

# **Are Covered Bond Systems attractive for the Islamic Markets?**

# Abstract

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## 1. Objective

2. Definition

3. Dimension and Relevance of C.B. in Europe

4. CB vs MBS

5. Different organisational structures of issuers

6. Characteristics and special requirements

7. Strengths

# 1. Objective

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- Aim of all covered bond systems = to get funding from capital markets

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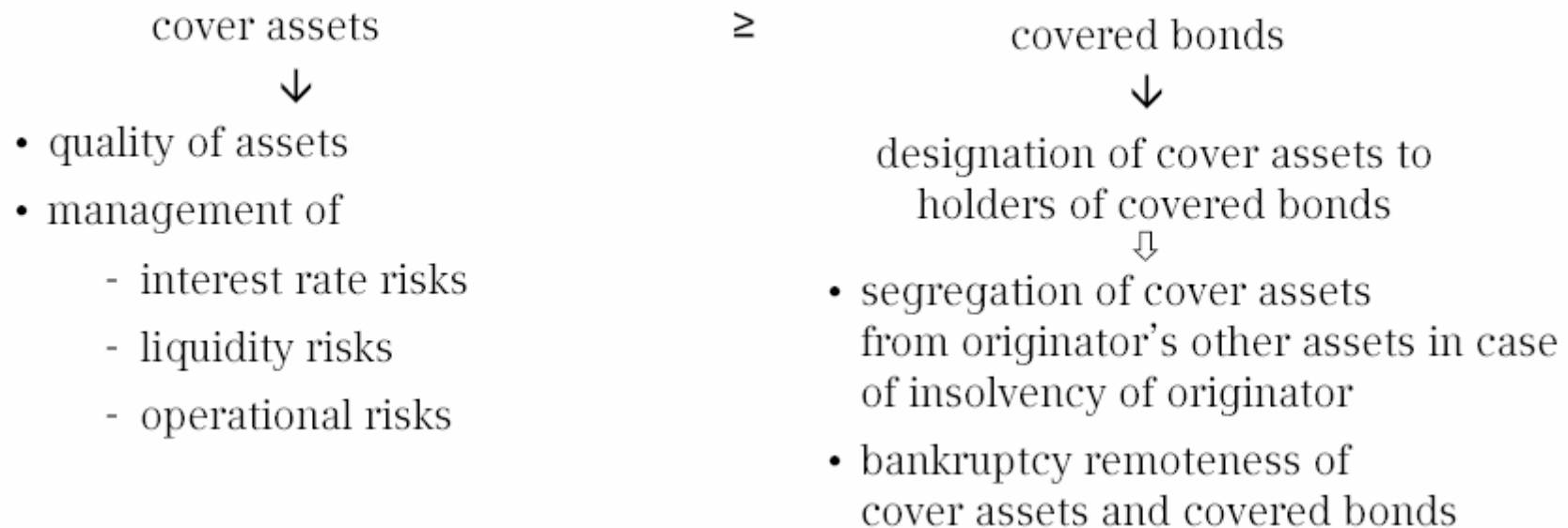
7. Strengths

## 2. Definition

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What does „covered“ mean?

purpose = transformation of cover assets into covered bonds (securitisation)



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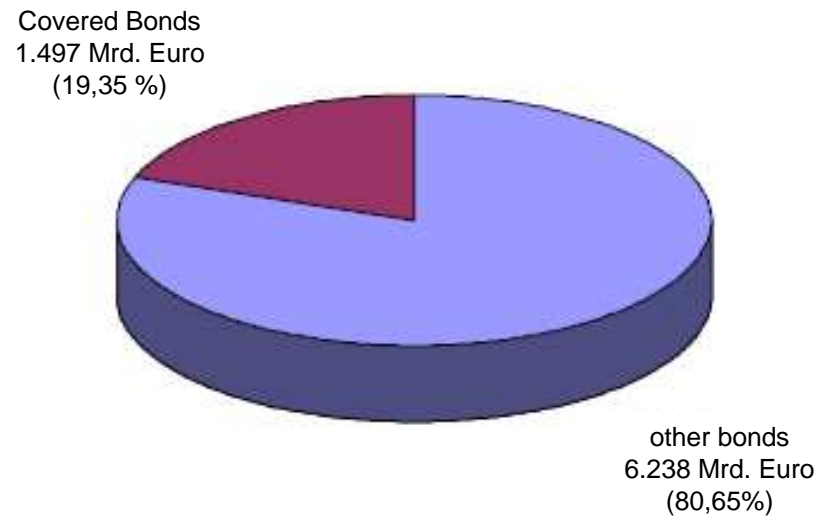
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### 3. Dimension and Relevance of C.B. in Europe

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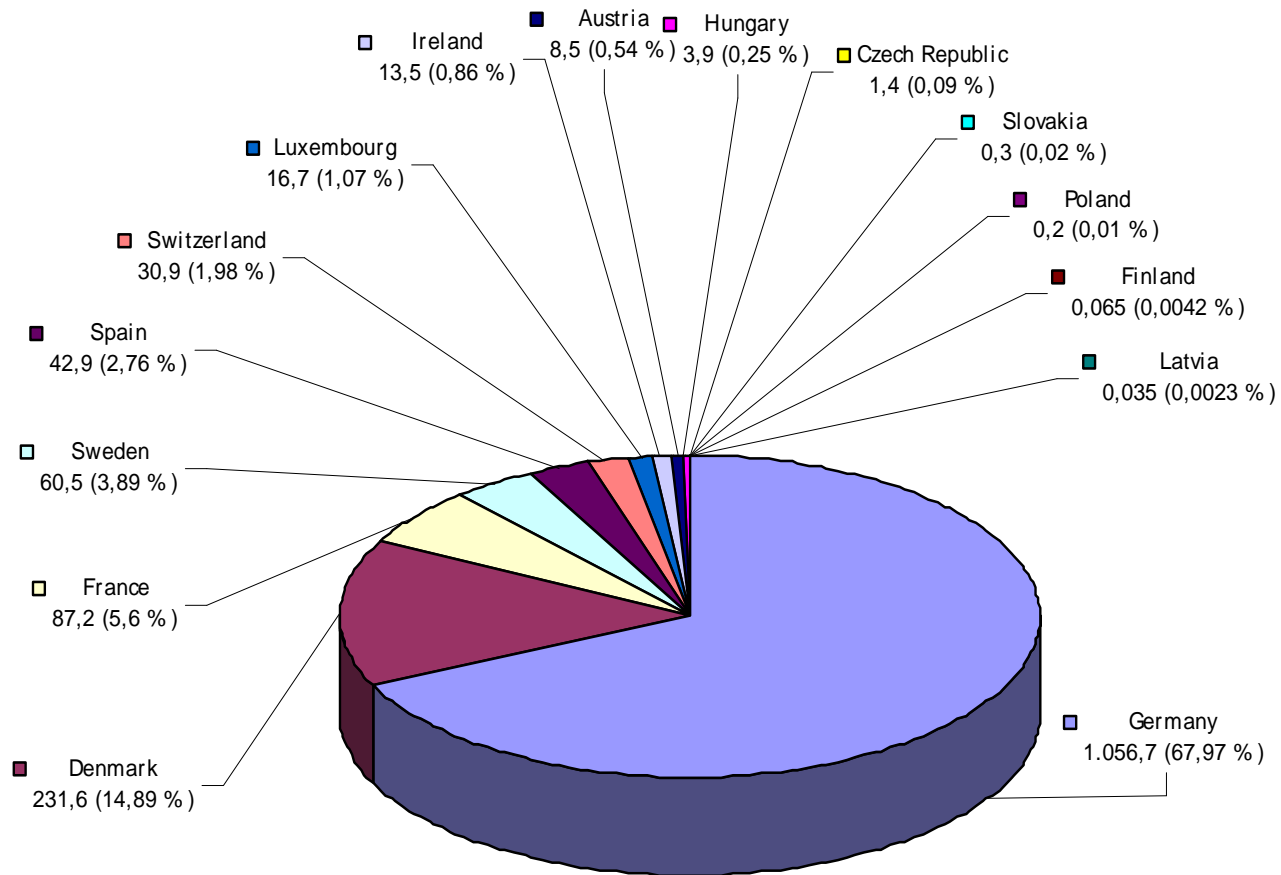
The European Bond Market: 7.735,7 Mrd. Euro  
(End of 2002)



1. (Source: Kälberer/vdp-Büro Brüssel, Merrill Lynch)

### 3. Dimension and Relevance of C.B. in Europe

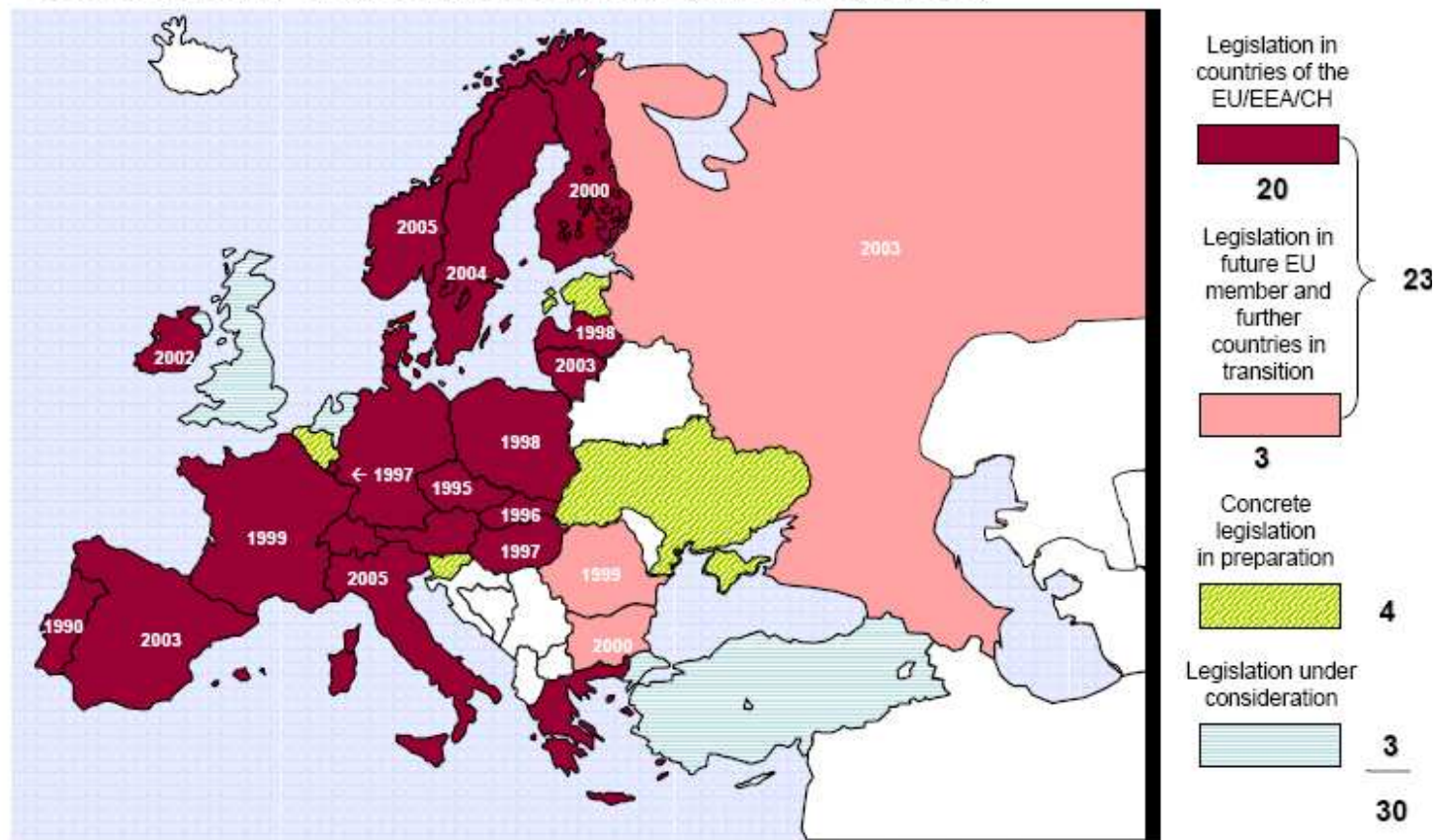
Market Share of the European Covered Bond Countries  
in the European Covered Bond Market (end of 2003): 1.554 bn €



(Source: EMF/VDH – 22.11.2004)

### 3. Dimension and Relevance of C.B. in Europe

Geographical Overview  
Covered Bond Legislation in Europe (as of May 2005)

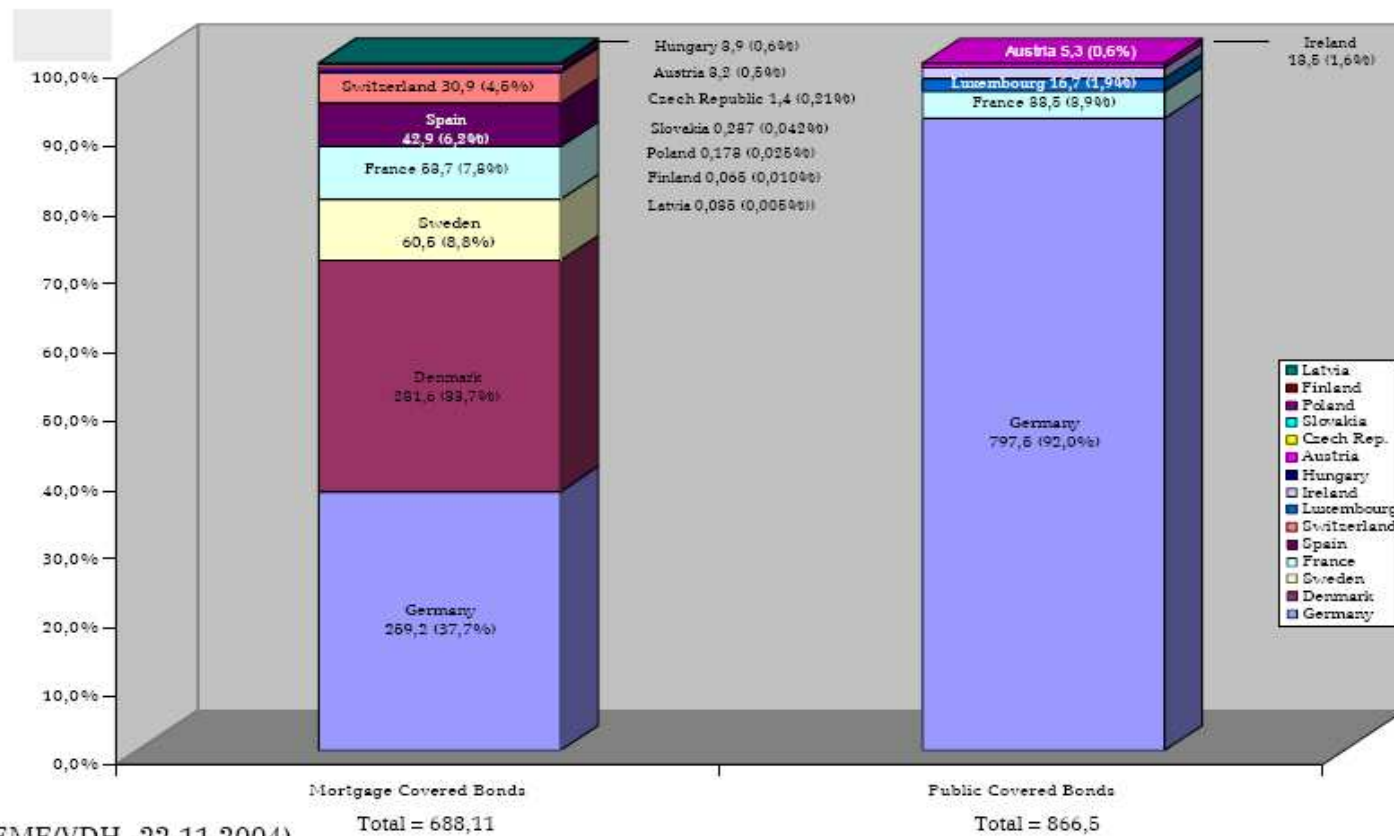


(Source: VdP)

GRAF KANITZ, SCHÜPPEN & PARTNER

### 3. Dimension and Relevance of C.B. in Europe

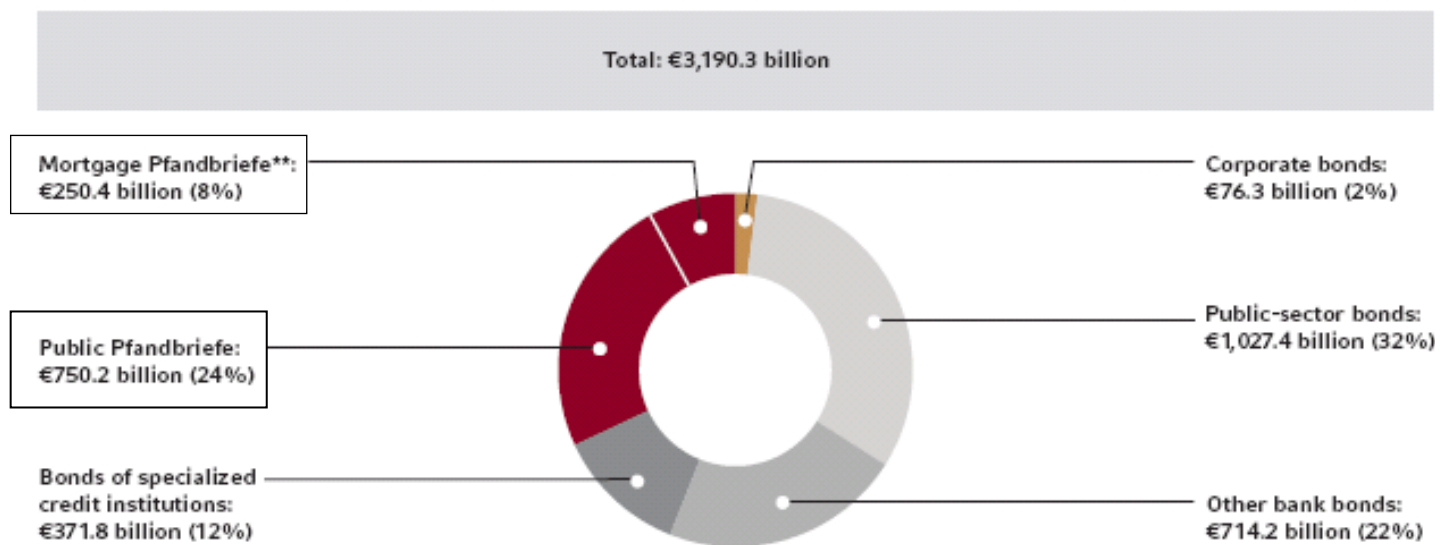
Public Covered Bonds in the EU, compared with Mortgage Covered Bonds (end of 2003, in bn. EUR)



### 3. Dimension and Relevance of C.B. in Europe

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Volume of fixed-income securities outstanding\* (as at March 2005 / only Germany)



\* including registered bonds  
\*\* including Ship Pfandbriefe

Source: Deutsche Bundesbank, Statistical Supplements to Monthly Reports

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## 4. Covered Bond vs Mortgage Backed Securities

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- on / off-balance sheet
- standardization / individual contracts
- flexibility
- costs

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## **5. Different organisational structures of issuers**

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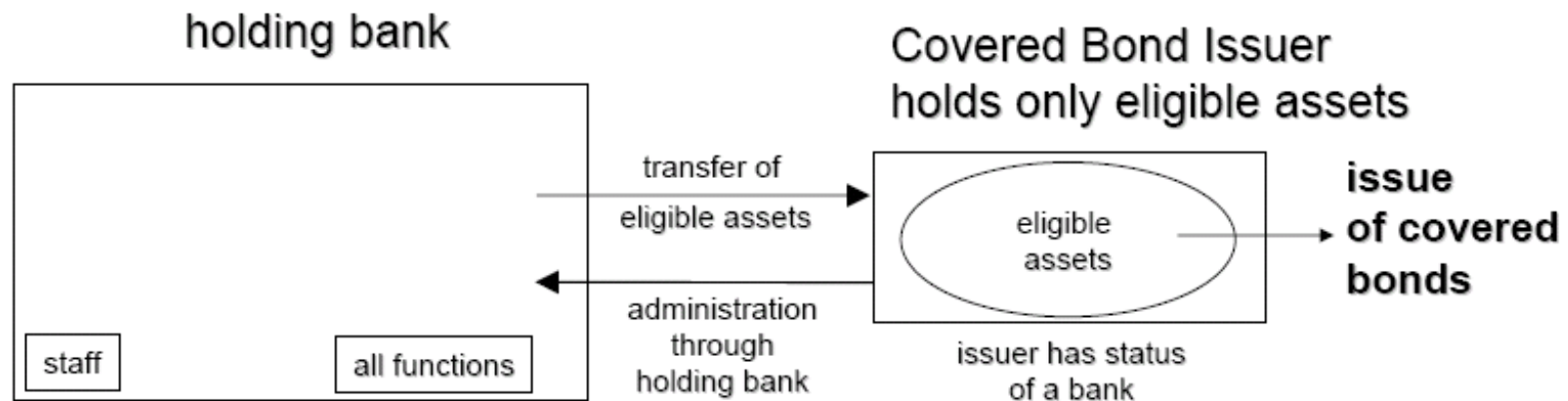
- Total specialisation
- Specialisation with non eligible assets
- Universal banks with specialised covered bond license
- All banks, no special license

## 5. Different organisational structures of issuers

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- (1) French Model: covered bond issuer  
= totally specialised funding vehicle

Finland, France, Ireland, Norway, partially Sweden



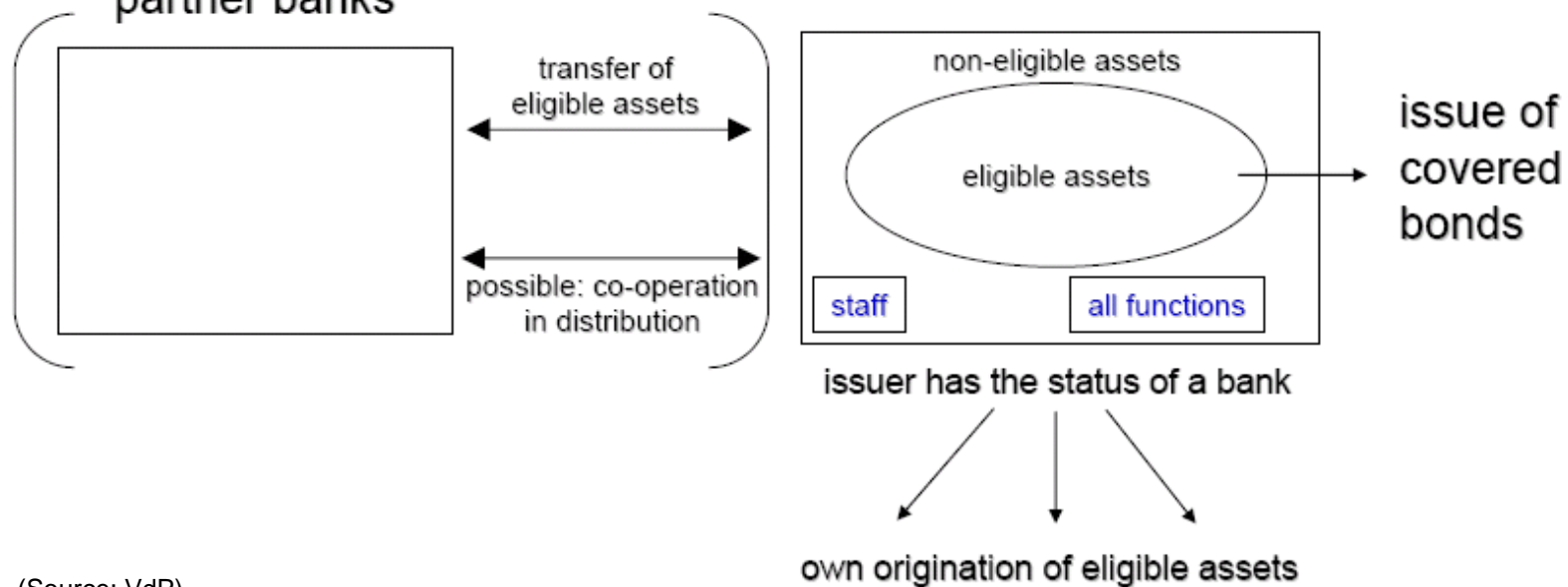
(Source: VdP)

## 5. Different organisational structures of issuers

(2) Specialised banks without/with non-eligible business

Denmark, Germany (HBG), Hungary, Luxemburg, Poland, partially Sweden

possibly holding bank / partner banks



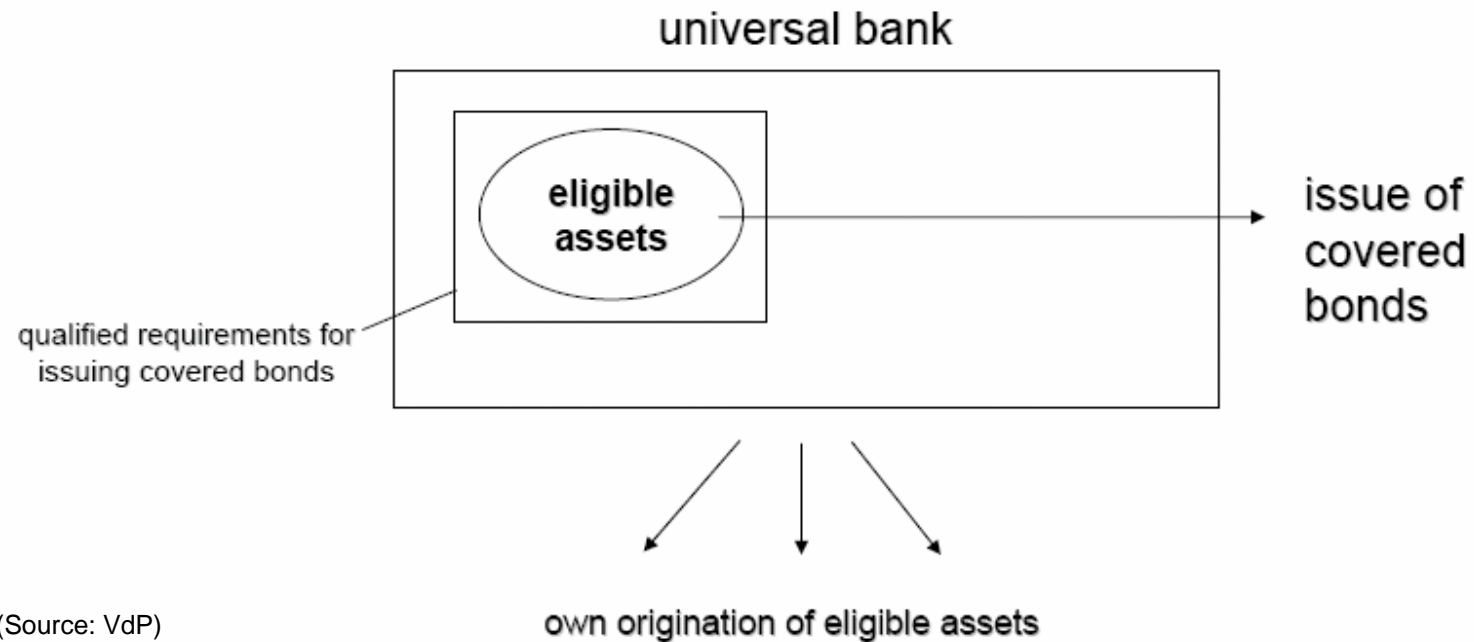
(Source: VdP)

## 5. Different organisational structures of issuers

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(3) Universal bank with qualified covered bond license

Germany (PFandBG), Latvia, Russia, Slovenia (draft law)



(Source: VdP)

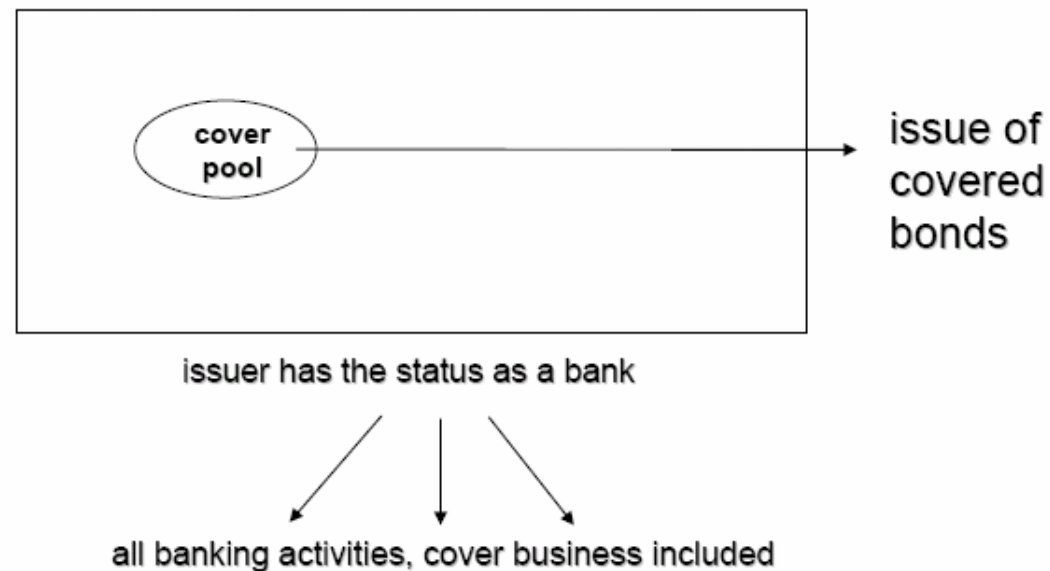
## 5. Different organisational structures of issuers

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- (4) Right to issue covered bonds for all banks without license or with mandatory license, but without requirements to obtain the license

**Without license:** Bulgaria, Czech Republic, Lithuania, Spain

**Mandatory license:** Slovakia



(Source: VdP)

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## **6. Characteristics and special requirements**

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- 6.1 Regluationary requirements
- 6.2 Operative requirements
- 6.3 Requirements for quality of cover assets
- 6.4 other characteristics

## 6. Characteristics and special requirements

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### 6.1 Regulatory requirement

- Specific license  
(Business plan, Sustainability, minimum capital, organisation new market rules)
- Sanctions
- Special banking supervision  
(regular, ad-hoc-audits)
- Independant cover pool monitor
- linsolvency privilege
- Clear emergency plan  
(i.e. detailed regulation about involvency procedere, cover pool administrator)
- Funding register

# 6. Characteristics and special requirements

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## 6.2 Operative requirements

- Specific professional risk management
- Cover and matching principles
- Over collateralisation
- Sustainable Pfandbrief issuance
- Enhanced transparency rules  
(maturity structure, geographical distribution, type of collateral,  
amount in arrears etc.)
- Expertise of executives

## **6. Characteristics and special requirements**

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### 6.3 Requirements for quality of cover assets

- conservative evaluation (MLV)
- 60 % LTV
- No special real estate

## 6. Characteristics and special requirements

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### 6.4 Other characteristics

- Traditional vs Jumbo Pfandbrief (outstandings)

Traditional ca. Euro 550 billion

Jumbo ca. Euro 450 billion

- Characteristics of Jumbo Pfandbriefe

(minimum standard)

- Euro 1 billion
- fixed coupon, payable annually in arrears, bullet reduction  
(= straight bond format)
- three market makers at least
- official listing

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## **7. Strengths**

## 7. Strengths of Covered Bonds/Pfandbriefe

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7.1	Quality	→	AAA-Rating
7.2	Price	→	very competitive funding
7.3	Costs	→	low
7.4	Technique	→	simple
7.5	Liquidity	→	high (Jumbo)

## 7. Strengths of Covered Bonds/Pfandbriefe

### 7.1 Quality / Rating

	Public Pfandbriefe			Mortgage Pfandbriefe		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
AHBR	Aa1	AAA	AAA	Aa3	AAA	AA+
Berlin Hyp	-	AAA	-	-	-	-
DEPFA Deutsche Pfandbriefbank	Aaa	AAA	AAA	Aaa	-	AAA
Deutsche Hypo	Aaa	AAA	-	Aaa	-	-
Dexia Hypothekenbank Berlin	-	AAA	-	-	-	-
DG HYP	-	AAA	AAA	-	AAA	AAA
Eurohypo	Aaa	AAA	AAA	Aa1	AAA	AAA
Hypo Real Estate Bank	Aa1	AAA	AAA	Aa3*	-	AA+
Hypothekenbank in Essen	Aa1	AAA	AAA	Aa2	-	-
HypoVereinsbank	Aa2**	AAA	AAA	Aa3**	-	AAA
MünchenerHyp	Aaa	-	-	Aaa	-	-
SEB Hyp	-	AAA	-	-	-	-
WL-BANK	-	AAA	-	-	AAA	-
Württembergischer Hypo	Aa1	AAA	-	Aa2	AAA	-
Wüstenrot Hypothekenbank	-	AAA	AAA	-	-	AA+

\* watchlist positive; \*\* review for possible upgrade

Source: VDH, August 2004

## 7. Strengths of Covered Bonds/Pfandbriefe

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7.1 Quality → AAA-Rating

**7.2 Price → very competitive funding**

7.3 Costs → low

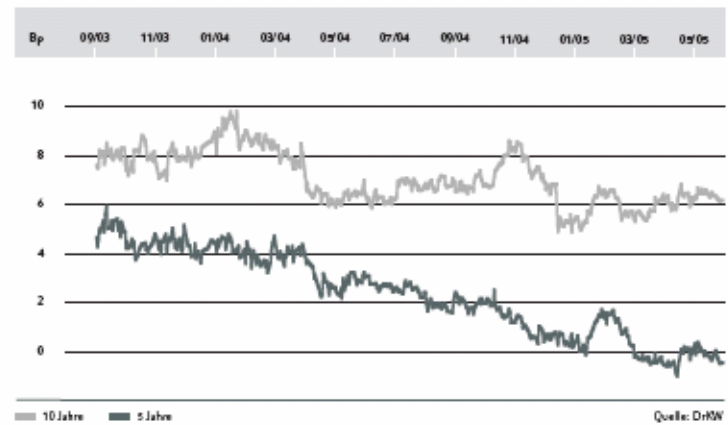
7.4 Technique → simple

7.5 Liquidity → high (Jumbo)

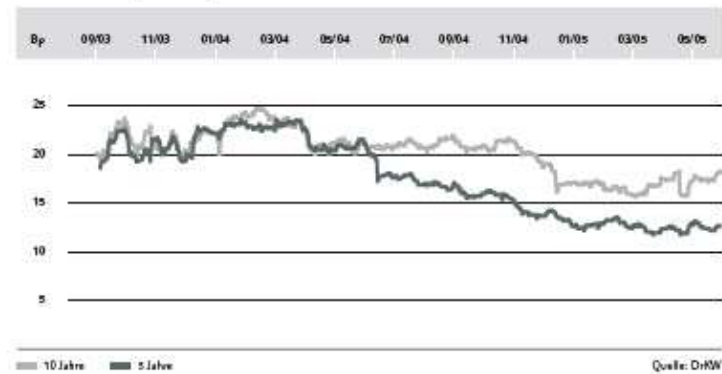
# 7. Strengths of Covered Bonds/Pfandbriefe

## 7.2 Price

Jumbo-Swap-Spreads September 2003 – Mai 2005



Jumbo-Bund-Spreads September 2003 – Mai 2005



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