank may add new assets to the Cover Pool, issue further bonds and enter new hedging arrangements. Each of these actions could negatively impact the value of the Cover Pool.
- More generally, by the incorporation of the strength of the Sponsor Bank into Moody's rating method.

As a result of this linkage, the probability of default of the Covered Bonds may be higher than expected for **Aaa** rated senior unsecured debt. However, Moody's primary rating target is the expected loss, which also takes severity of loss into account. In this case, the severity of loss is consistent with a **Aaa** rating.

### **TPIs assess the likelihood that a timely payment will be made**

Moody's Timely Payment Indicators ("TPIs")<sup>4</sup> assess the likelihood that a timely payment will be made to Covered Bondholders following Sponsor Bank Default, and thus determine the maximum rating a covered bond programme can achieve with its current structure while allowing for the addition of a reasonable amount of over-collateralisation.

### **Having an independent cover pool administrator may reduce potential conflicts of interest between the Covered Bond investors and other creditors**

Aspects specific to this programme that are TPI-positive include:

- Austrian Mortgage Bank Act, including:
  - At the time of a declaration of bankruptcy of the Sponsor Bank, a cover pool administrator will take over management responsibility of the Covered Bond programme. The cover pool administrator will act independently from the insolvency administrator of the Sponsor Bank. Having an independent cover pool administrator may reduce potential conflicts of interest between the Covered Bond investors and other creditors.
  - Set-off: Moody's understanding from legal and industry advisors with respect to Austrian Public Sector Covered Bonds is that set-off risk for loans registered in the Cover Pool (including Trust Receivables) is excluded by the operation of the Austrian Mortgage Bank Act.
  - Ability of the cover pool administrator to raise funds against the cover pool assets, for example bridge loans. Moody's understanding from legal and industry advisors is that the party providing bridge financing to the Cover Pool (upon the segregation of the Cover Pool) would enjoy senior status with respect to the Covered Bondholders.
- Type of Assets: Some part of the cover pool assets are government bonds.

### **All outstanding Covered Bonds are bullet without any extension period**

Aspects specific to this programme that are TPI negative include:

- All Covered Bonds outstanding have a bullet repayment at maturity, without any extension period for the repayment of the bonds.
- The programme does not benefit from any designated source of liquidity if cash flow collections are interrupted.
- Commingling risk: It is Moody's understanding that, upon the appointment of the cover pool administrator, the latter has priority claim on all cash flows stemming from the Cover Pool assets. However, the cover pool administrator has to separate these cash flows from other cash flows to the Sponsor Bank before payment is made to Covered Bondholders.

Based on the considerations discussed above, Moody's has assigned a TPI of "High" to this Covered Bond programme.

<sup>4</sup> See Moody's Rating Methodology: "Timely Payment in Covered Bonds following Sponsor Bank Default" published March 2008

## MONITORING

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The Issuer is expected to deliver certain performance data to Moody's on an ongoing basis. In the event that this data is not made available to Moody's, Moody's ability to monitor the ratings may be impaired. This could negatively impact the ratings or, in some cases, Moody's ability to continue to rate the Notes.

## RELATED RESEARCH

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For a more detailed explanation of Moody's approach to this type of transaction as well as similar transactions, please refer to the following reports:

### **Rating Methodologies**

- Moody's Rating Approach to European Covered Bonds, June 2005 (English version - SF57011)
- Moody's Rating Approach to European Covered Bonds, July 2005 (German version – SF58550)
- Timely Payment in Covered Bonds following Sponsor Bank Default, March 2008 (SF109992)

### **Special Reports**

- 2007 Review & 2008 Outlook Covered Bonds: Strong Market Growth in 2007 but Credit Challenges Lie Ahead, February 2008 (SF121193)
- European Covered Bond Legal Frameworks: Moody's Legal Checklist, January 2006 (German version – SF67969)
- European Covered Bond Legal Frameworks: Moody's Legal Checklist, December 2005 (English version – SF66418)

### **Credit Opinion**

- Moody's Global Credit Research – Credit Opinion: Erste Bank der österreichischen Sparkassen AG, 28 March 2008

*To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.*

# APPENDIX 1: COVER POOL INFORMATION

## Public Sector Assets

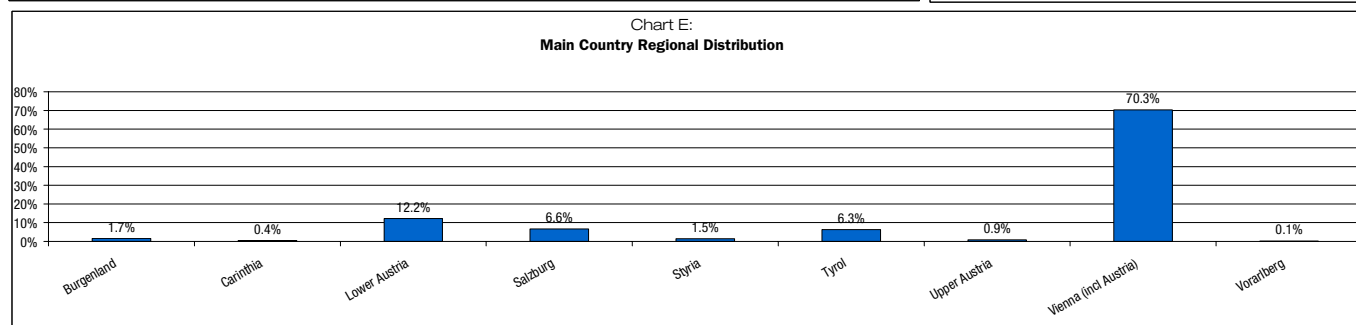
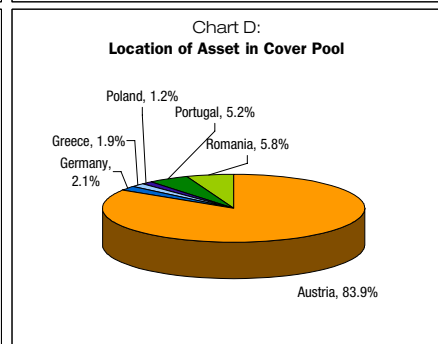
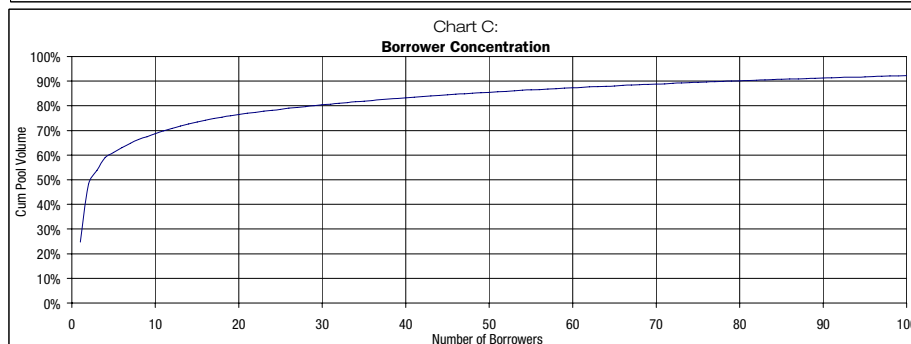
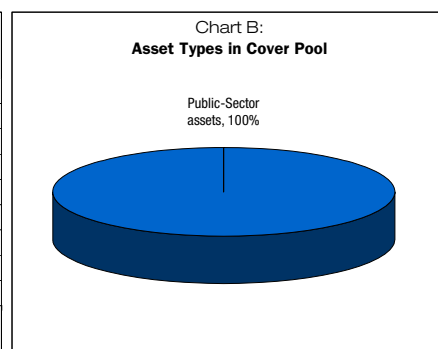
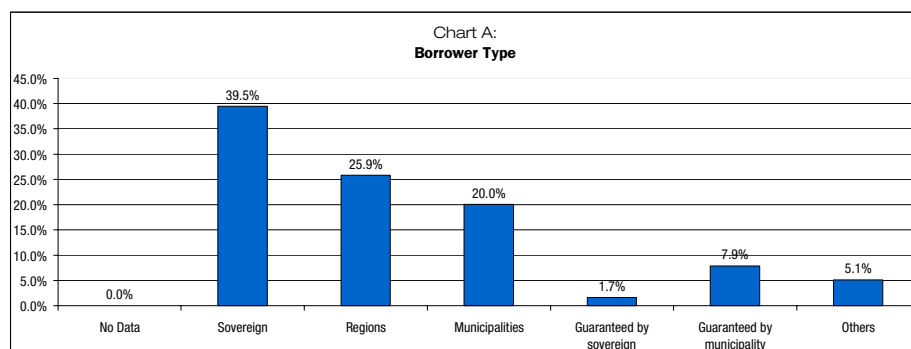
### Overview

Collateral Score :	4.8%
Asset balance :	1,454,749,518
WA Remaining Term (in months) :	84
Number of borrowers :	322
Number of loans :	963
Exposure to the 10 largest borrowers :	68.7%
Average exposure to borrowers :	4,517,856

(\*) n/d : information not disclosed by issuer

### Specific Loan and Borrower characteristics

Repo eligible loans :	75.0%
Percentage of fixed rate loans :	35.0%
Percentage of bullet loans/ bonds :	50.0%
Loans in non-domestic currency :	0.3%
<b>Performance</b>	
Loans in arrears ( ≥ 2months - < 6months) :	0.0%
Loans in arrears ( ≥ 6months - < 12months) :	0.0%
Loans in arrears ( > 12months) :	0.0%
Loans in a foreclosure procedure :	0.0%



## Qualitative Collateral Information

All Cover Pool characteristics are actual level (not assumed levels) based on reporting from Erste Bank.

As of the date of this report around 43% of the total Cover Pool assets are Trust Receivables from Austrian Savings Banks or other financial institutions of the Austrian S-Group.

## APPENDIX 2: LEGAL FRAMEWORK FOR AUSTRIAN PUBLIC-SECTOR COVERED BONDS

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### General Provisions in the Austrian Mortgage Bank Act

#### ***Erste Bank issues Covered Bonds in accordance with the Austrian Mortgage Bank Act***

Erste Bank has established a Public-Sector Covered Bond programme according to the Austrian Mortgage Bank Act, under which Public-Sector Covered Bonds will be issued from time to time, in each case constituting direct, unconditional and senior obligations of the Sponsor Bank. The outstanding Covered Bonds are secured by a pool of assets (Cover Pool). Eligible assets for this Cover Pool are (i) direct claims against public-sector entities located in Austria and member states of the European Economic Area or Switzerland or local and regional governments located in these countries, or (ii) debt guaranteed by the aforementioned public-sector entities.

#### ***Upon Sponsor Bank Default, a special cover pool administrator takes over management responsibility for the covered bond programme***

Upon Sponsor Bank Default, the Cover Pool will be segregated from the insolvency estate of the Sponsor Bank and a special cover pool administrator will be appointed upon the commencement of insolvency procedures. This special cover pool administrator will undertake the necessary administrative measures to satisfy claims by the creditors of the Covered Bonds by collecting claims that are due, selling individual cover assets or organising bridge financing. Moody's understanding from legal and industry advisors is that the party providing bridge financing to the Cover Pool (upon the segregation of the Cover Pool) would enjoy senior status with respect to the Covered Bondholders.

#### ***Scenarios following a Sponsor Bank Default***

Upon Sponsor Bank Default, the following scenarios may occur:

1. The special cover pool administrator may – if feasible – transfer the Cover Pool, as well as all obligations under the Covered Bonds (and the obligations vis-à-vis pari-passu creditors, such as hedge counterparties or liquidity providers) to another suitable bank, which will assume the obligations of the Cover Pool.
2. If the Cover Pool and the outstanding Covered Bonds are not transferred and the cover pool assets are not sufficient to satisfy all claims of Covered Bondholders against the Cover Pool, the special cover pool administrator may dispose of the cover pool assets, subject to the approval of the competent court. In this case, all Covered Bonds will become due and payable and the special cover pool administrator will distribute the proceeds stemming from the disposal of the cover pool assets among the Cover Bondholders on a pari-passu basis. If the proceeds are not sufficient to meet all claims of the Covered Bondholders, then the Covered Bondholders will have a senior unsecured claim against the general insolvency estate of Erste Bank.
3. If the Sponsor Bank has opted for an early redemption at present value in its articles of association, and if there is sufficient cover, the Cover Pool will not be transferred but the claims of the Covered Bondholders (and other pari-passu creditors) will be redeemed early at the then current NPV. This would also be subject to the approval of the competent court. Erste Bank has not opted for this latter alternative.

#### ***Nominal over-collateralisation of 2%***

The Sponsor Bank has elected under the Austrian Mortgage Bank Act to include in its articles of association a requirement to match the Cover Pool and Covered Bonds in accordance with a NPV test. The Austrian Mortgage Bank Act in general requires the covered bond issuer to maintain a minimum 2% nominal over-collateralisation for its Covered Bonds at all times. Covered Bondholders may benefit from voluntary and prescribed over-collateralisation in the Cover Pool following the commencement of insolvency proceedings for the covered bond issuer. Claims of hedge counterparties rank equally with Covered Bond investors. As of March 2008, Erste Bank has not entered any swap into the Cover Pool register.

#### ***Commingling risk: payments and receivables on the cover pool assets are not separated from other cash flows from the Sponsor Bank prior to the declaration of bankruptcy of the Erste Bank***

Erste Bank services the cover pool assets entered in the register. Payments and receivables on the cover pool assets are not separated from other cash flows from the Sponsor Bank prior to a declaration of bankruptcy of Erste Bank. Upon the commencement of insolvency proceedings, the Covered Bondholders would have a preferential claim on all receivables in the Cover Pool. The appointed special cover pool administrator will be obliged by operation of the Austrian Mortgage Bank Act to apply all collections to satisfy the preferential claims against the Cover Pool.

***Set-off risk is mitigated by the operation of law***

Moody's understanding from legal and industry advisors is that set-off against claims that have been entered into the Cover Pool is excluded by the operation of the Austrian covered bond legislation.

### **Erste Bank's Pooling Structure under the Austrian Covered Bond Legislation**

***Pooling of Trust Receivables***

According to the Austrian Mortgage Bank Act, a covered bond issuer such as Erste Bank may use mortgage loans or public-sector loans (following Trust Receivables) of another credit institution (for example, a Savings Bank) for the cover pools of its Mortgage or Public-Sector Covered Bonds. One requirement of the Austrian Mortgage Bank Act is that the covered bond issuer and the other credit institution enter into a written agreement that sets out the obligation of the involved parties of this transaction in more detail.

Erste Bank's Pooling Structure in a nutshell: The mortgage loans or public-sector loans are held in trust for Erste Bank by Austrian Savings Banks or other financial institutions in the Austrian S-group (following Savings Banks). It is Moody's understanding from legal advisor that Erste Bank – or upon a Sponsor Bank Default, ultimately the Cover Pool – will have the right to separate the loans and assets held in trust in case of a bankruptcy of the trustee – i.e. the other financial institution like for example the Savings Bank.

***Savings Bank has to supply a minimum amount of Trust Receivables ...***

Under the written agreement, the Savings Bank will have the contractual obligation to ensure that the Trust Receivables transferred to Erste Bank for the benefit of the Covered Bondholder will meet the requirements of the Austrian Mortgage Bank Act. In addition, the Savings Bank commits itself to transfer a certain minimum amount of eligible loans to Erste Bank, i.e. if for example loans are repaid or become non-eligible (for example if a loan becomes non-performing), the Savings Bank has the obligation to replace these loans with new and performing loans. Moody's understands that the Savings Bank will receive a fee on an ongoing basis from Erste Bank for the transferred Trust Receivables.

***... and will keep servicing these loans***

Following the transfer of the loans, the Savings Bank will keep servicing these loans. However, it will not be entitled to otherwise dispose of those assets. The loans are held in trust for the ultimate benefit of Erste Bank's Cover Pool on the balance sheet of the Savings Bank. In the event of an insolvency scenario of the Savings Bank, Erste Bank may segregate the loans. Prior to the segregation of the loans, the insolvency administrator of the Savings Bank will collect the cash flows on the Trust Receivables and forward those cash flows to Erste Bank (or – in the case of Erste Bank's insolvency – to the Cover Pool). In return for the surrendered loans or forwarded cash flows, the insolvency estate of the Savings Bank will have a senior unsecured claim against Erste Bank for adequate compensation.

It is Moody's understanding that the insolvency administrator may deduct some fees for the servicing of the Trust Receivables. These fees have been estimated to be in a similar amount of the fees of the cover pool administrator and have been taken into consideration in Moody's analysis. If Erste Bank asks to segregate mortgage loans, the land register needs to be change in order to enable Erste Bank (or – in the case of Erste Bank's insolvency – the cover pool administrator) to enforce – if needed – the security. Erste Bank or – in the case of Erste Bank's insolvency – the Cover Pool, will have to bear the costs for the change in the land register. In case of Trust Receivables for the benefit of the Mortgage Covered Bonds, Moody's has taken this cost also into account when calculating the potential losses for the Mortgage Cover Pool.

***Commingling mitigated via trigger***

Moody's treats the commingling risk for Trust Receivables and cover pool assets from Erste Bank similarly. Similar to the cover pool management on Erste Bank's balance sheet (see sub-section directly above), Moody's understands that there will also be no separate cash management of the Trust Receivables on the Savings Bank's balance sheet from day one. In the case of the Savings Bank's insolvency, the insolvency administrator will have to isolate the cash flows on the Trust Receivables before these can be forwarded to Erste Bank. The potential commingling risk is mitigated through the contractual obligation of the Savings Bank to re-direct all payments on the Trust Receivables to a third-party bank (rated at least **Prime-1** or an equivalent rating) outside the Erste Bank group upon the breach of a certain equity ratio (trigger event).

**No set-off risk for Trust  
Receivables by operation of the  
Austrian Mortgage Bank Act**

Erste Bank receives the transferred loans and will enter these loans into its Cover Pool. Pursuant to the Austrian Mortgage Bank Act, a claim – i.e. a loan – may only be recorded into the cover pool register once the covered bond issuer has notified the claim's debtor of its inclusion in the register and the exclusion of set-off. In the case of mortgage loans, the evidence that the mortgage forms part of Erste Bank's cover pool must be recorded in the land register as well (so-called *Kautionsband*). It is Moody's understanding from legal counsel that no set-off may be exercised by the borrower against the loans recorded in the Cover Pool by the operation of the Austrian Mortgage Bank Act. This applies as well for potential set-off between the Savings Banks and Erste Bank with respect of the Trust Receivables transferred under the agreement.

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