

## CEE event weighs new and old regulatory issues

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**The 12th Central European Covered Bond Conference took place last week, but while the event returned to Warsaw for the third time, it focused on several issues that have only recently come to the fore. The Cover discussed the highlights of the event with Otmar Stöcker, managing director of the Association of German Pfandbrief Banks, co-host of the conference with Poland's Mortgage Credit Foundation, which initiated the conference series.**

One topic new to the conference agenda was the relationship between covered bond holders and other creditors, notably depositors. The panel, "covered bond credibility in a stress scenario", included, among others, representatives of the Polish Bank Guarantee Fund.

"Previously this was something of a non-issue," said Stöcker, "as most issuers were specialised institutions with no or little deposits."

However, he said that the question of how covered bonds could affect the interests of depositors was first raised in Russia, where the banking crisis in the 1990s saw many depositors lose money. Meanwhile, the Russian parliament has started work on modern covered bond legislation.

More recently, the Financial Services Authority in the UK has addressed the issue and the Canadian and US authorities are dealing with it in their evolving frameworks. A few years ago the Australian Prudential Regulatory Authority prohibited covered bond issuance since it conflicts with the country's law protecting depositors.

In Poland, a draft law was recently brought before parliament, which suggests abolishing the special bank principle of Polish mortgage banks, but without compensating for this through quality securing measures - something that was much criticised at the conference.

Fritz Engelhard, director of European fixed income strategy at Barclays Capital and a moderator at the event, said that concerns about a conflict between the two classes of creditors are overdone.

"Covered bonds term out an issuer's funding, which is an appropriate way of funding mortgage lending as it is largely long dated," he said. "That helps improve the health of a financial institution, which is to the benefit of all creditors."

Stöcker said that the only issue is who pays for the overcollateralisation that covered bondholders benefit from, as this has to be paid for by other creditors. "What would be the consequences if in the UK covered bondholders were paid back and retail did not get all their money back as not the full amount of their deposits are guaranteed?" he asked.

"A sound deposit insurance system could be important, otherwise an insolvency of a bank could motivate politicians to interfere."

However, while the panel was able to drill down to what the real issues that need to be dealt with are, Stöcker said that no easy solution to this problem was reached and it was agreed by all that the issue needs more analysis and discussion.

### Monitoring no guarantee, but a safeguard

The conference also examined the monitoring of cover pools. The panel featured representatives of institutions responsible for this role, such as the Polish Financial Supervisory Authority, the head of Pfandbrief Competence Centre II at the German Federal Financial Supervisory Authority (Bafin), and a partner from KPMG Hungária Kft.

Stöcker said that these panellists highlighted the detailed processes involved in their monitoring. "The supervisors cannot check every asset," he said, "so they select certain ones at random and check that the principles upon which the business is being done are sound. If there is a problem, they then check whether that is related to the single asset itself or with the issuer's lending processes."

Engelhard said that one takeaway from the panel was that the benefit of monitoring was not only the knowledge that every issuer is complying 100% with regulations, but even more so the comfort that a supervisor will be able to detect early on any problems that might be occurring and take action before the situation becomes critical.

The panel also discussed just how the "special public supervision" described in the UCITS and CRD guidelines should be interpreted. "Nobody knows exactly what it means," said Stöcker. "So far, anything which goes beyond general banking supervision is regarded to qualify as being 'special' and gives room to special treatment of covered bonds, for example regarding risk weighting.

"The Warsaw conference showed that the countries that were represented on the panel go far higher than such a low level approach."

### No clear winner in transparency debate

The "structured versus legislation" debate was revisited, but mainly with regard to transparency under either model. The strengths and weaknesses of both were debated.

Stöcker said that information on structured covered bonds tended to one extreme or the other. "It is either low level information, or you need to get into very complex details of the structure," he said. "And sometimes there is information that is only disclosed to the rating agencies that is not accessible to investors, especially the legal opinions on critical issues.

"In that sense, it is a less transparent approach."



Otmar Stöcker

But Engelhard said that legislation could also have its drawbacks.

“In the prospectus for a structured covered bond, issuers cannot write what they want,” he said. “They have to mention risk factors. And sometimes it is written more clearly than the details of a law.”

And he said that while the presence of a legislation could lead one to expect issuance to be more standardised, which should help transparency, this could actually be misleading. “In some legislative jurisdictions the business models of issuers differ more than in the UK, for example, where the business models of issuers are more similar,” said Engelhard.

The event closed with a discussion of what could be done to ease the inclusion of foreign assets in cover pools. Stöcker said that this issue had recently come to light when Pfandbrief issuers had looked at buying cross-border commercial mortgage portfolios to include as collateral, but found that the assets did not meet the necessary criteria, with the legal ownership of the mortgage and valuation methods, for example, falling short of the demands of German legislation.

He said that the European Commission’s attempts to enhance mortgage markets had not yet dealt with such considerations in a concrete way, but that they needed to be examined.

Stöcker said that there is the intention to continue the conference series, which he said is meant as a think-tank on fundamental issues while other covered bond conferences concentrate on capital market issues, especially the liquidity of covered bonds.