UniCredit Jelzálogbank Mortgage Bonds

Mortgage Covered Bonds / Hungary

Closing Date

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DEFINITIVE RATINGS

Cover Pool	Ordinary Cover Pool Assets	Covered Bonds	Rating
HUF78.5 billion	Residential and Commercial Mortgages	HUF64.9 billion	**Aa3**

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.

TRANSACTION SUMMARY

Moody's has assigned a definitive long-term rating of **Aa3** to the mortgage bonds ("*jelzáloglevél*" or "**Covered Bonds**") issued by UniCredit Jelzálogbank ("**UniCredit Mortgage Bank**" or the "**Issuer**") under the Hungarian Mortgage Bank Act. As of the end of June 2008, the total value of the assets in the Cover Pool, comprising around 9,845 residential mortgage loans, 13 commercial mortgage loans and four government bonds, was approximately HUF78.5 billion. The mortgage loans are secured by properties in Hungary. The residential mortgage loans have a weighted-average seasoning of 49 months, a weighted-average remaining term of 145 months and a weighted-average loan-to-value (LTV) of 36.2%.

The rating takes into account the following factors:

1) The credit strength of the Issuer
2) The credit quality of the pool of assets (the "**Cover Pool**") securing the payment obligations under the Covered Bonds in an insolvency scenario of the Issuer.
3) The Hungarian legal framework for Covered Bonds: Under the terms of the Hungarian Mortgage Bank Act, the Issuer is regulated and supervised by the Financial Supervisory Authority of Hungary (*Pénzügyi Szervezetek Állami Felügyelete*; "PSZÁF" or "HFSA").
4) Moody's relies on 8.5% uncommitted over-collateralisation on a nominal basis.

Moody's has relied on "uncommitted" over-collateralisation over and above that required by the Hungarian covered bond legislation when assigning the ratings for UniCredit Mortgage Bank's Covered Bonds. However, Moody's notes that if the Issuer's credit quality deteriorates below a certain threshold, it would remove from its analysis the benefit of any over-collateralisation that was not "committed".

Moody's considers this transaction, like all existing Covered Bonds, to be linked to the credit strength of the Issuer, particularly from a default probability perspective. If the Issuer's credit strength deteriorates, all other things being equal, the rating of the covered bonds might come under pressure.

If the Issuer's rating or the pool quality deteriorates, the Issuer 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 under these circumstances could lead to negative rating actions.

The principal methodologies used in rating the transaction were "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. All can be found on www.moodys.com in the Credit Policy & Methodologies directory, within the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Credit Policy & Methodologies directory.

OPINION

Strengths of the Transaction

– **Issuer:** The Covered Bondholders have a direct claim against UniCredit Mortgage Bank, a specialised financial institution under Hungarian law and regulated by the HFSA. UniCredit Mortgage Bank is a 100% owned subsidiary of UniCredit Bank Hungary, which is a 100% subsidiary of UniCredit Bank Austria AG (rated **Aa2**).

– **The Hungarian Mortgage Bank Act:** The Covered Bonds were issued in accordance with the Hungarian Mortgage Bank Act, which explicitly protects the status of the Covered Bondholders. The Hungarian covered bond legislation has a number of strengths, including, *inter alia,* the following:

- Under the terms of the Hungarian legislation, the Issuer is regulated and supervised by the HFSA.
- Covered Bonds are secured by a separated pool of assets (the Cover Pool), which are subject to conservative eligibility criteria. In general, mortgage loans over Hungarian properties and over certain properties located in other member states of the European Economic Area are eligible assets. Covered Bonds can only be issued against the exposure held by the Issuer and within the first 70% of the lending value of the residential mortgages and 60% of the lending value of commercial mortgages.
- According to the law, the nominal value of the cover pool assets has to exceed the nominal value of all outstanding Covered Bonds at all times. Similarly, the net present value (NPV) of the cover pool asset has to exceed the NPV of the outstanding Covered Bonds.
- Upon declaration of insolvency of the Mortgage Bank a Credit Institution Liquidator Public Company (*Hitelintézeti Felszámoló kht* or Liquidator) will assume management responsibility of the Mortgage Bank as a whole, including the Cover Pool and outstanding Covered Bonds. To ensure that claims from Covered Bondholders and other privileged creditors (such as swap-counterparties, for example, if the derivative is registered into the Cover Pool) the competent court will also appoint another natural person from the Credit Institution Liquidator Public Company, who will be responsible for payments on the outstanding Covered Bonds and the management of the cover pool assets ("Cover Pool Administrator").
- An independent cover pool monitor will monitor various operations with respect to the Cover Pool on a day-to-day basis.

– **Credit Quality of the Cover Pool:** The Covered Bond claims are secured by a pool of loans. The majority of these loans are backed by residential mortgages originated by the Issuer or its Financial Partners in Hungary. Some commercial mortgage loans as well as some Hungarian government bonds also form part of the Cover Pool. The quality of the collateral is exemplified by its collateral score of around 20.1%. In more detail, some important features of the Cover Pool are:

- Moody's relies on 8.5% uncommitted over-collateralisation on a nominal basis.
- The vast majority of the mortgage loans were performing as of the end of June 2008. Only around 0.2% of the residential mortgage loans are in arrears (≥2 months). All of the commercial mortgage loans were performing as of June 2008.

- The weighted-average LTV of the residential mortgage loans in the Cover Pool is 36.2%, which is low compared to other cover pools based on residential mortgages in Europe. The weighted-average LTV for the commercial mortgages is currently 39.3%.
- Moody's understands that within its standard underwriting process the Issuer stresses the payments for any loan when determining whether a borrower will be able to afford to make required payments on the loan.

– **Refinancing Risk**. If there is an Issuer Default[1], Moody's understands from a legal advisor that the appointed Cover Pool Administrator will have access to the cash flows of the cover pool assets and certain liquid assets on the balance sheet of the Mortgage Bank. The Cover Pool Administrator also has the ability to transfer the Cover Pool together with the Covered Bonds or sell the cover pool assets. Moody's has taken this into consideration for its Timely Payment Indicator (TPI) analysis. In addition, the margins earned on the residential mortgage loans in the Cover Pool are above the average margin for this asset class in European covered bond transactions rated by Moody's.

– **Market Risk:** On an NPV basis, the value of the Cover Pool assets has to match the value of the outstanding Covered Bonds.

– **Linkage:** Following an Issuer Default, to ensure the claims from Covered Bondholders, the competent court will also appoint another natural person from the Credit Institution Liquidator Public Company, who will be responsible for payments on the outstanding Covered Bonds and the management of the cover pool assets ("Cover Pool Administrator").

Weaknesses and Mitigants

– **Issuer:** As with most covered bonds, up until an Issuer Default the Issuer can materially change the nature of the programme. For example, new assets may be added to the Cover Pool, new bonds issued with varying promises and new hedging arrangements entered into. These changes could impact the credit quality of the Cover Pool, refinancing risk and market risks. **Mitigant:** The Covered Bondholders have a direct claim on the Issuer. Although the Issuer is not publicly rated, Moody's has a private monitored rating for the Issuer.

– **Credit Quality of the Cover Pool**:

- As of June 2008, the Cover Pool comprised loans secured by properties in Hungary. Around 30% of the mortgage loans have a variable rate and around 37.4% of the residential mortgage loans are denominated in a non-HUF currency. **Mitigants:** Moody's collateral score model takes into account *inter alia* the impact of concentration on borrower, regional and country levels as well as the payment profile of the loans.
- As in most covered bond programmes there are few restrictions on the future composition of the Cover Pool and hence substitution risk exists. **Mitigants:** The quality of the Cover Pool, over time, will be protected by, among others, the requirements of the Hungarian Mortgage Bank Act. This act sets out rules detailing which assets qualify as cover assets for Mortgage Covered Bonds in Hungary. In addition, Moody's will monitor the Cover Pool. If the quality of the collateral deteriorates below a certain threshold, the Issuer 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.
- Moody's has received some but only limited information on mortgage loans from Financial Partners, which serve as security for the loans to these Financial Partners. **Mitigants:** (i) Moody's understands that if a mortgage loan is non-performing the Financial Partners have the obligation to repurchase the independent liens of that non-performing loan; and (ii) where information has not been provided, Moody's has accordingly penalised its credit risk analysis.

[1] Issuer Default is defined as the removal from the Cover Pool of (i) support provided by entities within the Issuer group, (ii) ancillary activities of the Issuer group (i.e. those not related to the Cover Pool) and (iii) usually, management functions of the Issuer.

  - In a scenario where both the Issuer and its Financial Partner are insolvent, Moody's understands from a legal advisor that Covered Bondholders might be exposed to general deposit set-off. **Mitigant:** Moody's has received information on the potential amount of these risks and has taken these risks into account within its analysis.

- **Refinancing risk:** Following an Issuer 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 an Issuer Default the market value of these assets may be subject to substantial volatility. In this context, Moody's assesses, for example, the fact that 37.4% of the residential mortgage loans in the Cover Pool are not denominated in HUF as negative. **Mitigants:** (i) The credit strength of the Issuer. The higher the rating of the Issuer the lower the chances of being exposed to this risk; and (ii) The stressed refinance margins applied.
- **Market risk:** As with most European covered bonds, there is potential for market risks. For example, following an Issuer 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 as of June 2008. **Mitigants:** (i) The requirement that the value of the Cover Pool has to exceed the NPV of the total of outstanding Covered Bonds issued. (ii) Moody's has taken into consideration these risks in its analysis, for example, Moody's has assumed a currency gap of 20% in its calculations.
- **Time Subordination**: After Issuer Default, if several Covered Bonds with differing maturities have been issued, the 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 before later-maturing Covered Bonds. This could lead to over-collateralisation being eroded before any payments are made to later-paying Covered Bonds.

STRUCTURE SUMMARY

Issuer:	UniCredit Jelzálogbank
Sponsor Bank:	UniCredit Jelzálogbank
Structure Type:	Mortgage Securities or "*jelzáloglevél*"
Issued under Covered Bonds Law:	Yes
Applicable Covered Bonds Law:	Hungarian Mortgage Bank Act
Main Originators:	UniCredit Jelzálogbank and UniCredit Bank Hungary
Main Servicers:	UniCredit Jelzálogbank and UniCredit Bank Hungary
Intra group Swap Provider:	No
Monitoring of Cover Pool:	Yes, a cover pool monitor is mandatory by operation of the Hungarian Mortgage Bank Act (in the case of UniCredit Jelzálogbank an external audit firm)
Trustees:	No
Timely Payment Indicator	The Issuer is not publicly rated by Moody's. Therefore this information has not been disclosed.

COVERED BONDS SUMMARY

Total Covered bonds Outstanding	HUF64.9 billion
Currency of covered bonds:	HUF (94.5%) and euro (5.5%), other currencies might also be used for issuance
Extended Refinance Period:	No
Principal Payment Type	Hard bullet
Interest Rate Type:	Fixed-rate coupons (77.6%) and floating-rate coupons (22.4%)

COLLATERAL SUMMARY

Size of Cover Pool:	HUF78.5 billion
Main collateral type in Cover Pool:	Residential Mortgages (60.7%), commercial mortgages (22.6%) and government bonds (16.7%)
Main Asset Location:	Hungary (100%)
Loans Count:	9,845 (residential), 13 (commercial), 4 (public-sector)
Currency:	HUF (77.6%), euro (22.4%) and CHF (<0.01%)
WA Current LTV (unindexed):	36.2% (residential), 39.3% (commercial)
WA Seasoning:	49 months (residential), 32 months (commercial)
WA Remaining Term:	145 months (residential), 36 months (commercial)
Interest Rate Type:	Fixed-rate loans (74.9%) and floating-rate coupons (25.1%)
"Committed" Over Collateralisation:	0% (by operation of the Hungarian Mortgage Bank Act)
Collateral Score:	20.1%
Further details:	See Appendix 1
Pool Cut-off Date:	30 June 2008

STRUCTURAL AND LEGAL ASPECTS

Mortgage Bonds are governed by the Hungarian Mortgage Bank Act

UniCredit Jelzálogbank's Mortgage Bonds are governed by the Hungarian Mortgage Bank Act. No structural feature outside the Hungarian Mortgage Bank Act is envisaged by the Issuer. UniCredit Jelzálogbank is using mortgage loans from its own balance sheet as well as claims against Financial Partners as eligible assets for its Cover Pool.

The Mortgage Bank Act allows Mortgage Banks to provide financing for the mortgage lending business of Financial Partners. In this case, the relevant mortgage loans are serviced by the Financial Partner and remain on its balance sheet. The Financial Partners are obliged to set up procedures to determine Lending Value according to the Mortgage Bank Act, which is important to determine the eligible part of the loan for the mandatory cover test.

Moody's understands that loans originated by a Financial Partner which become non-performing, have to be bought back by it at par value (plus accrued interests and costs). If a Financial Partner defaults while some of its loans are registered in a Cover Pool, the relevant mortgages are transferred to the Mortgage Bank which finances them.

There is a more detailed description of the general legal framework in Appendix 3.

MOODY'S RATING METHODOLOGY

Moody's covered bond rating methodology (Moody's Rating Approach to European Covered Bonds, published 13 June 2005) details the approach used for rating covered bond transactions. The main premise is that until Issuer Default, the Covered Bond obligations are sufficiently supported by the Issuer. After Issuer Default, the Programme will only rely on the quality of the Cover Pool, including if applicable the swaps to the extent they have survived. The impact of the credit strength of the Issuer and the quality of the Cover Pool are analysed below.

Credit Strength of the Issuer

The Covered Bondholders benefit from a direct claim against the Issuer

The Covered Bonds are full recourse to the Issuer. To assess the default probability for the Issuer, the credit strength of UniCredit Jelzálogbank has been analysed and will be monitored by Moody's.

UniCredit Jelzálogbank was established in 1998. UniCredit Mortgage Bank is a 100% owned subsidiary of UniCredit Bank Hungary, which is a 100% subsidiary of UniCredit Bank Austria AG (rated **Aa2**).

The Issuer carries out its activity as a specialised credit institution under Hungarian law, with a focus on the domestic residential mortgage business. The Hungarian Financial Services Authority issued the operating licence for the Issuer to operate as a mortgage bank.

The Credit Quality of the Cover Pool

The Cover Pool comprises loans backed by Hungarian residential and commercial mortgages

Mortgage loans are originated either directly from UniCredit Jelzálogbank's or from its Financial Partners. Moody's understands that UniCredit Mortgage Bank mainly uses brokers to originate new loans. Moody's was provided with good quality information on the Cover Pool assets. As of June 2008, around 60.7% of the cover pool assets were residential mortgage loans and 22.6% were commercial mortgage loans. All the mortgage loans are secured by properties in Hungary. The remaining 16.7% of the cover pool assets are so-called Supplementary Cover, which are Hungarian government bonds. The quality of the collateral is exemplified by its Collateral Score[2].

[2] 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.

Residential Mortgages

The weighted-average LTV of the residential mortgage loans in the Cover Pool is 36.2%, based on the lending value of the property. This is below both the average LTV for other Hungarian and also European transactions. The LTV is one of the parameters driving the Collateral Score. For further information, see Appendix 1 for a summary of the Cover Pool, and Appendix 2 for income underwriting and valuation of the Issuer.

Stressed affordability test in case of applicants in own mortgage book

Positive characteristics of the credit quality of the Cover Pool include:

- The weighted-average LTV of the Cover Pool is 36.2%. LTV calculations are based on a lending value (which may not exceed the market value of the property).
- As per the Hungarian Mortgage Bank Act, Covered Bonds can only be issued against the exposure held by the Issuer and within the first 70% of the lending value of the residential mortgages.
- Every property financed has been individually valued by either an internal or external appraisal based on UniCredit Mortgage Bank's own valuation guideline. By law this guideline has to be approved by HFSA. Moody's understands that in general the properties were inspected when the valuation was done i.e. as a rule at the time of loan origination. As a rule and in line with the requirements of the Hungarian legislation and Issuer's valuation guidelines, Moody's understands that these valuers are independent from the credit decision.
- The vast majority of the mortgage loans are performing and were not in arrears as of June 2008.
- All the residential mortgage loans have an average seasoning of around 49 months.
- As part of its underwriting procedure, UniCredit Jelzálogbank and UniCredit Bank Hungary run an affordability test for applicants of a mortgage loan, and apply a stressed payment level when testing the affordability of the loan for the borrowers. Moody's understands that further stressed payment scenarios apply for loans, which are non-HUF-denominated.
- For loans originated by UniCredit Mortgage Bank, the interest and principal payments on all loans in the Cover Pool are monthly, and the majority of the borrowers are employed.
- Around 0.5% of the residential mortgage loans benefit from a guarantee by the Hungarian government (so-called surety). The beneficiaries of these state-guaranteed loans are for example public servants, civil servants, employees of armed forces or young first-time buyers.
- Moody's understands that loans originated by a Financial Partner which become non-performing, have to be bought back by it at par value (plus accrued interest and costs).

Limited income verification for most of the loans

Negative characteristics of the credit quality of the Cover Pool include:

- Moody's understands that at the time of granting the loan, the Issuer asks the borrower to state its income, but UniCredit Mortgage Bank does not verify the information provided by the applicant in the vast majority of the cases.
- Moody's did not receive information on the occupancy type of the properties. We have accordingly penalised this risk in our analysis of the credit risks. Moody's also understands from discussions with market participants that the vast majority of the mortgage loans are to borrowers with owner-occupied properties.
- Moody's has received only limited information on the mortgage loans from Financial Partners, which serve as security for the loans to these Financial Partners. Moody's has accordingly penalised in its analysis on the credit risks when the information has not been provided.
- Around 3.1% of UniCredit Jelzálogbank's residential mortgage loans in the Cover Pool are in arrears (because loans originated by UniCredit Jelzálogbank account for just around 10% of the Cover Pool, this translates into around 0.4% of all mortgage loans in the Cover Pool). Around 1.5% of UniCredit Jelzálogbank's (or 0.2% in total) mortgage loans in the Cover Pool are in arrears by more than two months.
- There is some geographical concentration in the metropolitan area of Budapest.

- In a scenario where both the Issuer and its Financial Partners were insolvent, Moody's understands from a legal advisor that Covered Bondholders might be exposed to general deposit set-off (for more information please refer to appendix 3). Moody's has received information on the potential amount of these risks and has taken these risks into account within its analysis.

Scoring model is used to assess credit quality of residential mortgages in the Cover Pool

The above-mentioned factors have been incorporated into Moody's analysis. Moody's calculates a Collateral Score based on the characteristics of the residential loan pool using a scoring model in order to assess the credit quality of this portion of the Cover Pool.

Commercial Mortgages

Low weighted average LTV

Positive characteristics of the credit quality of the Cover Pool include:

- The weighted-average LTV of the Cover Pool is 39.3%. LTV calculations are based on a lending value (which may not exceed the market value of the property).
- As per the Hungarian Mortgage Bank Act, Covered Bonds can only be issued against the exposure held by the Issuer and within the first 60% of the lending value of the commercial mortgages.
- Every property financed has been individually valued by either an internal or external appraisal based on UniCredit Mortgage Bank's own valuation guideline. By law this guideline has to be approved by HFSA. Moody's understands that in general the properties were inspected when the valuation was done i.e. as a rule at the time of loan origination. As a rule and in line with the requirements of the Hungarian legislation and Issuer's valuation guidelines, Moody's understands that these valuers are independent from the credit decision.
- All the commercial mortgage loans are performing and were not in arrears as of June 2008.
- The majority of the loans (by loan volume 58% of the commercial mortgage loans) are secured by office buildings.

Material borrower concentration

Negative characteristics of the credit quality of the Cover Pool include:

- The proportion of commercial mortgage loans in the Cover Pool only consists of claims against 11 borrowers, which are secured by 30 different properties. This adds material borrower concentration to the Cover Pool.
- Some exposures (42% of the commercial mortgage loans by loan volume) are secured with hotels or industrial sides, which in Moody's assessment are more risky than offices or retail buildings.
- Geographical concentration: all loans are secured by properties in Hungary. The majority of these properties are concentrated in the metropolitan area of Budapest (80.7% of the commercial mortgage loans by loan volume).

Monte Carlo simulation is used to assess credit quality of commercial mortgages in the Cover Pool

These factors have been incorporated into Moody's analysis. Moody's calculates a Collateral Score based on the characteristics of the commercial portion of the pool using a Monte Carlo simulation approach to assess the credit quality of this portion of the Cover Pool. Moody's commercial calculator takes into account *inter alia* the impact of concentration on borrower, regional and country levels as well as the different types of properties securing the loan.

Summary

The Collateral Score of 20.1% reflects the good credit quality of the Cover Pool

These factors have been incorporated into Moody's analysis of the credit quality of the Cover Pool. The credit quality of the Cover Pool is measured by a "Collateral Score" – the lower the Collateral Score, the better the credit quality of the Cover Pool. For this transaction the Collateral Score is 20.1%. This is above the average Collateral Score for European mortgage covered bond deals rated by Moody's.

As with most Covered Bond programmes, there are few restrictions on the future composition of the Cover Pool and this may create substitution risk. There is no assurance that the credit quality of the Cover Pool will not deteriorate over time as new assets are added. Mitigants to substitution risk include:

Substitution risks are mitigated by the Hungarian covered bond legislation

- Requirements of the Hungarian covered bond legislation.
- The Cover Pool composition will be monitored.

If the quality of the collateral deteriorates below a certain threshold, the Issuer would have the ability, but not the obligation, to increase the over-collateralisation in the Cover Pool to support the current rating. If additional over-collateralisation is not added following a marked deterioration of the collateral, this could lead to a negative rating action.

For further information on the credit quality of the Cover Pool and income underwriting and valuation standards, see Appendix 1 and 2.

Refinancing Risk

Following Issuer Default, where 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 an Issuer Default, the market value of these assets may be subject to substantial volatility. Examples of the stressed refinance margins used by Moody’s for different types of prime quality assets are published in Moody’s methodology. An update on the stressed refinance margins used has been published in February 2008 (please see Related Research: “Moody’s Rating Approach to European Covered Bonds”, published in June 2005 and Press Release: “Moody’s announces update of covered bond refinance stresses following credit crisis”, published in February 2008).

Cover Pool Administrator has also access to certain liquid assets outside the Cover Pool

Aspects specific to this programme that are refinancing positive include:

- Hungarian Mortgage Bank Act:
  - The Cover Pool Administrator has the ability to transfer the whole or parts of the Cover Pool together with the Covered Bonds or sell the cover pool assets to raise funds.
  - Moody’s understands from legal council that the Cover Pool Administrator may have – in addition to the cash flows stemming from the cover pool assets – also access to certain liquid assets on the balance sheet of the mortgage bank. This is specified by the Hungarian legislation.
  - The mandatory NPV test.
- Moody’s understands, that during the entire life of the loan, an administrator of the Cover Pool may be able to change the rate charged (including the margin) to the underlying borrowers for some of at least the variable-rate loans in the Cover Pool within 12 months. For subsidised loans, the rates are defined by either one of the three applicable subsidy schemes for residential mortgage loans, which are governed by Hungarian law.
- Margins earned on the residential mortgage loans in the Cover Pool are above the average margin for this asset class in European covered bond transactions rated by Moody’s.

All Covered Bonds have a bullet repayment

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. There is also some currency mismatch between cover pool assets and outstanding Covered Bonds.
- Credit quality of the cover pool assets:
  - The credit quality of the Cover Pool, which is reflected in the Collateral Score. The lower the credit quality of the Cover Pool, the higher the expected write-off for losses upon Issuer Default and hence the higher the refinancing margins, which will be applied for these loans. The Collateral Score for this transaction is broadly in line with the other Hungarian covered bond transactions rated by Moody’s, but the Collateral Score is higher compared to the average Collateral Score of other European covered bond markets.
  - For the majority of the residential mortgage loans, which have been underwritten by UniCredit Mortgage Bank, Moody’s understands that the income of the borrowers has not been verified.

– There are commercial mortgage loans in the Cover Pool (22.6% of the total cover pool assets), which attract a higher refinancing stress in Moody's assessment compared to residential mortgages and public-sector debt.

– There are some subsidised loans in the Cover Pool, where the largest part of the margin is stemming from this state subsidiary. If these loans have to be sold, only other Hungarian mortgage banks are eligible for such subsidies i.e. the potential market for such loans is currently limited to two other Hungarian mortgage banks.

Market Risk

Potential market risks upon Issuer Default

As with the majority of European covered bonds, there is potential for market risks. For example, following Issuer Default, Covered Bondholders may be exposed to interest rate risk, which could arise from the different payment promises and durations made on the Cover Pool and the Covered Bonds.

Following Issuer 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:
Overview Assets and Liabilities

	Assets (%)	Liabilities (%)	WAL assets (years)	WAL liabilities (years)
Fixed rate	74.9	77.6	7.1	2.2
Variable rate	25.1	22.4	3.0	2.2

WAL = weighted-average life

As of the date of this report UniCredit Jelzálogbank has not included any swap or derivative into its Cover Pool.

Mandatory NPV test

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. Moody's understands that UniCredit Mortgage Bank is running an internal stress test in addition to the requirements by law, to ensure NPV coverage in more stressed scenarios.

– Currently around 22% of the liabilities and 25% of the cover pool assets have a variable rate.

Currency mismatch of 20% assumed in Moody's calculations

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

– There is some currency risk as of June 2008. Moody's has modelled a 20% currency mismatch in its calculations.

– Around 75% of the cover pool assets have a fixed rate and have a longer weighted-average life compared to the fixed rate covered bonds outstanding.

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 could potentially lead to a crystallisation of interest rate losses. Interest rate risk is partially mitigated by the mandatory NPV test.

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

LINKAGE

All Covered Bonds are linked to the Issuer

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

– Refinancing risk: Following Issuer 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 Issuer has defaulted may negatively impact the ability to raise funds against the Cover Pool.

- The programme is exposed to the choices of the Issuer. For example, prior to Issuer Default, the Issuer 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 Issuer in the Moody's rating method.

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

TPIs assess the likelihood that a timely payment will be made

Moody's TPIs[3] assess the likelihood that timely payments will be made to Covered Bondholders following Issuer 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 a 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:

- Hungarian Mortgage Bank Act, including:
  - Upon declaration of insolvency of the Mortgage Bank a Credit Institution Liquidator Public Company ("*Hitelintézeti Felszámoló kht.*" or "Liquidator") will assume management responsibility of the Mortgage Bank as a whole, including the Cover Pool and outstanding Covered Bonds. To ensure that claims from Covered Bondholders and other privileged creditors (such as for example swap-counterparties, if the derivative is registered into the Cover Pool) the competent court will also appoint another natural person from the Credit Institution Liquidator Public Company, who will be responsible for payments on the outstanding Covered Bonds and the management of the cover pool assets ("Cover Pool Administrator").
  - The ability of the Cover Pool Administrator to sell all or parts of the cover pool assets or to transfer the Cover Pool together with the Covered Bonds to another Mortgage Bank.
  - Moody's understands from legal council that the Cover Pool Administrator may – in addition to the cash flows stemming from the cover pool assets – also have access to certain liquid assets on the balance sheet of the mortgage bank. This is specified by the Hungarian legislation. Moody's also understands that the Cover Pool Administrator may use all cash flows from cover pool assets to meet payments on outstanding Covered Bonds, including also the "ineligible" part of a mortgage loan (i.e. the part above the relevant LTV threshold).
- UniCredit Mortgage Bank is a specialised financial institution, which does not take deposits from its clients. This effectively mitigates deposit set-off risk for loans directly from UniCredit Mortgage Bank to borrowers.
- Moody's understands that during the entire life of the loan, an administrator of the Cover Pool may be able to change the rate charged (including the margin) to the underlying borrowers for some of at least the variable-rate loans in the Cover Pool within 12 month.

All Covered Bonds have a bullet repayment

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.
- There are currently some currency mismatches between cover pool assets and outstanding Covered Bonds.
- Commingling risk: Upon the appointment of the Cover Pool Administrator, it is Moody's understanding that the Cover Pool Administrator 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 Issuer before payment is made to Covered Bondholders.

[3] See Moody's Rating Methodology: "Timely Payment in Covered Bonds following Sponsor Bank Default" published in March 2008.

– Set-off: Moody’s understands that the Covered Bondholders might be exposed to set-off risk, if both the Financial Partner and the Mortgage Bank are insolvent at the same time (for more details please refer to Appendix 3 of this report).
– Some weaknesses concerning the quality of the Cover Pool assets, which arguably might make it more difficult to sell the loans in a stressed market environment and in a limited timeframe, including the following: Moody’s understands that for the majority of the loans originated by UniCredit Mortgage Bank the income of the borrowers has not been verified.

The Issuer is not publicly rated by Moody’s. Therefore the TPI for this transaction has not been disclosed.

MONITORING

The Issuer is expected to deliver certain performance data to Moody’s on an ongoing basis. If this data is not made available to Moody’s, its 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 Covered Bonds or Notes.

RELATED RESEARCH

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

– Assessing Swaps as Hedges in the Covered Bond Market, September 2008, (SF142765)
– Timely Payment in Covered Bonds following Sponsor Bank Default, March 2008 (SF109992)
– Moody’s Rating Approach to European Covered Bonds, German Translation, July 2005 (SF58550)
– Moody’s Rating Approach to European Covered Bonds, June 2005 (SF57011)

Special Reports

– EMEA Covered Bonds 2008 Review & 2009: Refinancing Risk Comes to the Fore, January 2009 (SF152665)
– EMEA Structured Finance Asset Performance Outlooks, September 2008 (SF140664)
– A Framework For Stressing House Prices In RMBS Transactions in EMEA, July 2008 (SF131751)
– European Covered Bond Legal Frameworks: Moody’s Legal Checklist, German Translation, January 2006 (SF67969)
– European Covered Bond Legal Frameworks: Moody’s Legal Checklist, December 2005 (SF66418)

Announcement

– Moody’s announces update of covered bond refinance stresses following credit crisis, 29 February 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.

Residential Assets (UniCredit Mortgage Bank)

Overview	
Collateral Score:	–
Asset balance:	7,590,172,805
Average loan balance:	5,767,609
Number of loans:	1,316
Number of borrowers:	1,170
Number of properties:	752
WA Remaining Term (in months):	144
WA Seasoning (in months):	53

Details on LTV	
WA current LTV (*):	37.8%
WA Indexed LTV:	n/a
Valuation type:	Lending Value
LTV threshold:	70%
Junior ranks:	n/d
Prior ranks:	0.0%

Specific Loan and Borrower characteristics	
Loans benefiting from a guarantee:	0.3%
Interest Only Loans:	0.0%
Loans for second homes / Vacation:	0.0%
Buy to Let loans / Non owner occupied properties:	0.0%
Limited income verified	0.0%
Adverse Credit Characteristics(**):	0.5%

Performance	
Loans in arrears (≥ 2months - < 6months):	1.3%
Loans in arrears (≥ 6months - < 12months):	0.0%
Loans in arrears (> 12months):	0.2%
Loans in a foreclosure procedure:	0.0%

Multi-Family Properties	
Loans to tenants of tenant-owned Housing Cooperatives:	0.0%
Other type of Multi-Family loans (****)	0.0%

(*) Based on original property valuation (lending value)
(**) Refers to Borrowers with previous missed payments, Borrowers with a previous personal bankruptcy or Borrowers with record of court claims against them at time of origination
(***) n/d : information not disclosed by Issuer
(****) This "other" type refers to loans directly to Housing Cooperatives and to Professional Landlords

Chart A:
Balance per LTV-band

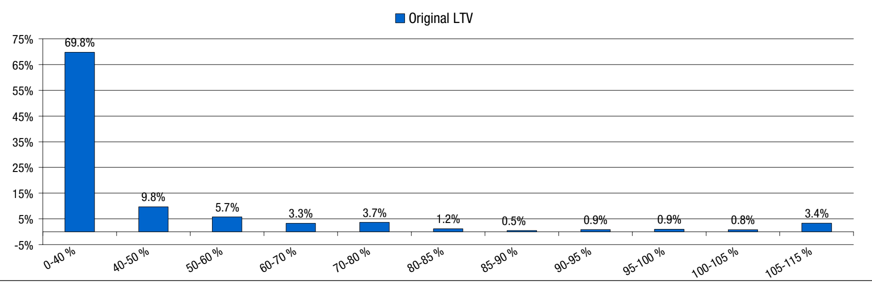


Chart B:
Cover Pool Composition

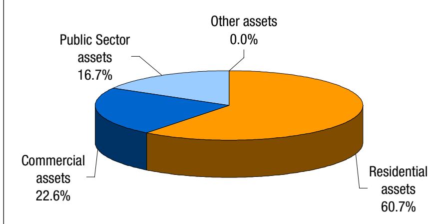


Chart C:
Seasoning

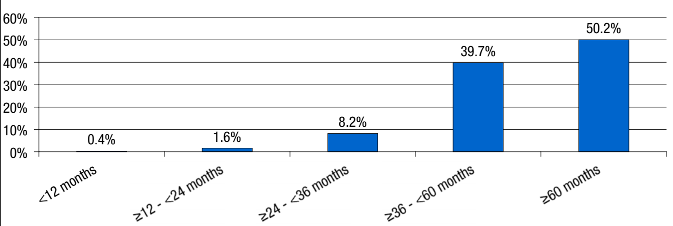


Chart D:
Interest Rate Type

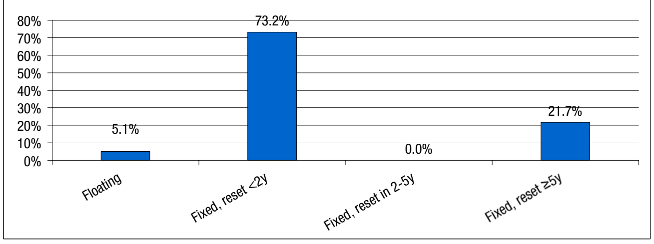
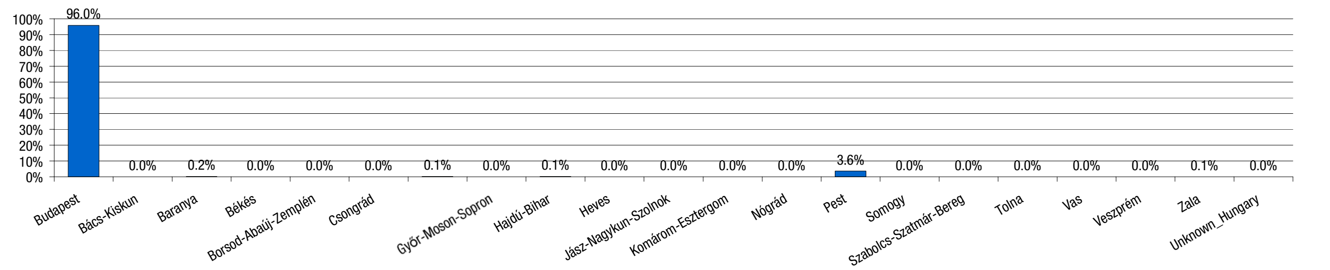


Chart E:
Regional Distribution



Residential Assets (Financial Partner)

Overview	
Collateral Score:	–
Asset balance:	39,508,393,278
Average loan balance:	4,632,242
Number of loans:	8,529
Number of borrowers:	n/d
Number of properties:	9,901
WA Remaining Term (in months):	145
WA Seasoning (in months):	48

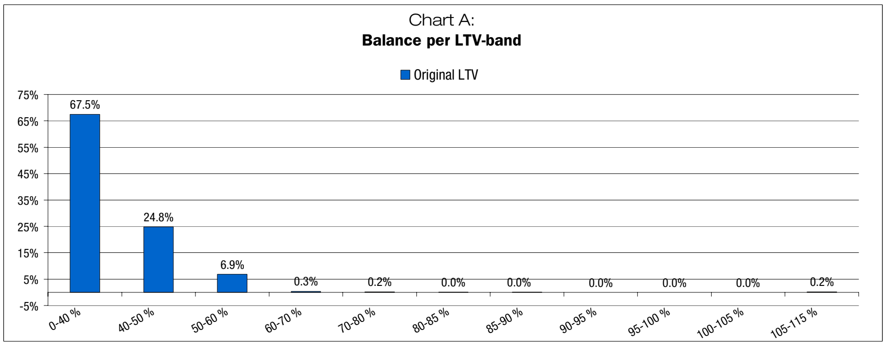
Details on LTV	
WA current LTV (*):	35.9%
WA Indexed LTV:	–
Valuation type:	Lending Value
LTV threshold:	70%
Junior ranks:	n/d
Prior ranks:	n/d

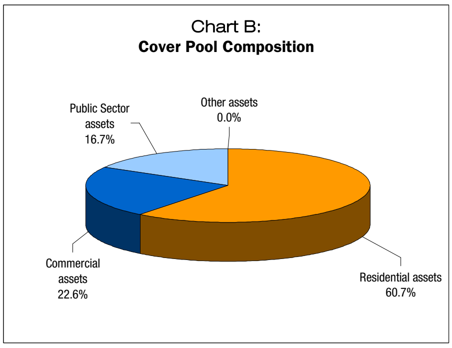
Specific Loan and Borrower characteristics	
Loans benefiting from a guarantee:	0.6%
Interest Only Loans:	n/d
Loans for second homes / Vacation:	n/d
Buy to Let loans / Non owner occupied properties:	n/d
Limited income verified	n/d
Adverse Credit Characteristics(**):	n/d

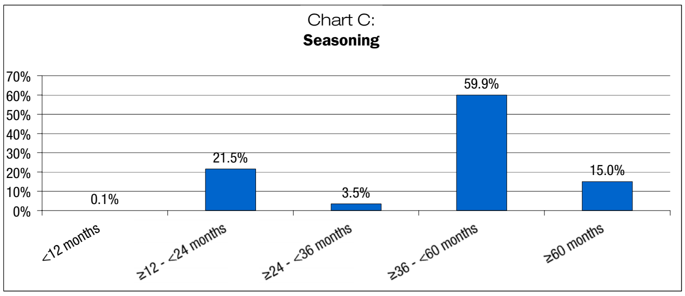
Performance	
Loans in arrears (≥ 2months - < 6months):	n/d
Loans in arrears (≥ 6months - < 12months):	n/d
Loans in arrears (> 12months):	n/d
Loans in a foreclosure procedure:	n/d

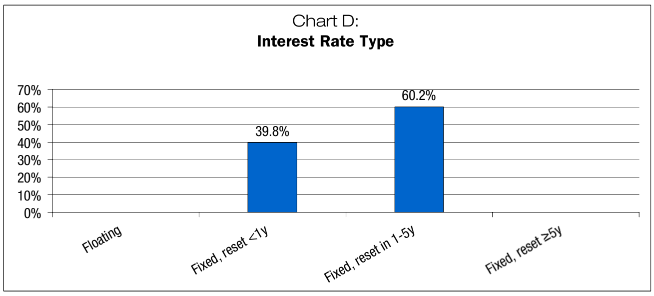
Multi-Family Properties	
Loans to tenants of tenant-owned Housing Cooperatives:	n/d
Other type of Multi-Family loans (****)	n/d

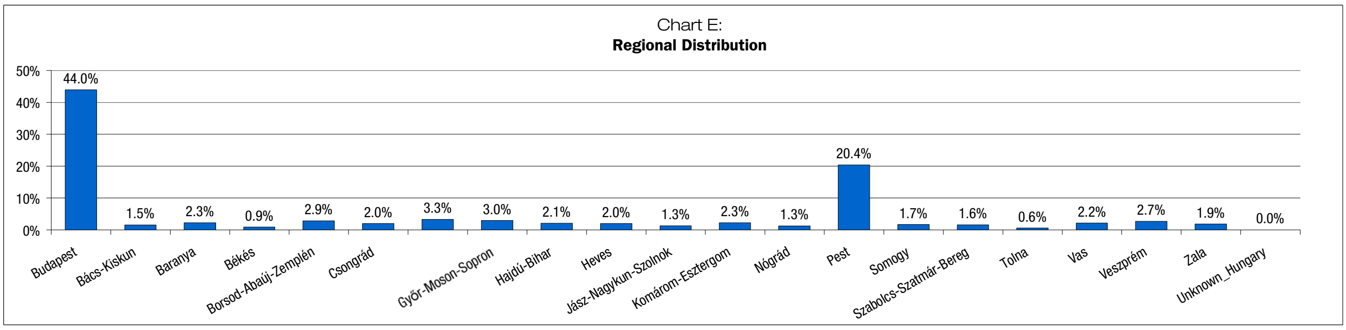
(*) Based on original property valuation (lending value)
(**) Refers to Borrowers with previous missed payments, Borrowers with a previous personal bankruptcy or Borrowers with record of court claims against them at time of origination
(***) n/d : information not disclosed by Issuer
(****) This "other" type refers to loans directly to Housing Cooperatives and to Professional Landlords











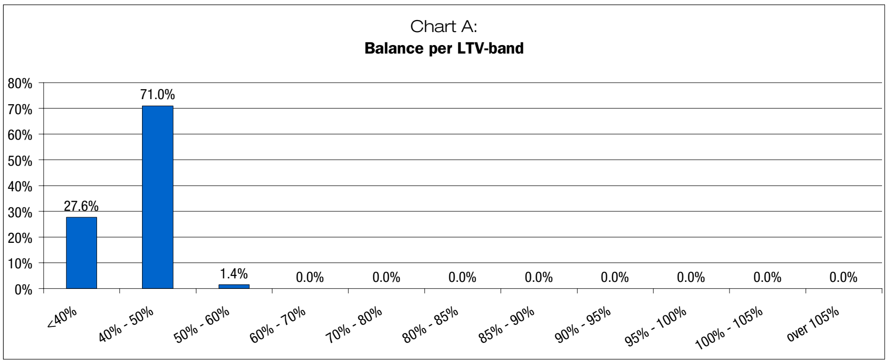
Commercial Assets

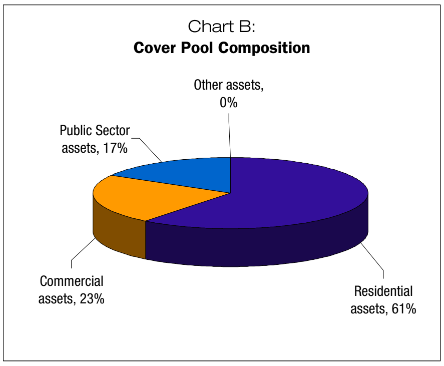
Overview	
Collateral Score:	–
Asset balance:	17,538,738,049
Average loan balance:	1,349,133,696
Number of loans:	13
Number of borrowers:	11
Number of properties:	30
Largest 10 loans:	97.9%
Largest 10 borrowers (commercial pool):	99.7%
WA Remaining Term (in months):	36
WA Seasoning (in months):	32
Main Countries:	Hungary

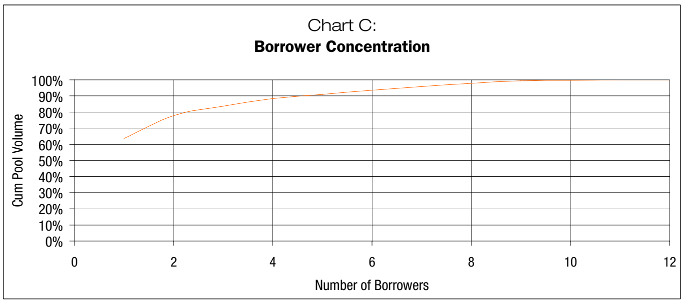
(*) Based on original property valuation

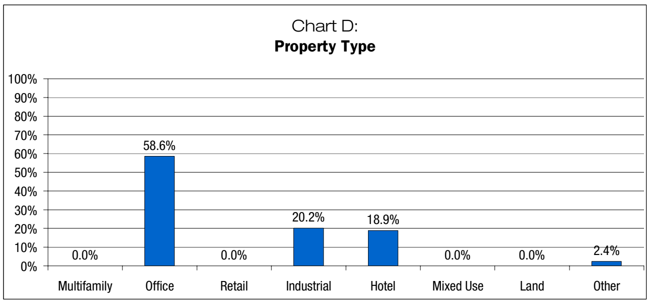
(**) n/d : information not disclosed by Issuer

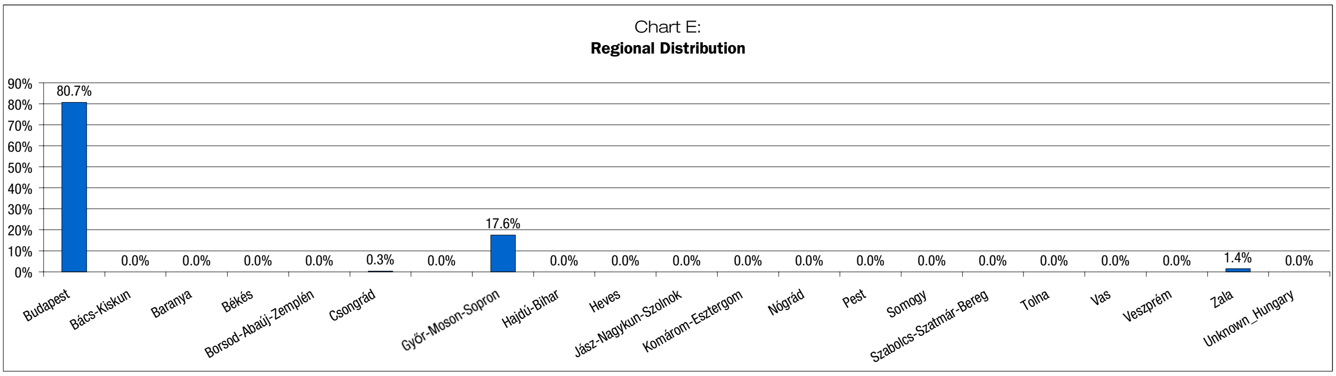
Specific Loan and Borrower characteristics	
Bullet loans:	69.8%
Loans in non-domestic currency:	0.0%
Main Interest Rate Type: variable rate	100.0%
Performance	
Loans in arrears (≥ 2months - < 6months):	0.0%
Loans in arrears (≥ 6months - < 12months):	0.0%
Loans in arrears (> 12months):	0.0%
Loans in a foreclosure procedure:	0.0%
Details on LTV	
WA current LTV (*):	39.3%
WA Indexed LTV:	n/a
Valuation type:	Lending Value
LTV Threshold:	60.0%
Junior ranks:	n/d
Prior ranks:	n/d











Qualitative Collateral Information

All pool characteristics are actual levels (rather than assumed levels) based on reports from UniCredit Mortgage Bank.

Moody's understands that LTV numbers reported are based on the Lending Value according to the UniCredit Mortgage Bank's internal regulations, which have been approved by HFSA.

Charts D in the overviews for the residential assets (pages 14-15) show the data based on the original term (time to re-set) of the loan.

APPENDIX 2: INCOME UNDERWRITING AND VALUATION

1. Income Underwriting

1.1	Is income always checked?	No.
1.2	Does this check ever rely on income stated by borrower ("limited income verification")?	Yes
1.3	Percentage of loans in Cover Pool that have limited income verification	90% of the new business originated by UniCredit Bank Hungary or UniCredit Mortgage Bank
1.4	If limited income verification loans are in the Cover Pool, describe what requirements lender has in place for these loans.	LTV may not exceed 80% (70% in case the loan is not denominated in HUF). Based on information provided, a debt service cover ratio of at least 1.2 has to be available
1.5	Does income in all cases constrain the amount lent (for example, through some form of Income Sufficiency Test ("IST")?	Yes
1.6	If not, what percentage of cases are exceptions.	No exceptions
For the purposes of any IST		
1.7	Is it confirmed that income after tax is sufficient to cover both interest and principal.	Yes
1.8	If so, over what period is it assumed that principal will be paid (typically on an annuity basis)? Any exceptions?	Payment of interest and principal on an annuity basis over typically 20 years, maximum up to 30 years.
1.9	Does the age of the borrower constrain the period over which principal can be amortised?	Yes
1.10	Are any stresses made to interest rates when carrying out the IST? If so, when and for what type of products?	Yes. The debt service cover ratio has to be at least 1.2 for loans with an LTV of less than 80%. For loans with a higher LTV a debt service cover ratio of 2 applies. In addition loan payments are stressed to a higher level, if the loan amount is not in HUF.
1.11	Are all other debts of the borrower taken into account at point loan made?	Yes
1.12	How are living expenses of the borrower calculated? What is the stated maximum percentage of income (or income multiple if relevant) that will be relied on to cover debt payments (specify if income is pre- or post-tax)	Expenses are based on standard indices prepared by the official statistical office in Hungary.
Other comments		Not applicable

2. Valuation

2.1	Are valuations based on market or lending values?	Lending Value
2.2	Are all – or the majority – of the valuations carried out by external valuers (with no direct ownership link to any company in the Sponsor Bank group)?	External valuers are used, but valuations are done according to the issuer's valuation guidelines and a sample of these valuations are double-checked by own internal valuers of the issuer
2.3	How are valuations carried out where an external valuer is not used?	International valuation standard (Red, Blue&White Book) and the valuation standard of the UniCredit Group
2.4	What qualifications do external valuers require?	University degree, professional qualification & certification
2.5	What qualifications do internal valuers require?	University degree, professional qualification & certification
2.6	Do all external valuations include an internal inspection of a property?	Yes (only for re-valuations desk-top valuations are accepted)
2.7	Any exceptions?	No
2.8	Do all internal valuations include an internal inspection of a property?	Yes
2.9	Any exceptions?	No
Other comments		Not applicable

Mortgage Bonds according to the Hungarian Mortgage Bank Act

Only Mortgage Banks may issue Mortgage Bonds

Mortgage Bonds are regulated by Hungarian law, namely Act No. XXX of 1997 on Mortgage Banks and Mortgage Bonds (the "Mortgage Bank Act") which contains the specific rules applicable to Mortgage Banks (*jelzálogbanks*) and Mortgage Bonds ("*jelzáloglevél*" or Covered Bonds). Issuers of Mortgage Bonds are regulated by the HFSA, and only Mortgage Banks are allowed to issue Mortgage Bonds. Mortgage Banks are specialised credit institutions which grant loans to borrowers which are secured by either mortgages on real estate or by independent mortgages liens registered on real estate property. For mortgages established in the form of independent liens, the creditor may only seek satisfaction from the mortgaged asset, i.e. the real estate. Mortgage Banks must apply for a license to carry out certain types of financial services, and there are certain minimum requirements for Mortgage Banks, including a minimum capitalisation of HUF3 billion.

Mortgage Bonds are backed by the Cover Pool

The Covered Bonds constitute in each case a direct, unconditional and senior obligation of the Mortgage Bank and are secured by a pool of assets (the Cover Pool). In general the Cover Pool may be composed of mortgage loans secured by residential or commercial properties in Hungary and other countries of the European Economic Area (EEA) or direct, unconditional surety undertaken by the Hungarian government. Furthermore, the law provides for the possibility to refinance lending of commercial banks, insurance companies and financial enterprises (together "Financial Partners") by purchasing mortgage loans from these Financial Partners and by purchasing independent mortgage liens from commercial banks. Together this is referred to as "Ordinary Cover".

Mortgage Banks may fund mortgage lending of Financial Partners

The Mortgage Bank Act procures the possibility for Mortgage Banks to provide financing to commercial banks by a special type of a purchase-repurchase transaction of independent mortgage liens. In this case the relevant mortgage loans are serviced by the Financial Partner and remain on its balance sheet. Accordingly, the claim of the Mortgage Bank against the commercial bank, which is secured by independent mortgage liens, will be entered into the Cover Pool. The relevant data and documents enabling the enforcement of the independent mortgage lien will be held by the Mortgage Bank. The Financial Partners are obliged to set up procedures to determine Lending Value (for more details see below).

If a Financial Partner is defaulting while some of its loans are registered in a Cover Pool, the relevant mortgages are transferred to the Mortgage Bank which has refinanced them. (for more details please refer to the next sub-section of this appendix).

A minimum of 80% of the Cover Pool has to consist of Ordinary Cover

At least 80%[4] of the Cover Pool has to consist of *inter alia* loans secured by mortgages ("*jelzálogjog*") or independent mortgage liens ("*önálló zálogjog*") or direct, unconditional surety undertaken by the Hungarian State ("*készfizető kezességvállalás*"). This is the Ordinary Cover, which is defined by the Hungarian Mortgage Bank Act. Supplementary coverage may consist of certain liquid assets, which are enumerated in the Hungarian Mortgage Bank Act as well. This includes, for example, money deposited to a separate blocked account at the National Bank of Hungary, securities issued by the Government of Hungary (or certain loans guaranteed by the Government of Hungary), securities issued by the member states of the EEA or the Organization for Economic Co-operation and Development (OECD), the European Investment Bank (EIB), the International Bank for Reconstruction and Development (IBRD), the Council of Europe Development Bank and the European Bank for Reconstruction and Development. This is referred to as Supplementary Cover.

[4] The share may be lower for newly created Mortgage Banks, but Moody's understands that the Mortgage Bank shall reach the 80% ratio by the third calendar year of its operation.

There is an LTV threshold based on the lending value

All Mortgage Banks are required to prepare their own internal regulation on the valuation of credit security (the "Regulation on the Valuation of Credit Security"), which must be approved by the HFSA. The rules for calculation of the mortgage lending value ("*hitelbiztosítéki érték*") of real estate are included in the Decree of the Minister of Finance No. 25/1997. (VIII. 1.) on Calculation Methods of the Mortgage Lending Value of Real Estate which does not Qualify as Agricultural Land (the "Non-Agricultural Land CSV Decree") and the Decree of the Minister of Agriculture No. 54/1997. (VIII. 1.) on Calculation Methods of the Mortgage lending value of Real Estate which Qualifies as Agricultural Land (the "Agricultural Land CSV Decree").

Although individual loans with an LTV up to 100% can be included in the Cover Pool, Covered Bonds can only be issued against the exposure held by the Issuer and within the first 70% of the lending value of residential mortgages and within the first-ranking 60% of the lending value of commercial mortgages (by operation of the Mortgage Bank Act).

Cross border lending

Cross border exposure can exist in both the Ordinary Cover, which may consist of mortgage loans backed by properties in the EEA as well as in the Supplementary Cover in form of securities issued by member states of the EEA and OECD and selected Supranational Institutions (see also above). Moody's understands that the exposure to assets related to properties outside Hungary is limited to 15% of the Cover Pool.

The Mortgage Bank is obliged to maintain a coverage on both NPV and notional basis

The Mortgage Bank is obliged to maintain at any point in time the Cover Pool at a sufficient size. It has to maintain a coverage register ("*fedezet-nyilvántartás*") which contains all cover pool assets (including derivatives) and Mortgage Bonds issued. The Mortgage Bond Act sets forth the obligation that the combined notional values of the Ordinary Cover and the Supplementary Cover have to be at least equal to the notional of Mortgage Bonds issued. Furthermore, the net present value (NPV) of the Cover Pool must be at least as high as the NPV of the Mortgage Bonds issued.

The Cover Pool is monitored by the Coverage Supervisor

A Coverage Supervisor must be appointed by the Mortgage Bank, an approval of the appointment by the HFSA is necessary. Although the contractual relationship between the Mortgage Bank and the Coverage Supervisor is governed by a civil law contract, the latter may not be instructed by the Mortgage Bank with respect to matters within the scope of his activities with respect to supervision of the Cover Pool. The Coverage Supervisor is responsible for monitoring and certifying, on a continuing basis, the existence of eligible security and the registration of the eligible security in the coverage register. A certificate from the Coverage Supervisor must be attached to each new issuance of Mortgage Bonds regarding the existence of sufficient the coverage.

The Liquidator will take over the responsibility to manage the Mortgage Bank upon its declaration of insolvency

At the time of insolvency of the Mortgage Bank, or earlier if HFSA sees the need for it, a Supervisory Commissioners ("*felügyeleti biztos*") can be delegated to the Mortgage Bank or any credit institution. Upon declaration of insolvency of the Mortgage Bank a Credit Institution Liquidator Public Company ("*Hitelintézeti Felszámoló kht.*" or "Liquidator") will assume management responsibility of the Mortgage Bank as a whole, including the Cover Pool and outstanding Covered Bonds. To ensure that claims from Covered Bondholders and other privileged creditors (such as for example swap-counterparties, if the derivative is registered into the Cover Pool) the competent court will also appoint another natural person from the Credit Institution Liquidator Public Company, who will be responsible for payments on the outstanding Covered Bonds and the management of the cover pool assets ("Cover Pool Administrator").

After insolvency of the Mortgage Bank all payments with respect to Covered Bonds and derivatives in the Cover Pool will maintain their respective due dates safe an uninterrupted solvency can no longer maintained. Moody's understands that the Cover Pool Administrator is granted access to payment flows that pertain to the non-eligible of the mortgage loan (i.e. also loan parts above the respective LTV thresholds, provided the entire loan has been registered into the Cover Pool) and certain liquid assets hold by the Mortgage Bank, but not recognised as cover pool assets compliant with the requirements set for Supplementary Cover (as defined by the Hungarian legislation). Both the fact that there is a separate administrator for the Cover Pool and that claims of Covered Bondholders (including derivatives counterparties) are well protected by the provisions described above may in Moody's assessment reduce potential conflicts of interest between the Covered Bondholders and other (unsecured) creditors of the Mortgage Bank.

Liquidity may be raised by transfer of cover pool assets or bridge finance against the cover pool assets

In an insolvency scenario of the Mortgage Bank, the Cover Pool or parts of it may be transferred to ensure liquidity. Moody's also understands from legal advisor that the Cover Pool Administrator may raise funds against the cover pool assets by taking bridge funding. This bridge funding will rank junior to claims of Covered Bondholders or claims from derivative counterparties (if registered into the Cover Pool).

Further, the Liquidator is entitled to transfer claims arising from Mortgage Bonds with the corresponding coverage in their entirety or in part to one and several other Mortgage Banks.

Acceleration of Covered Bonds

The Mortgage Act stipulates that the Cover Pool Administrator shall do everything within its control that the assets are sufficient to satisfy claims arising from Covered Bonds and derivatives in the Cover Pool when they are due. However, Moody's understands it is possible that the claims for the Covered Bondholders might accelerate. If uninterrupted solvency cannot be maintained, the Cover Pool Administrator shall take measures towards the satisfaction of Covered Bondholders pro rata to their principal claims, regardless of the dates at which Mortgage Bonds mature.

Commingling risk

The Mortgage Bank or the respective Financial Partner is servicing 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 covered bond issuer prior to a declaration of bankruptcy of the Mortgage Bank (or one of the Financial Partners). Upon the commencement of insolvency proceedings, the Covered Bondholders would have a preferential claim on all receivables in the Cover Pool. In addition liquid assets held by the Mortgage Bank and qualifying as Supplementary Cover for the Cover Pool (but not recognised as cover pool assets) will be available for the Covered Bondholders on a priority basis. In Moody's view, this mitigates commingling risk. However, the Cover Pool Administrator will still have to sort out cash flows upon the declaration of insolvency of the Mortgage Bank. Moody's also understands that the Cover Pool Administrator or any Covered Bondholder may demand within two years after the declaration of insolvency of the Mortgage Bank that the court should order additions to the assets specified as part of the Cover Pool from the assets available for the liquidation upon offering evidence that the cover pool assets fail to cover the claims of Covered Bondholders and that of the derivative partners. Missing the deadline precludes the right to do so.

Set-off risk is mitigated by the special banking principle

Mortgage Banks are restricted in their business to extend mortgage loans and issue Mortgage Bonds. Furthermore, no deposits can be taken from retail or corporate customers. This mitigates the risk of borrowers setting off their obligations after the default of the Mortgage Bank.

However, in a scenario where both the Mortgage Bank and its Financial Partner are insolvent, Moody's understands from a legal advisor that Covered Bondholders are potentially exposed to general deposit set-off (for more details please refer to the following sub-section of this appendix).

Refinancing Mortgage Loans from Financial Partners

Two alternatives

Mortgage Banks may use assets originated by other financial institutions as cover assets for its Covered Bonds. The Hungarian Mortgage Bank Act stipulates two alternatives to refinance mortgage loans from commercial banks and other Financial Partners: (i) purchase and assignment of mortgage loans from a commercial bank, financial enterprise or insurance company (together "Financial Partners") or (ii) purchase-repurchase of independent mortgage liens from commercial banks.

Purchase of mortgage loans

Where mortgage loans are purchased from a Financial Partner, the mortgage loan itself will be assigned to the Mortgage Bank. Accordingly, the instalments will be due to the Mortgage Bank, even if the originator of the mortgage loan will remain the servicer of the loan. However Moody's understands that the set-off claim of the borrower against the Mortgage Bank based on the borrower's unsettled claim against the Financial Partner cannot be entirely excluded. For example, if the Financial Partner becomes bankrupt and the Financial Partner owes a certain amount to the borrower based on a legal relationship already existing at the point of time when the borrower was notified about the assignment to the benefit of the Mortgage Bank, the borrower may still set-off his claims arising from this legal relationship with the Financial Partner, which would also be effective against the Mortgage Bank.

Purchase-repurchase of loans

If the Mortgage Bank purchases an independent mortgage lien from a commercial bank upon the condition that the commercial bank repurchases such lien in instalments or by deferred payment immediately upon the sale of such, the Mortgage Bank will have a claim primarily against the commercial bank, secured by an independent mortgage lien. The independent mortgage lien will not be transferred to the repurchasing commercial bank until the purchase price is paid up in full. The commercial bank selling and repurchasing the independent mortgage lien is at any time obliged to pay the instalments – even if the borrower fails to perform towards the commercial bank. If the commercial bank does not pay the instalments stipulated under the independent mortgage lien purchase agreement with the Mortgage Bank, or if the HFSA commences an insolvency procedure against the commercial bank, the mortgage loan secured by the independent lien will be assigned to the Mortgage Bank by law - effective as of the date of default, or the commencement of the insolvency procedure by the HFSA. Consequently, the Mortgage Bank has the right to notify the borrower about the assignment. Subsequently, the borrower will be obliged to pay the mortgage loan instalments to the Mortgage Bank. Although set-off claims against the Mortgage Bank based on the purchase of independent mortgage liens are mitigated through the operation of the Hungarian Civil Code, Moody's understands that the risk that the borrower may effectively set-off unsettled claims against the commercial bank at the point in time when he was notified, cannot be excluded.

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