
The Covered Bond universe redefined? Structured vs. regular Covered Bonds

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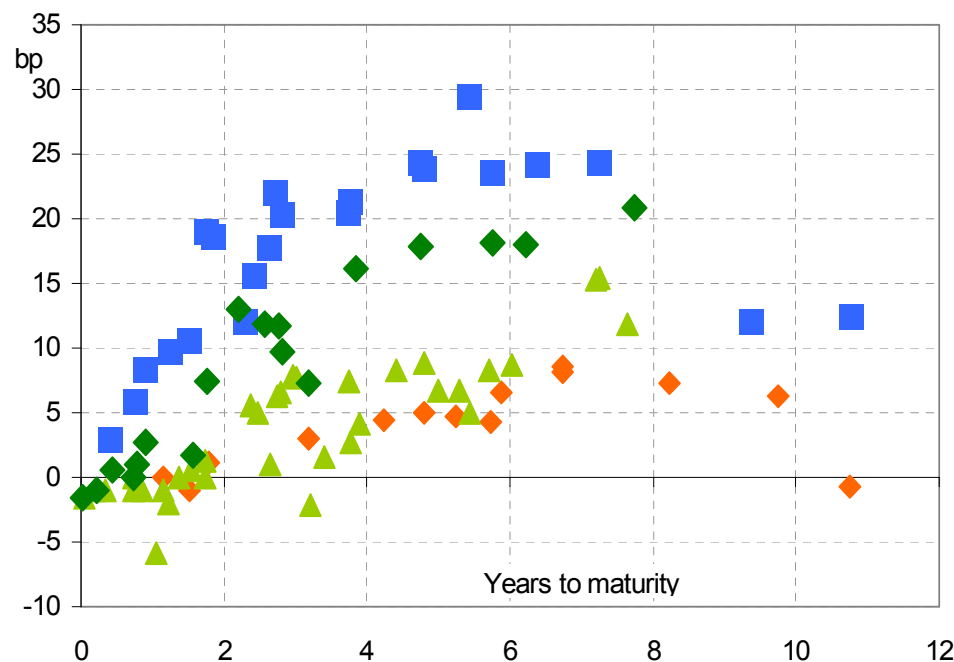
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October 2003

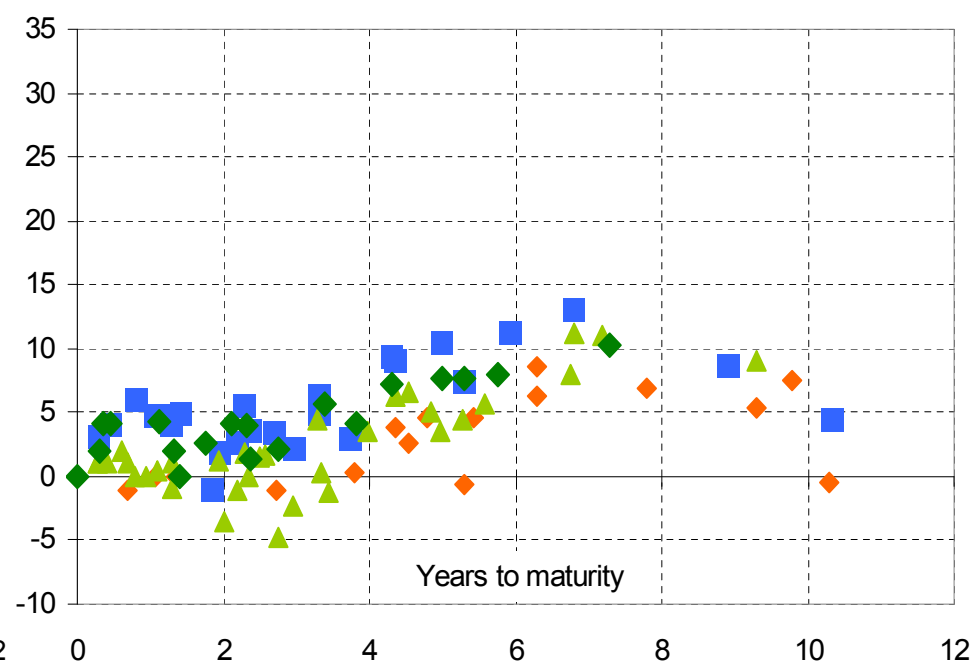
Trends 1: Spreads

- Calmness at the rating front, search for pick-up, and legislative amendments
=> Spread universe converging again

Swap spreads as at 1 Oct



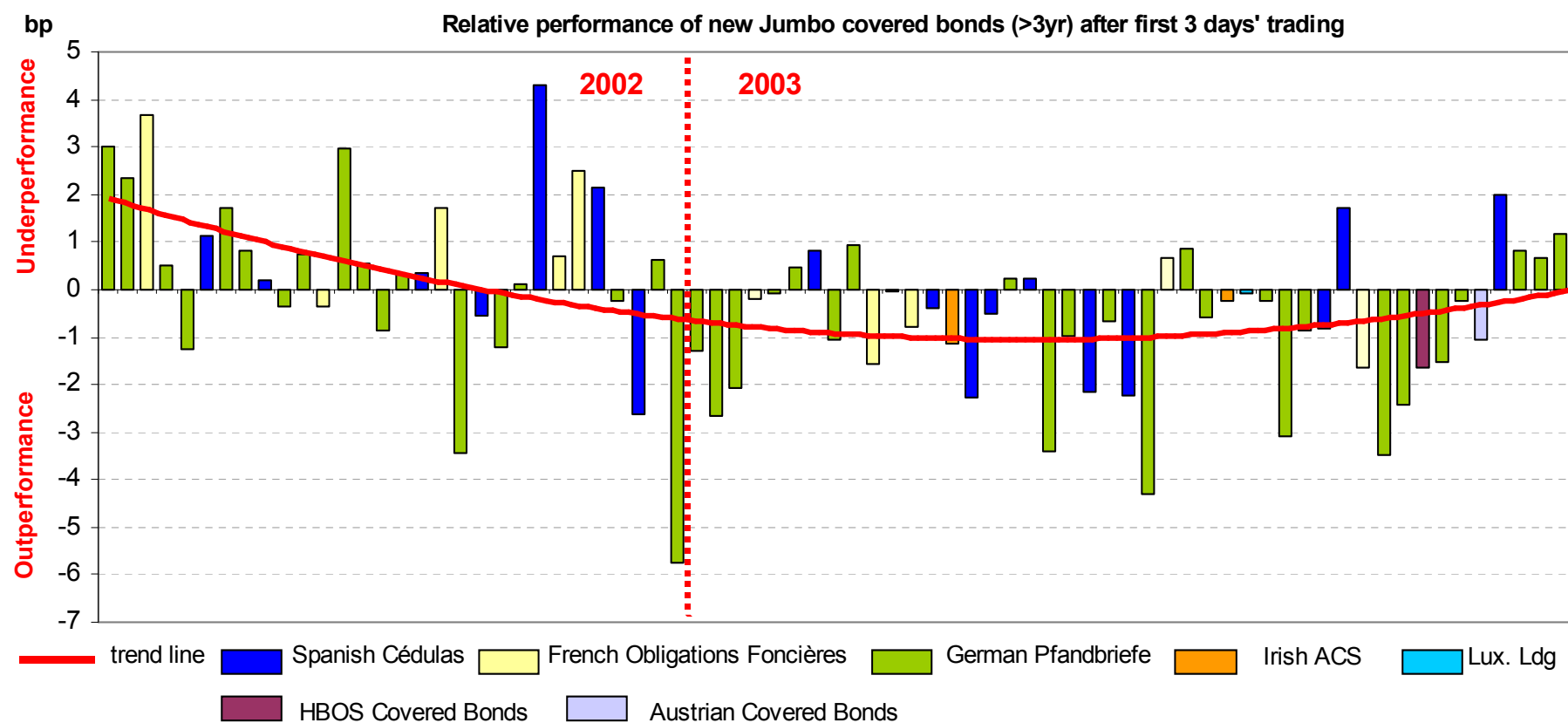
... and as at 03 Oct 2003



■ AHBR ◆ Depfa ▲ Eurohypo ◆ Hyp in Essen

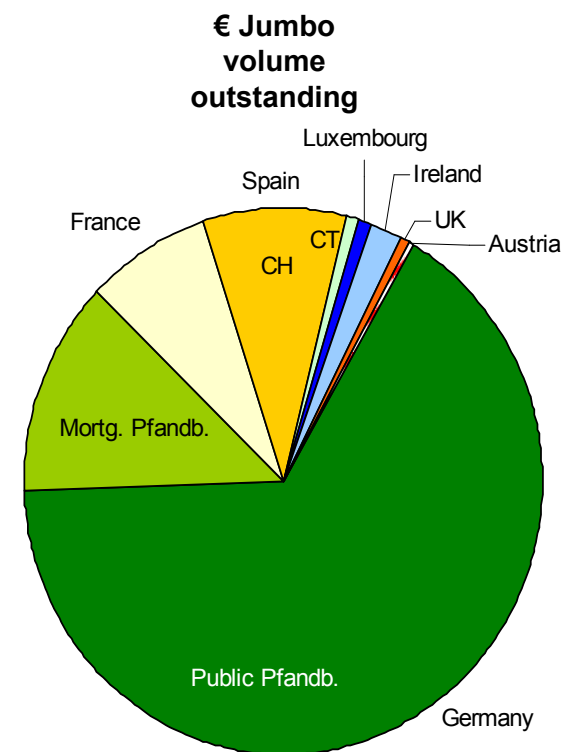
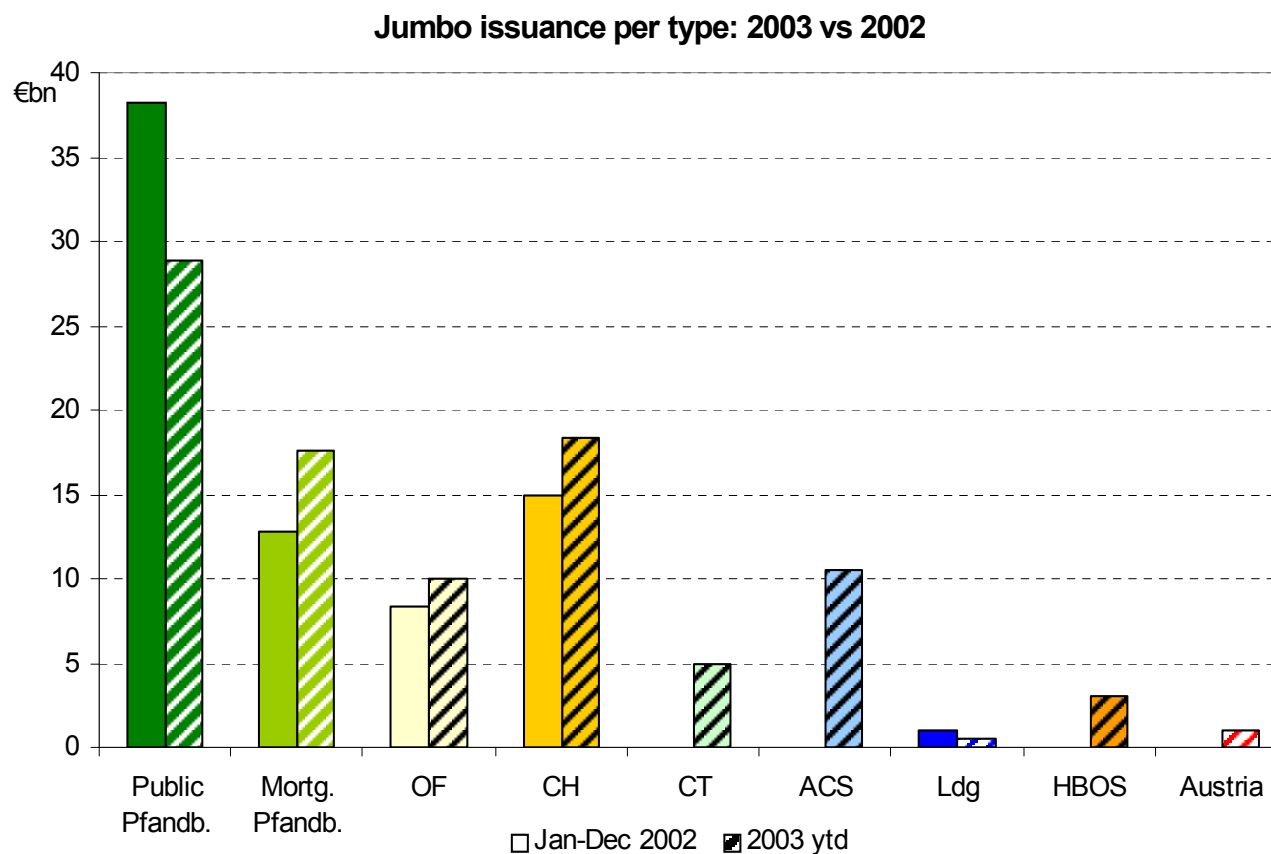
Trends 2: Pricing of new issues

- New issues are priced significantly more sensitive and investor-friendly
=> despite large issuance volumes no sustained negative effects on spreads

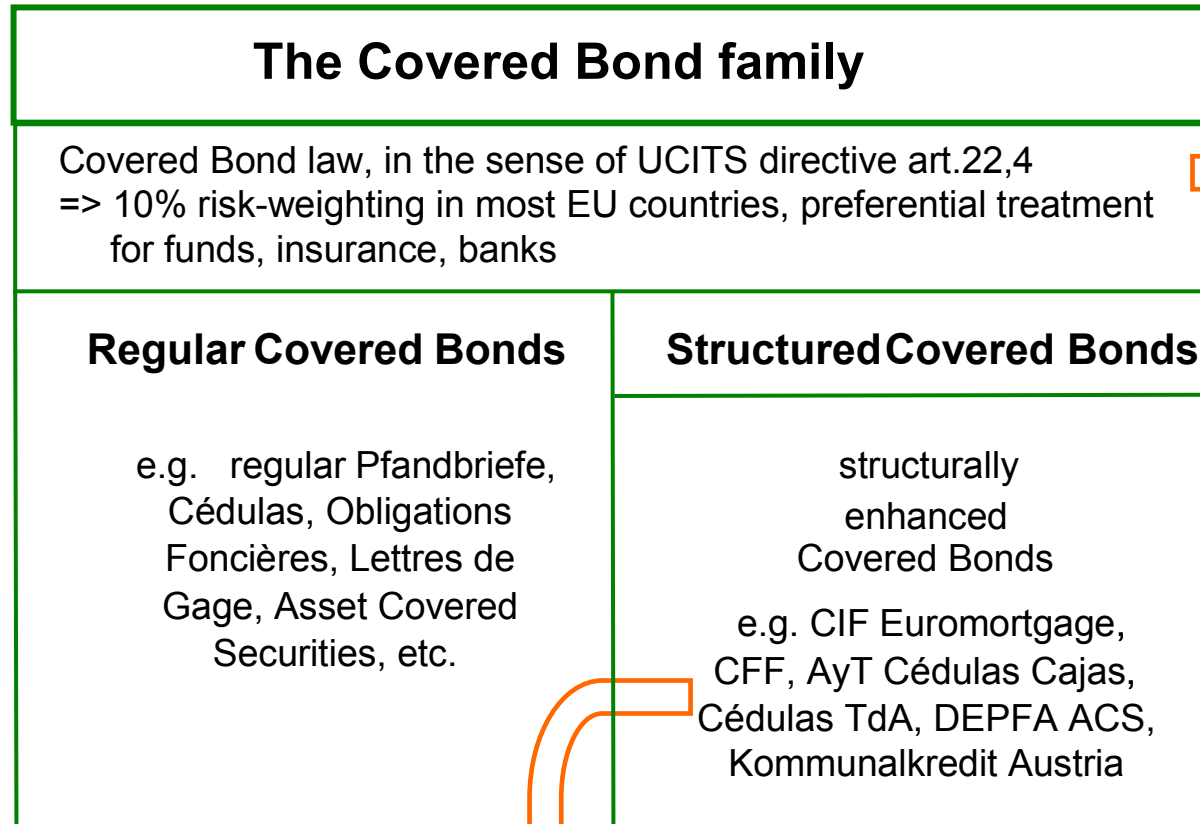


Trends 3: Issuance activity

- Strong increase of Covered Bond issuance outside Germany and introduction of new products (ACS, CT, Kommunalkredit Austria, HBOS)



What defines a Covered Bond?

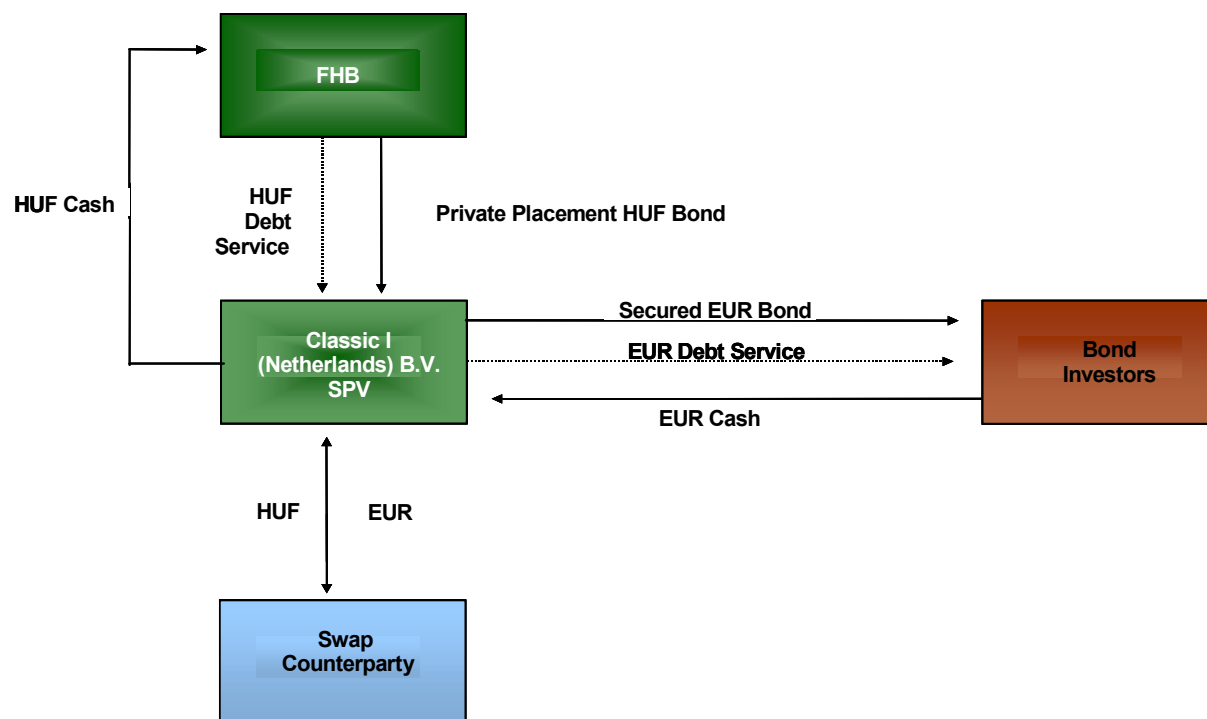


2. sufficient definition?
- Italian securitisation law (Law 130 of 30-Apr-99)
 - Hungarian covered bonds
 - CRH

1. partly structuring features, which are unknown to regular Covered Bond (e.g. AyT und TdA: legal maturity > expected maturity)
=> Even before HBOS, the Covered Bond world was more complicated in its product variety than many investor had probably been aware of

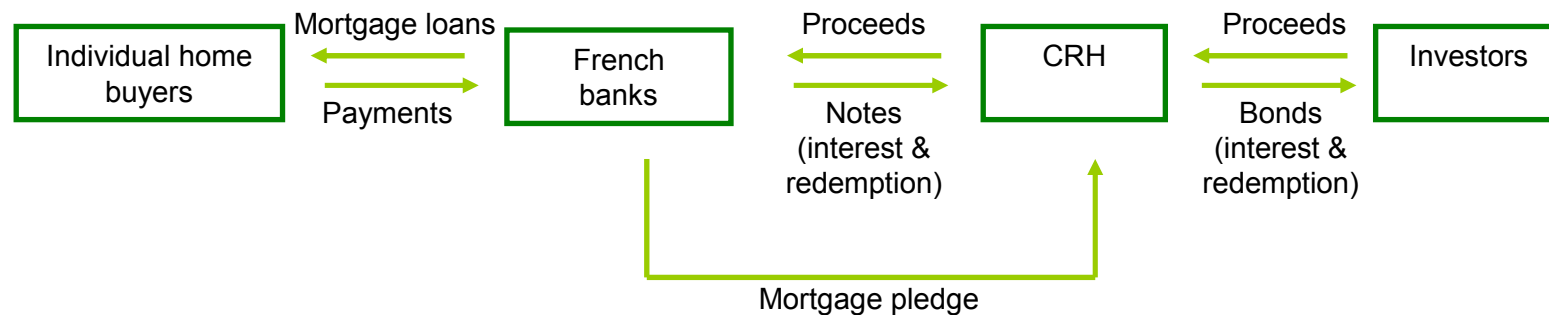
The example of FHB's €-issue

- Hungarian FHB bound to issue in HUF to not lose public subsidies
- An international €-issue therefore required an SPV-structure, bringing in additional credit factors
- Hungarian covered bonds themselves, however, do also not fulfill the UCITS requirement, simply because they are not issued by EU banks => no 10% weighting



The example of CRH

- Caisse de Refinancement de l'Habitat (CRH): refinances residential mortgages granted by its shareholding banks through the issuance of collateralised bonds (compare with AyT, TdA)



- No OF issuer (SCF) , but special status, legal framework und many similarities
- Strict requirements for collateral assets, min. 25% over-collateralisation, can demand cash advances of member institutes in case of one bank becoming failing on payment obligation to ensure timely payment, legally enforced transfer of ownership of pledged mortgages, etc.
- French ministry of Finance: UCITS directive (22,4) fulfilled => preferential treatment for funds
But: 20% risk-weighting

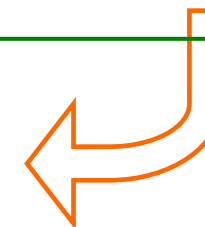
Essential Covered Bond characteristics

- Definition of Covered Bond status is a decision with discretionary elements
- “A Covered Bond is what a Covered Bond does”
- Essential ingredients:
 - Accepted legal environment geared to creditor protection
 - Claim against the issuer + collateralisation through mortgages and/or public sector assets
 - Preferential treatment of creditors to these assets in the event of the issuer’s insolvency, which means that ideally the cash flows of the covered bond remain unaffected
 - Rules assuring collateral quality, such as minimum coverage requirements, ensuring that the assets used indeed provide sufficient cover for the Covered Bonds issued
 - Within these rules flexible management of the collateral pool
 - Independent supervision

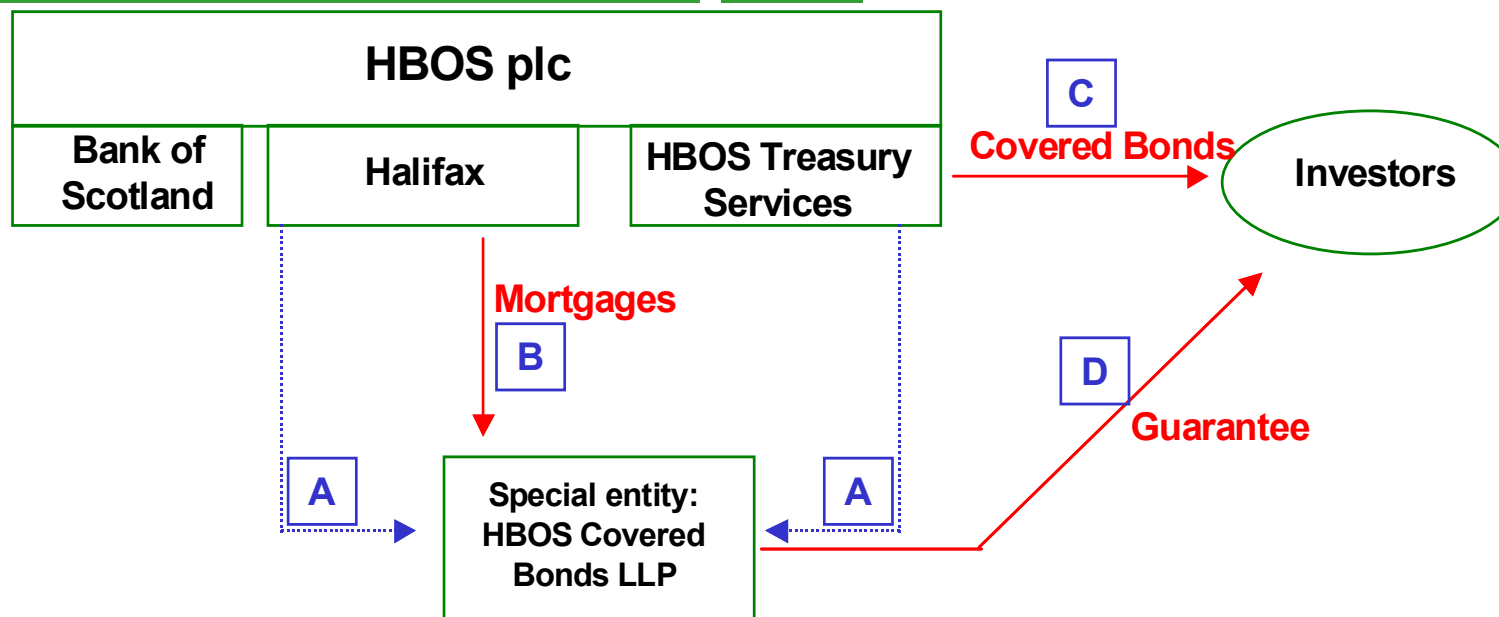
Covered Bonds: A broader definition

The Covered Bond family (see also: Moody's)		
Covered Bond law, in the sense of UCITS directive art.22,4 => 10% risk-weighting in most EU countries, preferential treatment for funds, insurance, banks		No Covered Bond law, 20% risk-weight, no preferential treatment, higher complexity
Regular Covered Bonds	Struktured Covered Bonds	
e.g. regular Pfandbriefe, Cédulas, Obligations Foncières, Lettres de Gage, Asset Covered Securities etc.	structurally enhanced Covered Bonds e.g. CIF Euromortgage, CFF, AyT Cédulas Cajas, Cédulas TdA, DEPFA ACS, Kommunalkredit Austria	Comparably secured bonds, which replicate Covered Bond characteristics through structuring techniques outside a Covered Bond law e.g. HBOS Covered Bond, ABN AMRO Bouwfonds

1. Strict quality requirements necessary
2. Compensation of the above disadvantages through as high credit quality and liquidity as possible



HBOS Covered Bonds: Half empty or half full?



Half empty...

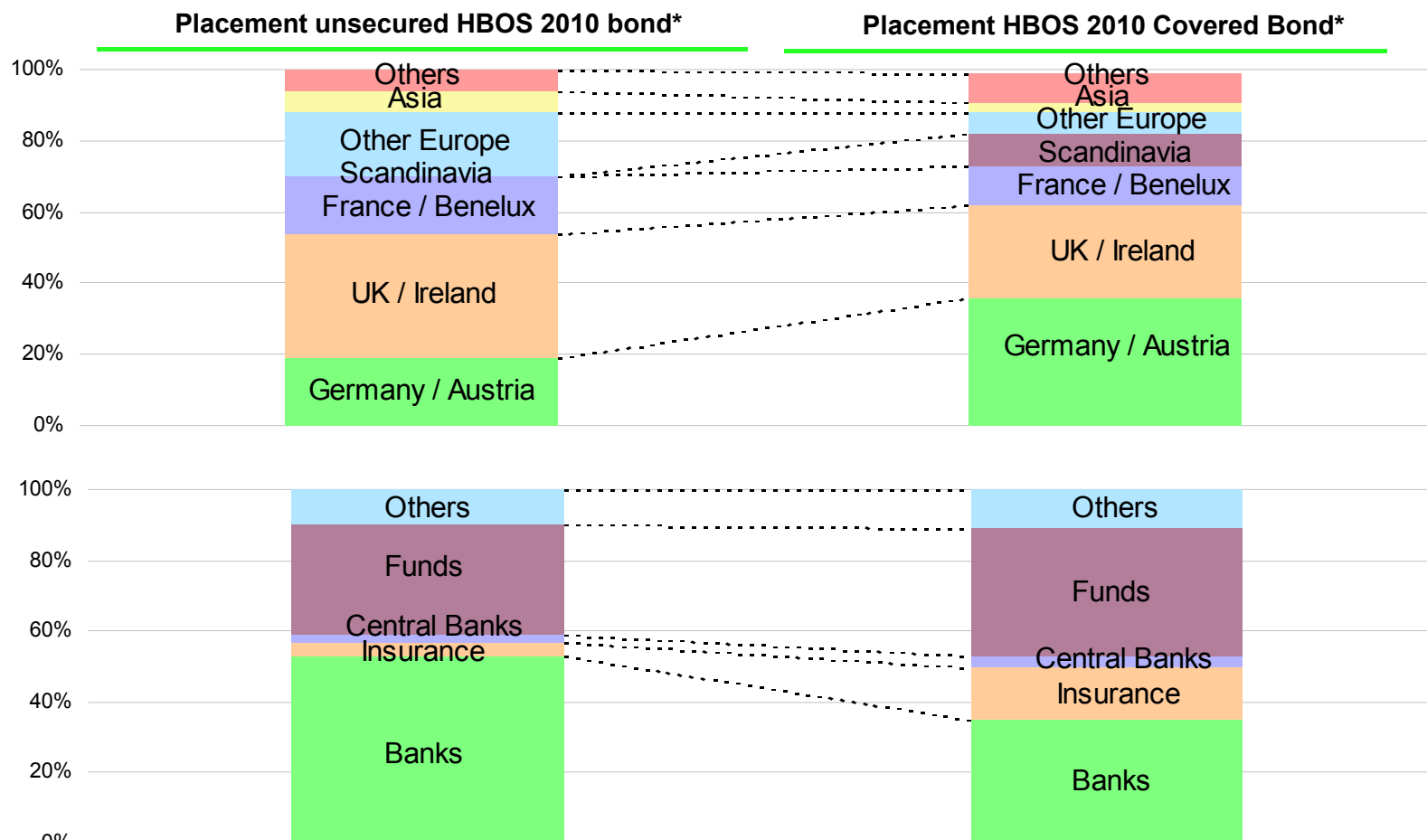
- Regular contract law instead of specialized Covered Bond law
- 20% risk-weighting
- No preferential treatment for funds, insurance or banks
- etc.



Half full...

- Largely “de-linked” triple-A ratings
 - Rating triggers
 - Extensive over-collateralisation requirements
 - Pre-maturity test
- Solid liquidity
- etc.

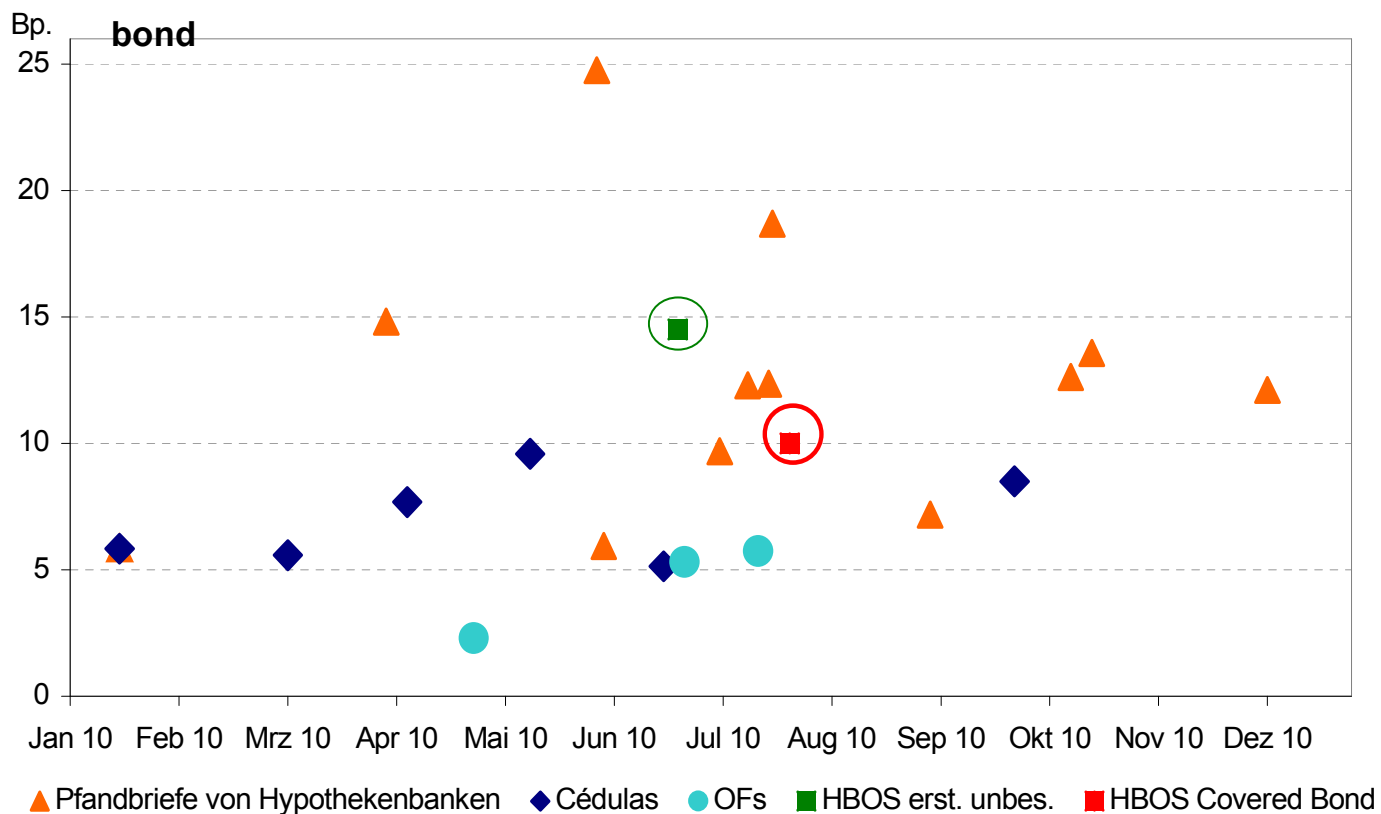
HBOS: Diversification of investor basis...



* Data contains placement of Lead managers according to DrKW ebookbuilding

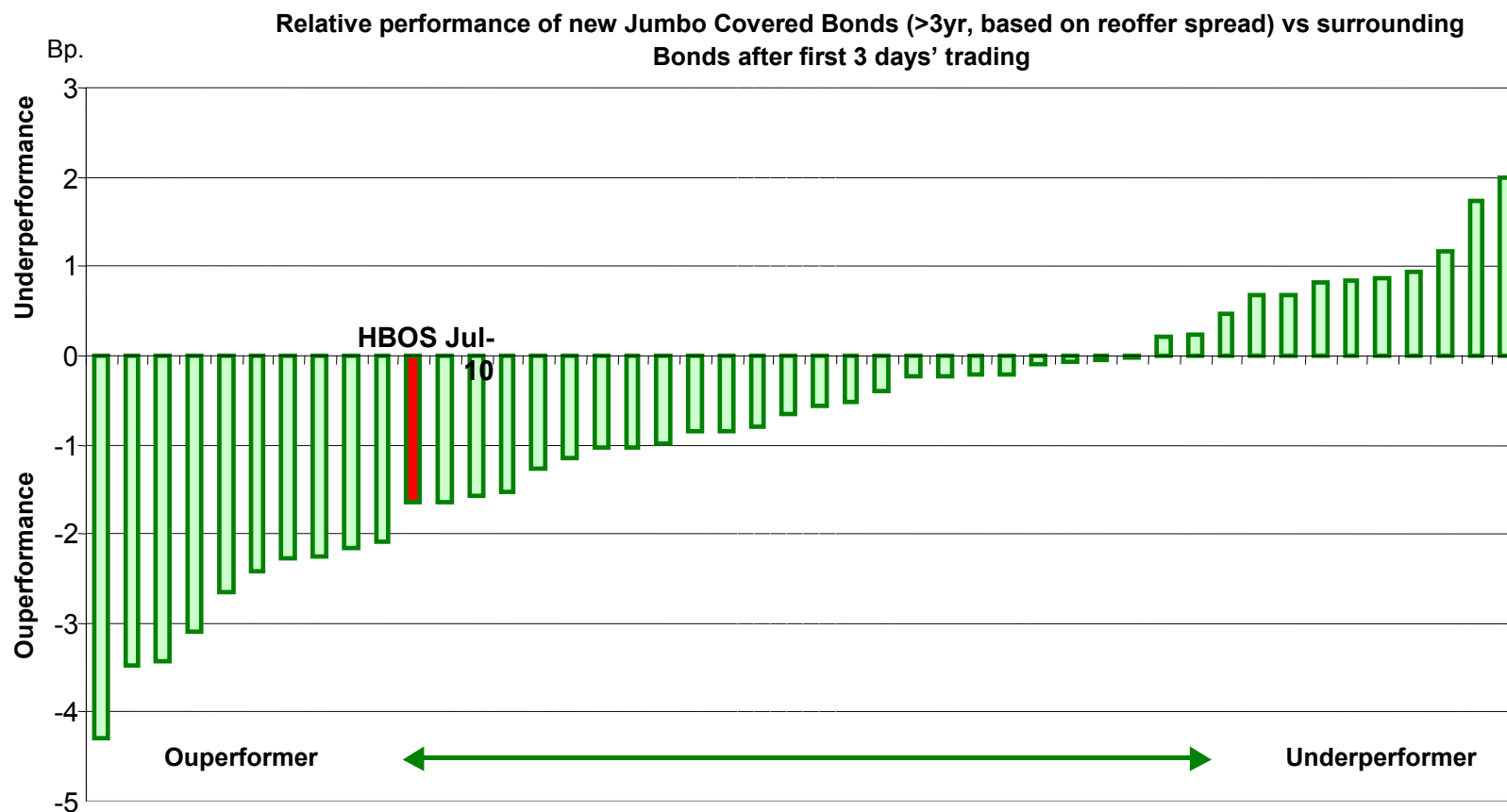
... at attractive funding level

The 2010 Covered Bond segment (spreads vs swap) at issuance of HBOS covered

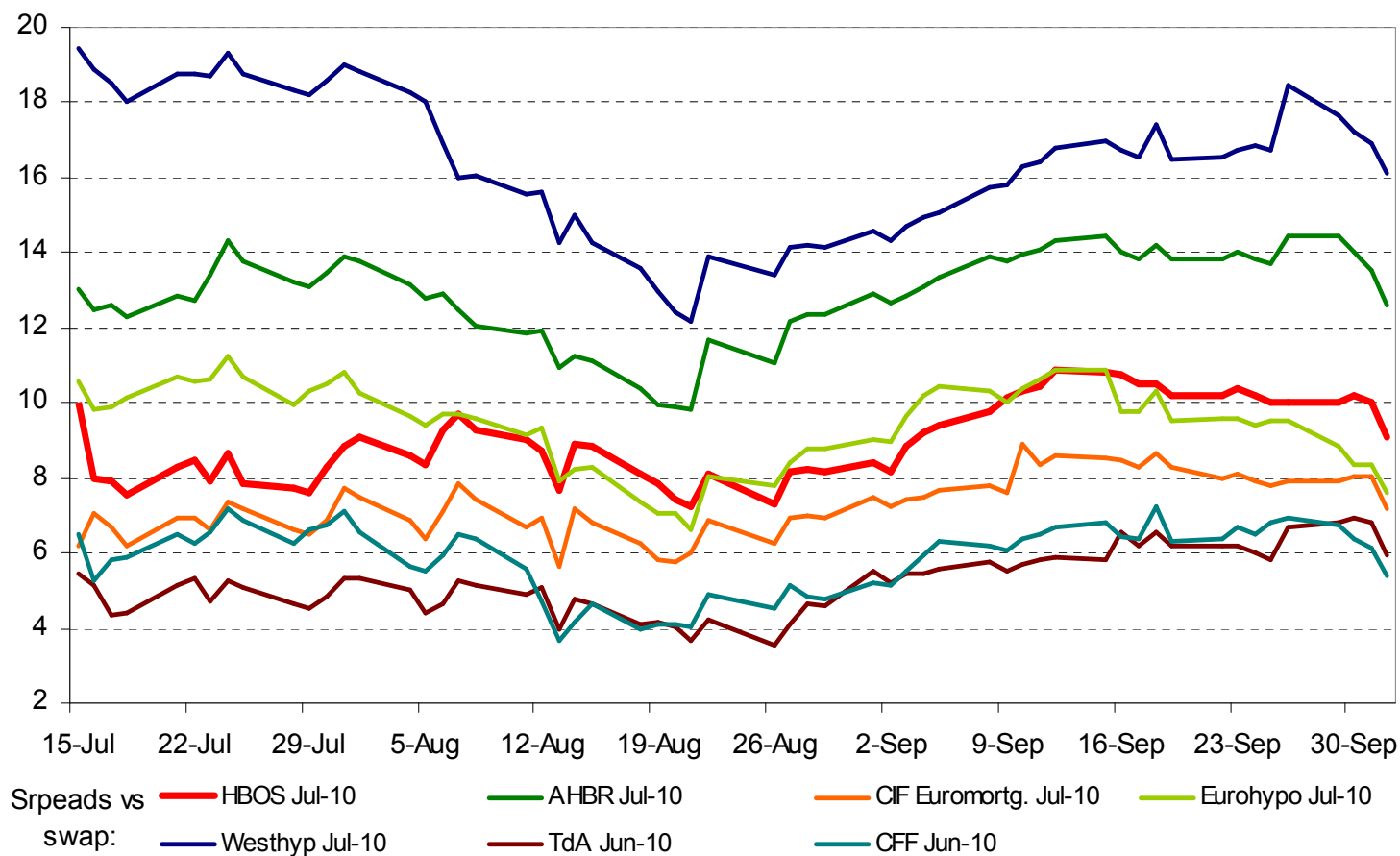


➤ Pricing around 5-7bp tighter than required for unsecured new issue

Solid secondary market performance (1)



Solid secondary market performance (2)



- Price determination in line with regular Covered Bonds
- Good investor acceptance

More structures to come

- UK:
 - A number of banks is checking the adaptability of the HBOS modell
 - Probably usage of almost the same structure targeted
 - Possible candidates: Northern Rock, Nationwide, etc.
- Netherlands:
 - ABN Amro Bouwfonds issues similarly structured bonds for quite some time already
 - Some re-pricing of outstanding paper with HBOS issue
 - Stronger marketing towards Covered Bond status
- Italy:
 - Covered Bond law in preparation, but timing still unknown
 - Italian Banks are likely to go ahead with own structures based on securitisation Law 130 of 1999 in case of further delays in the creation of a dedicated Covered Bond law
 - 2004 market premiere the one or the other way
 - Possible candidates : Unicredito, Intesa, etc.

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