



New Legislation on Covered Bonds in Europe: Structure of Issuer, ALM, Banking Supervision, Segregation and Bankruptcy Remoteness

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9th Central European Covered Bond Conference**

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Association of German Pfandbrief Banks. Berlin**



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A. Introduction: Covered Bonds in Europe

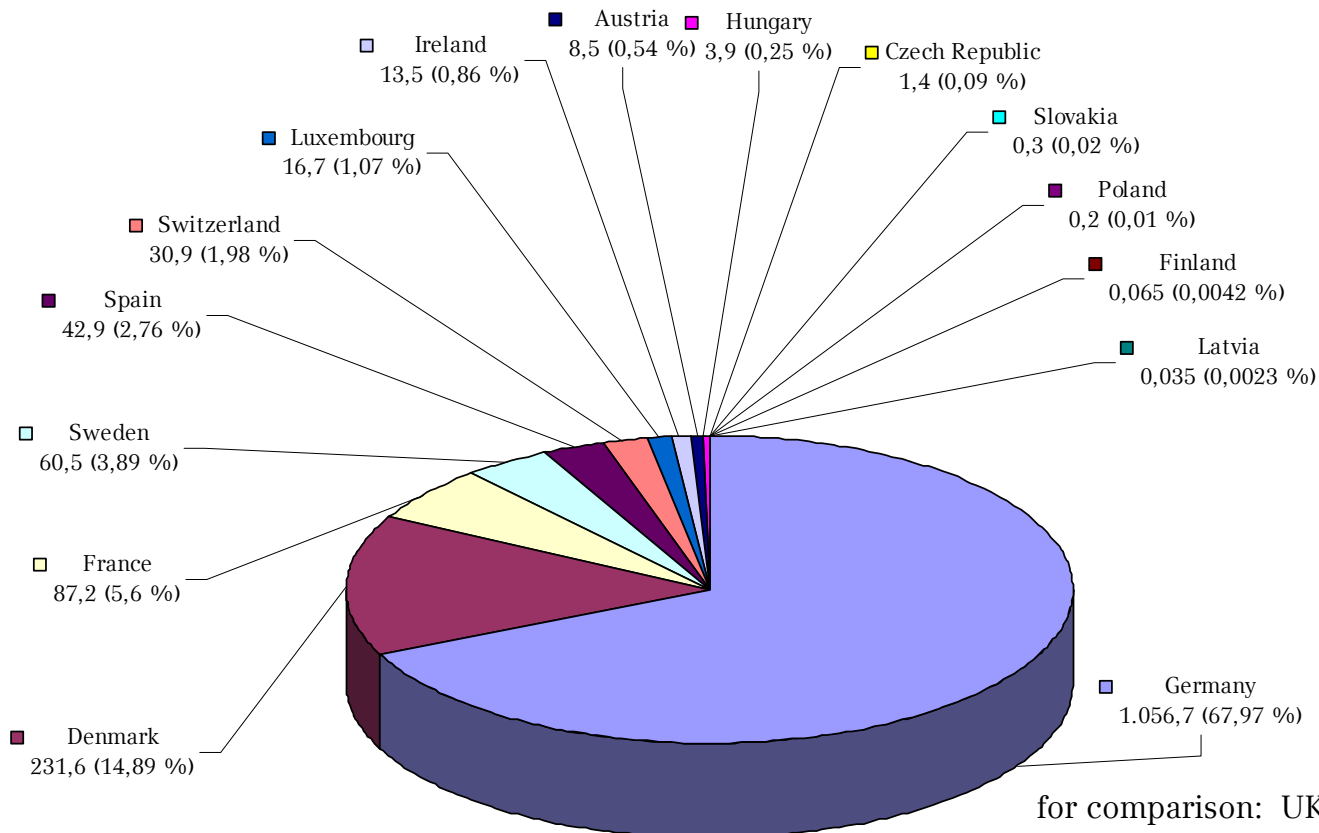


Covered Bonds in Europe



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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)

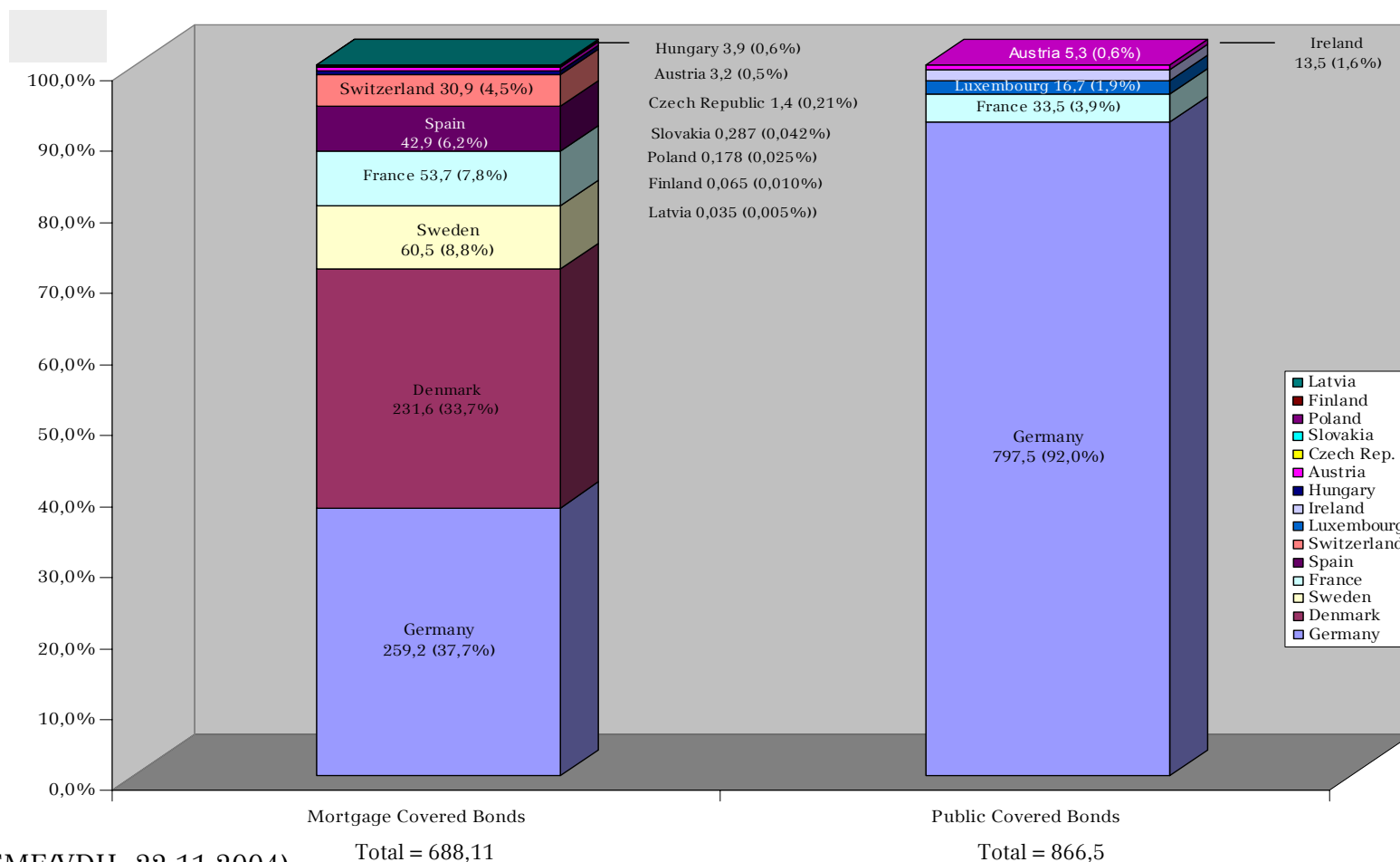
for comparison: UK “covered bonds”
= 11 bn € (09/2004 = 14 bn €)



Covered Bonds in Europe



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



(Source: EMF/VDH -22.11.2004)

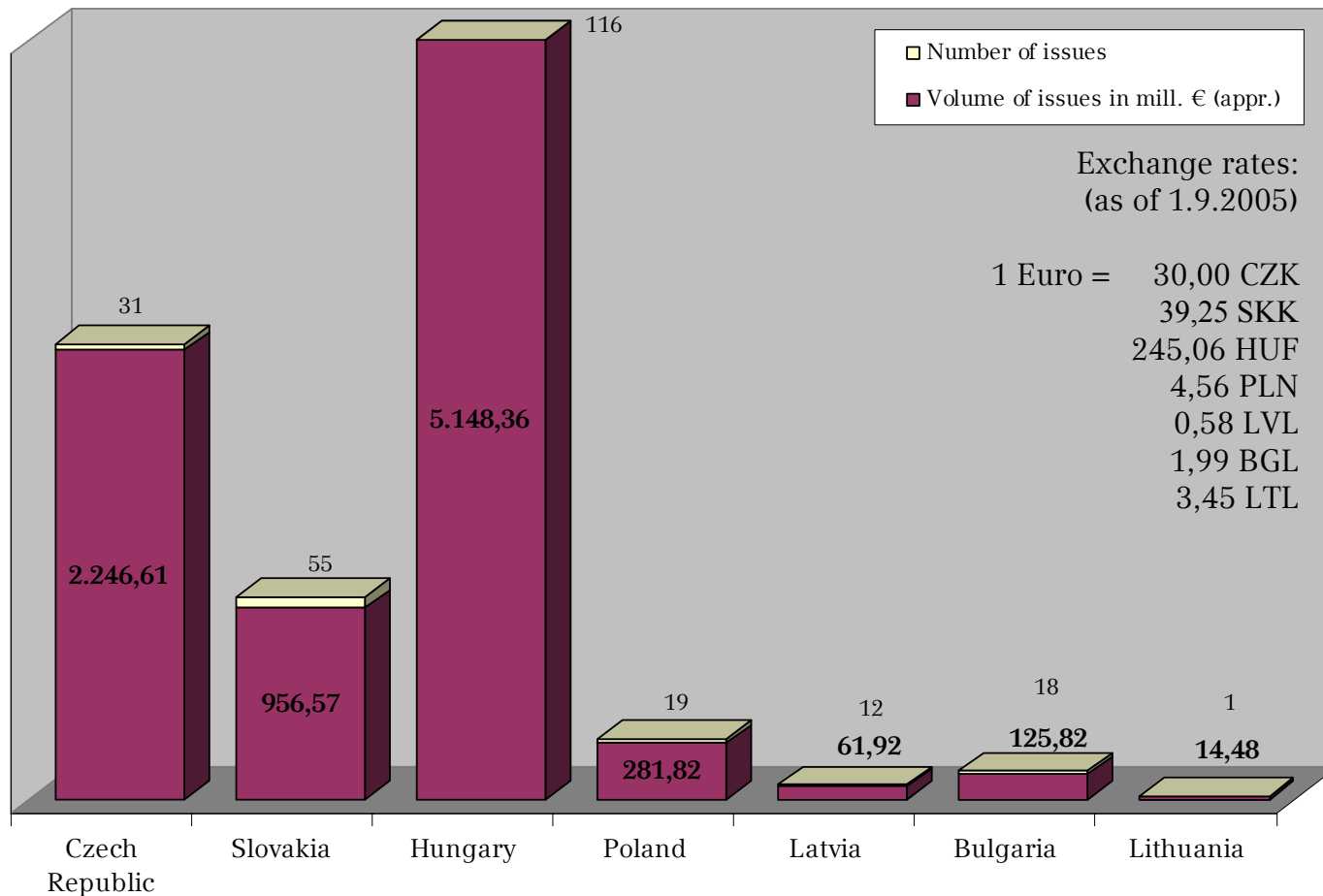


Covered Bonds in Europe



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Covered bonds outstanding in central Europe since 1996: Czech Republic, Slovakia, Hungary, Poland, Latvia, Bulgaria, Lithuania (as of 1.9.2005)



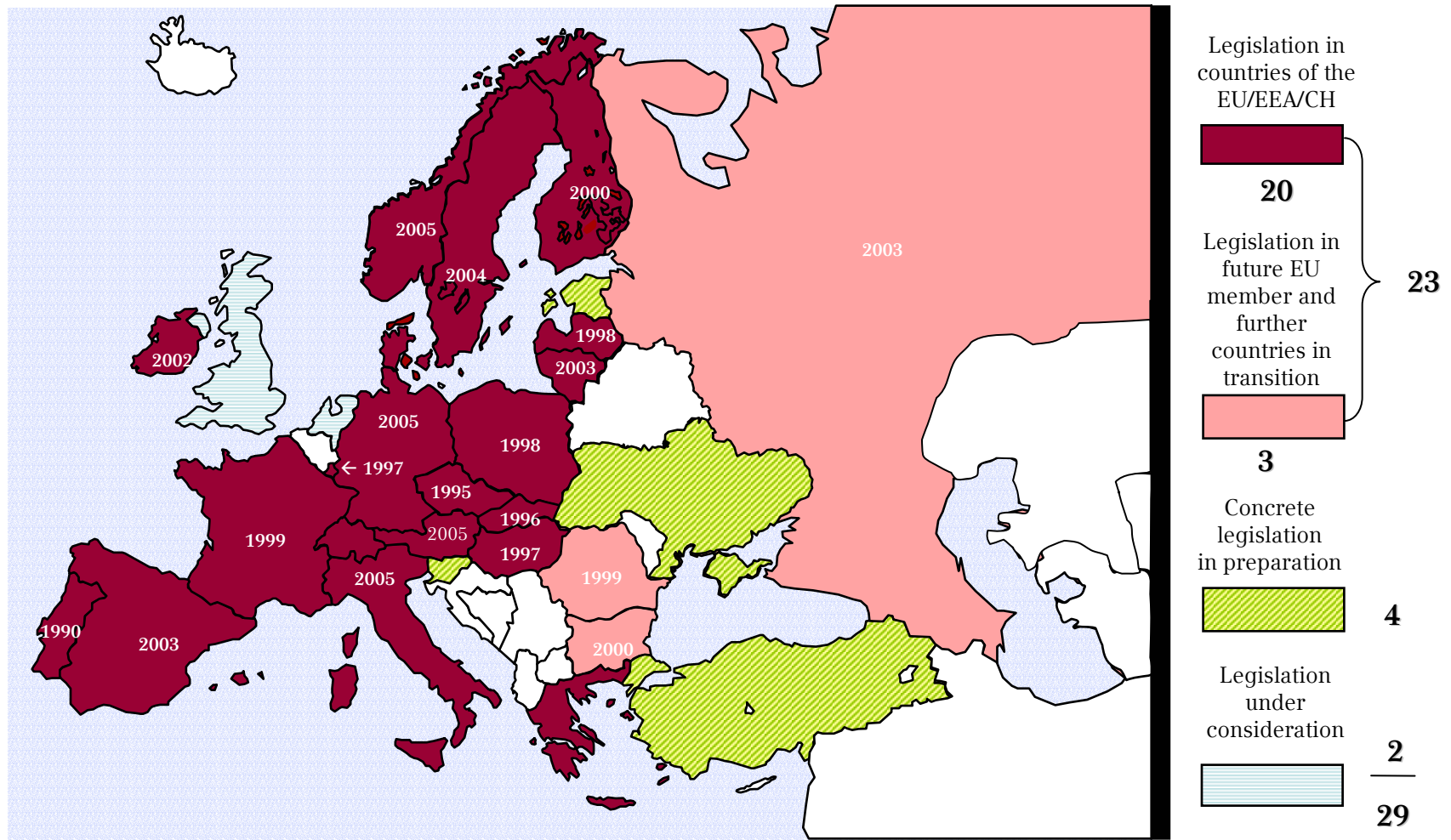


Covered Bonds in Europe



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





I. Structure of the Issuer

1. Who is the issuer?
2. Does the issuer hold the cover assets on his balance sheet or are they transferred to a SPV guaranteeing the covered bonds?
3. Specialized bank principle?
4. What is the legal relation of the covered bonds and the cover assets - is there a direct legal link between each other?
5. Static or dynamic cover pool?

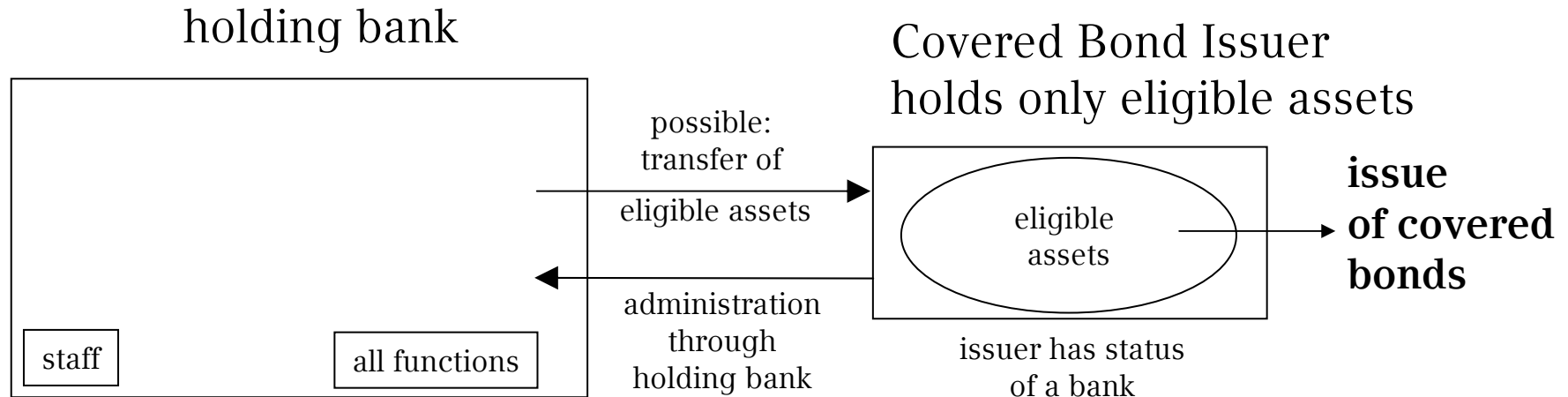


I. Structure of the Issuer



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

Finland, France, Norway, partially Sweden





I. Structure of the Issuer

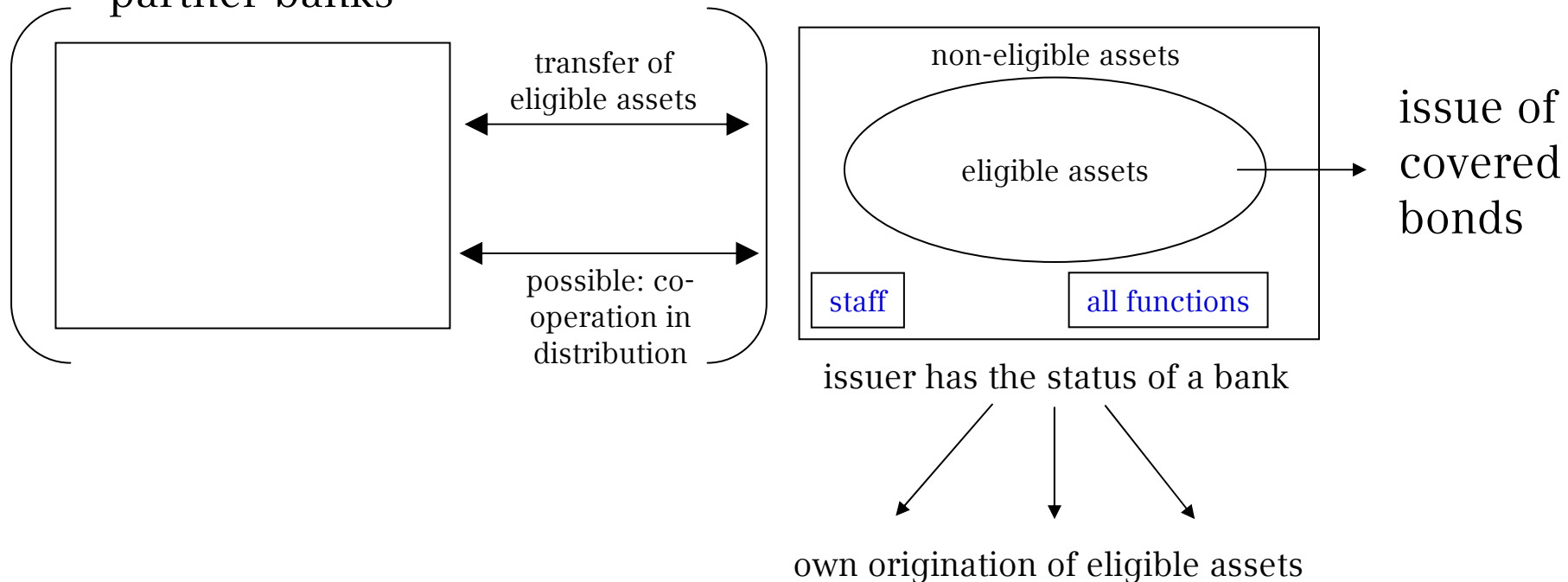


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(2) Specialised banks without/with non-eligible business

Austria (HBG), Denmark, Hungary, Ireland, Luxemburg, Poland, partially Sweden

possibly holding bank /
partner banks



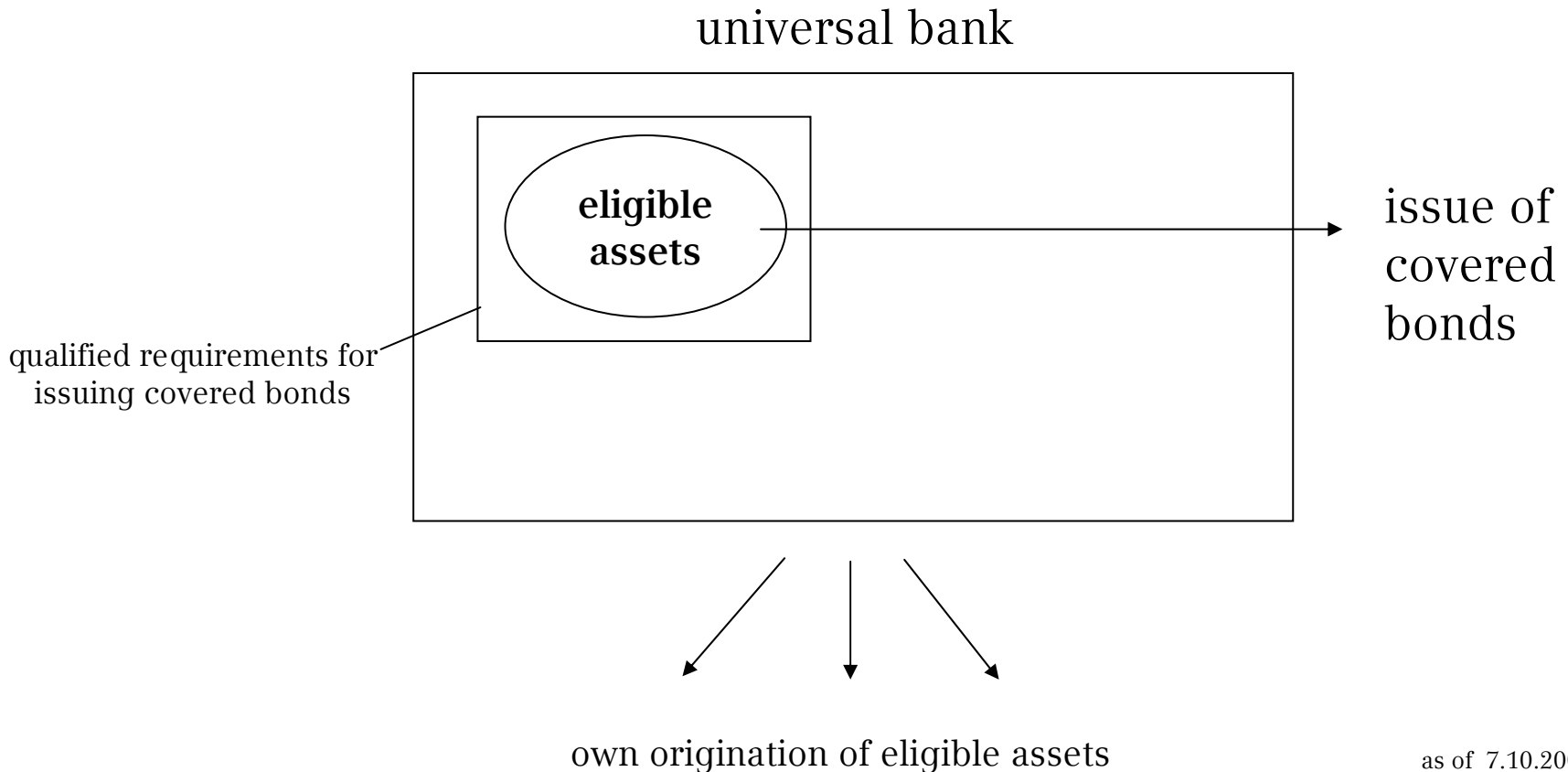


I. Structure of the Issuer



(3) Universal bank with qualified covered bond license

Austria (ÖPG), Germany, Latvia, Russia, Slovenia (draft law)





I. Structure of the Issuer

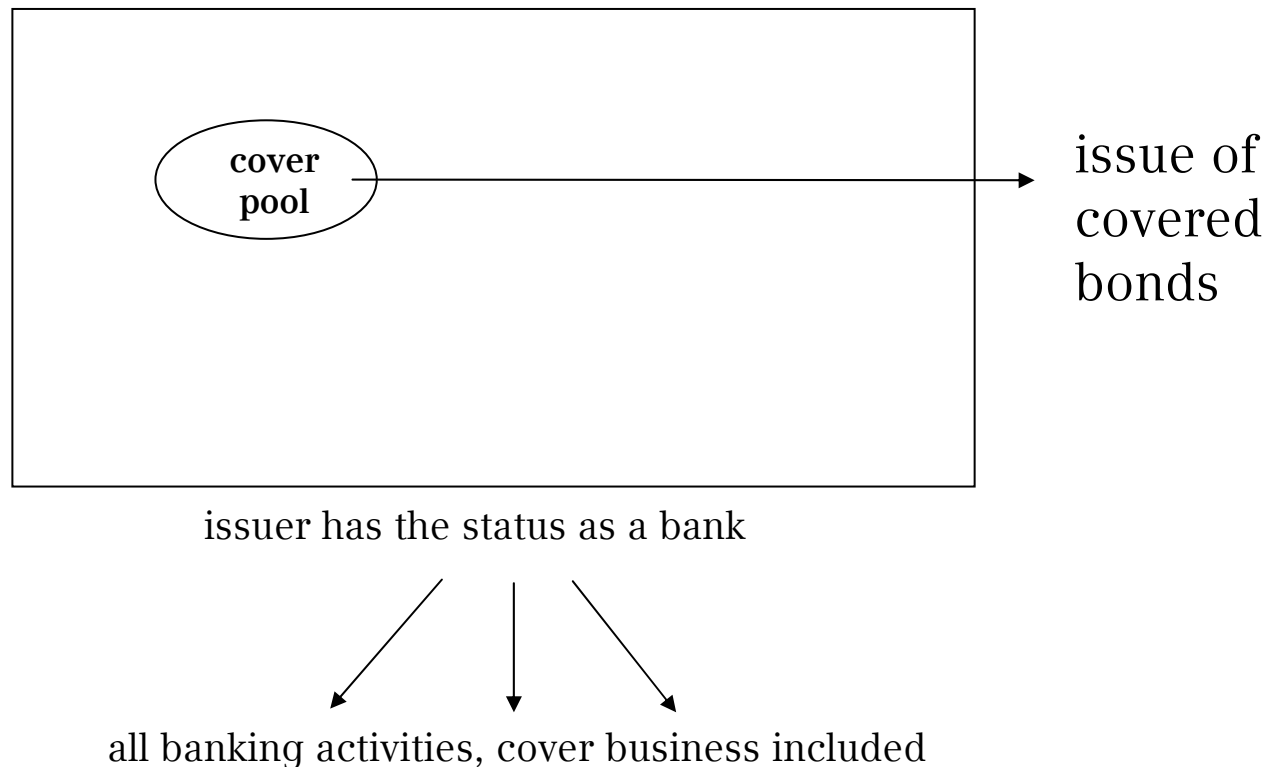


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(4) Right to issue covered bonds for all banks without specific covered bond license (or with mandatory license, but without requirements to obtain the license)

Without license: Bulgaria, Czech Republic, Lithuania, Spain

Mandatory license: Austria (fundierte SV), Slovakia

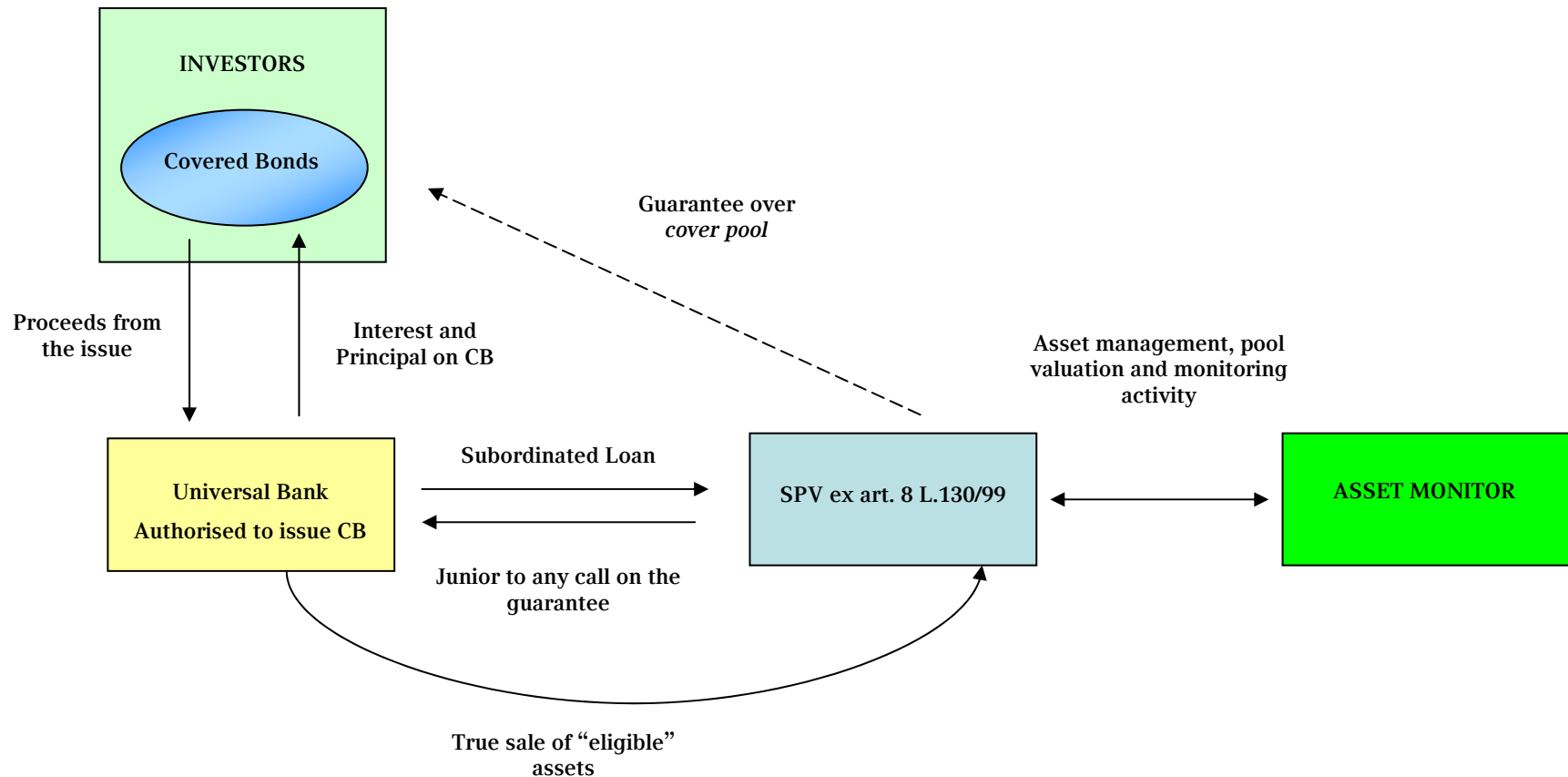




I. Structure of the Issuer



(5) Italian Covered Bond – Structural Diagram -





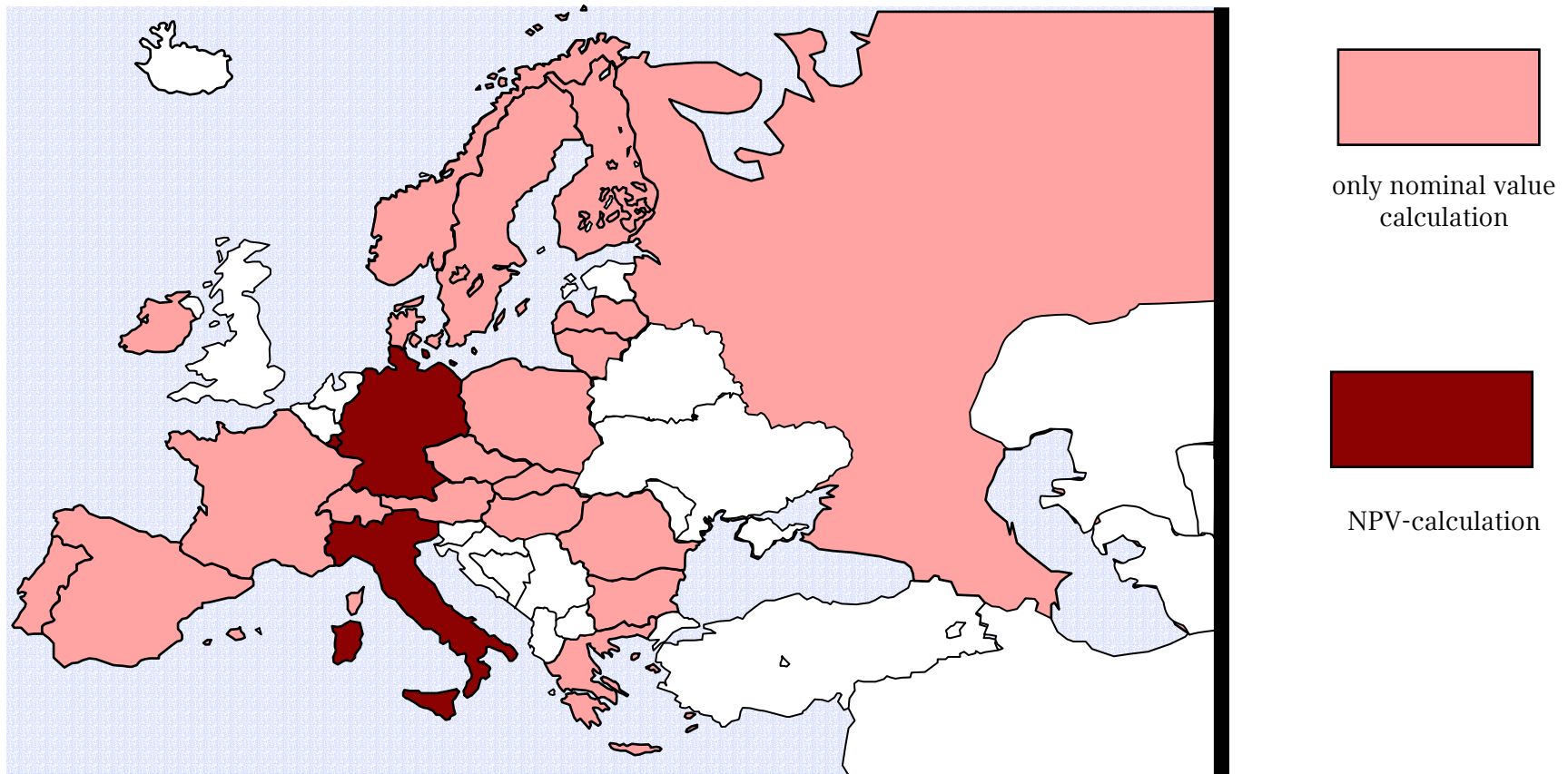
II. Only basic regulations on balance principle or sophisticated ALM-necessities?



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as of 12.10.2005



III. What valuation and LTV criteria are regulated?

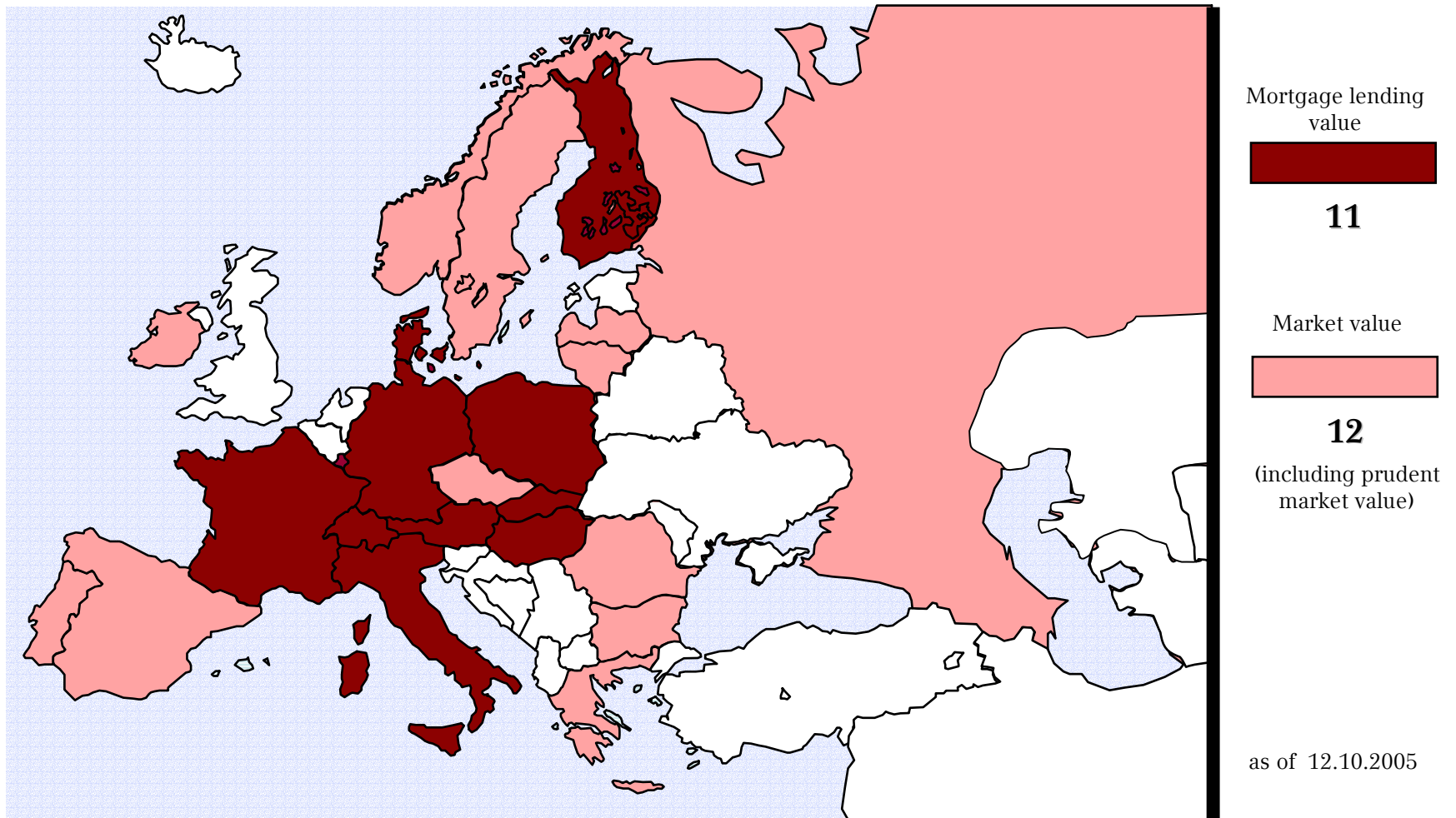


III. What valuation and LTV criteria are regulated?



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Important Differences of Covered Bond Regulations - valuation as basis of eligibility criteria for cover mortgages -





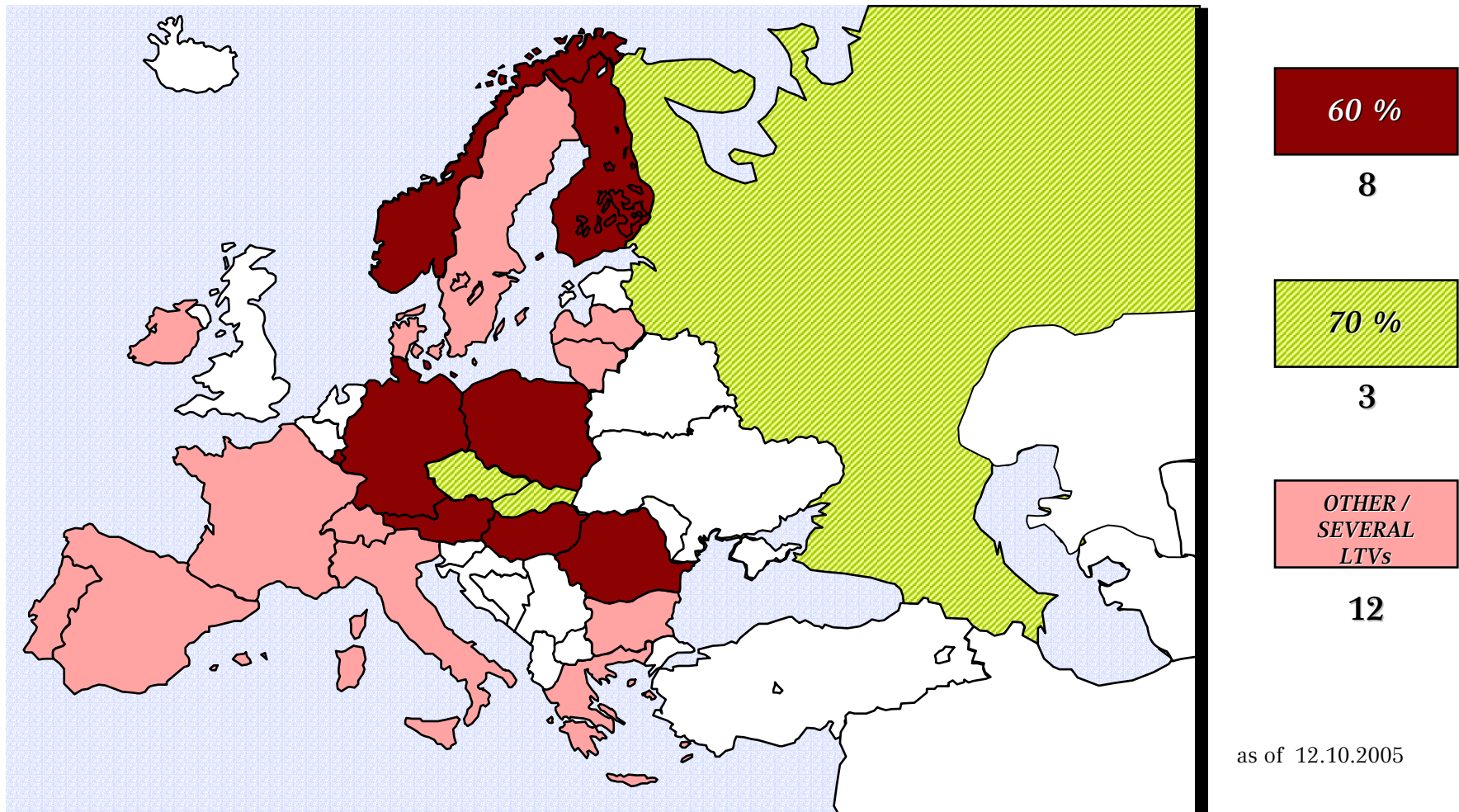
III. What valuation and LTV criteria are regulated?



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Important Differences of Covered Bond Regulations

- loan to value ratio as basis of eligibility criteria for cover mortgages -





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IV. Cover pool monitor and banking supervision

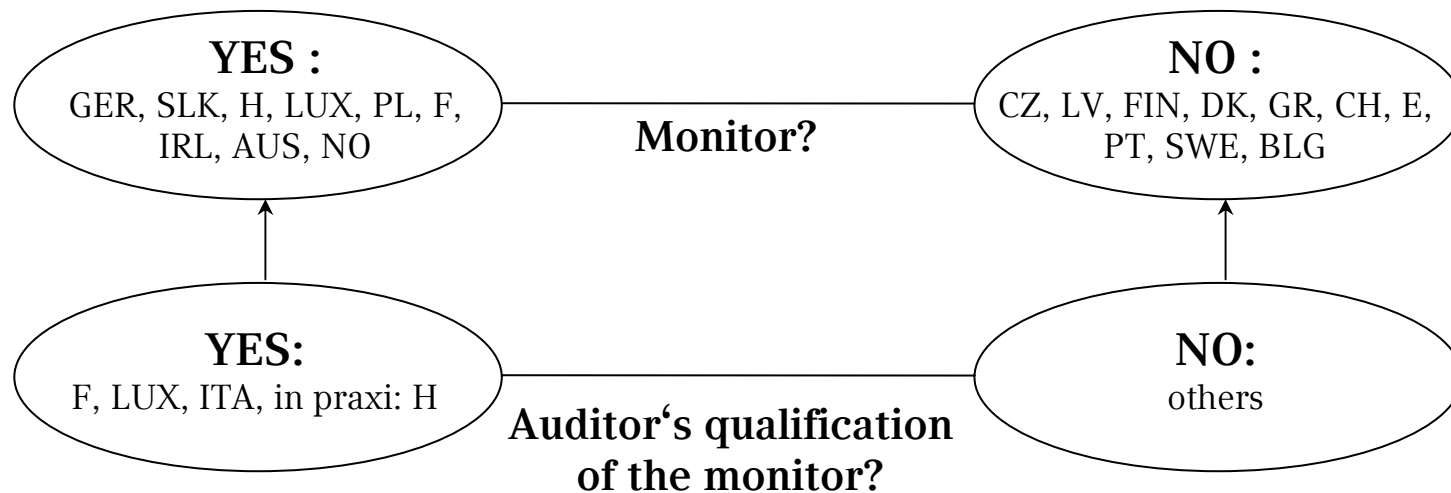


IV. Cover pool monitor and banking supervision



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Basic differences between the new laws for mortgage banks and Pfandbrief-like products in Europe





**V. How are segregation of cover assets and
bankruptcy remoteness of covered bonds
regulated?**

= pillar of security!



V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



What does „covered“ mean?

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

cover assets

≥

covered bonds



- quality of assets
- management of
 - interest rate risks
 - liquidity risks
 - operational risks

designation of cover assets to holders of covered bonds



- segregation of cover assets from originator's other assets in case of insolvency of originator
- bankruptcy remoteness of cover assets and covered bonds



timeliness of payment realistic?



The less covered bond issuers are legally specialised, the more and detailed regulations their covered bonds need in order to achieve clear segregation and bankruptcy remoteness and to convince capital markets of it.



V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



Questionnaire in order to check the level of segregation and bankruptcy remoteness of cover assets and of covered bonds:

1. How to identify the cover?
2. How to segregate the cover assets from the insolvency's estate?
3. Are covered bonds touched by the insolvency procedure?
4. How to ensure liquidity in case of insolvency of the issuer?



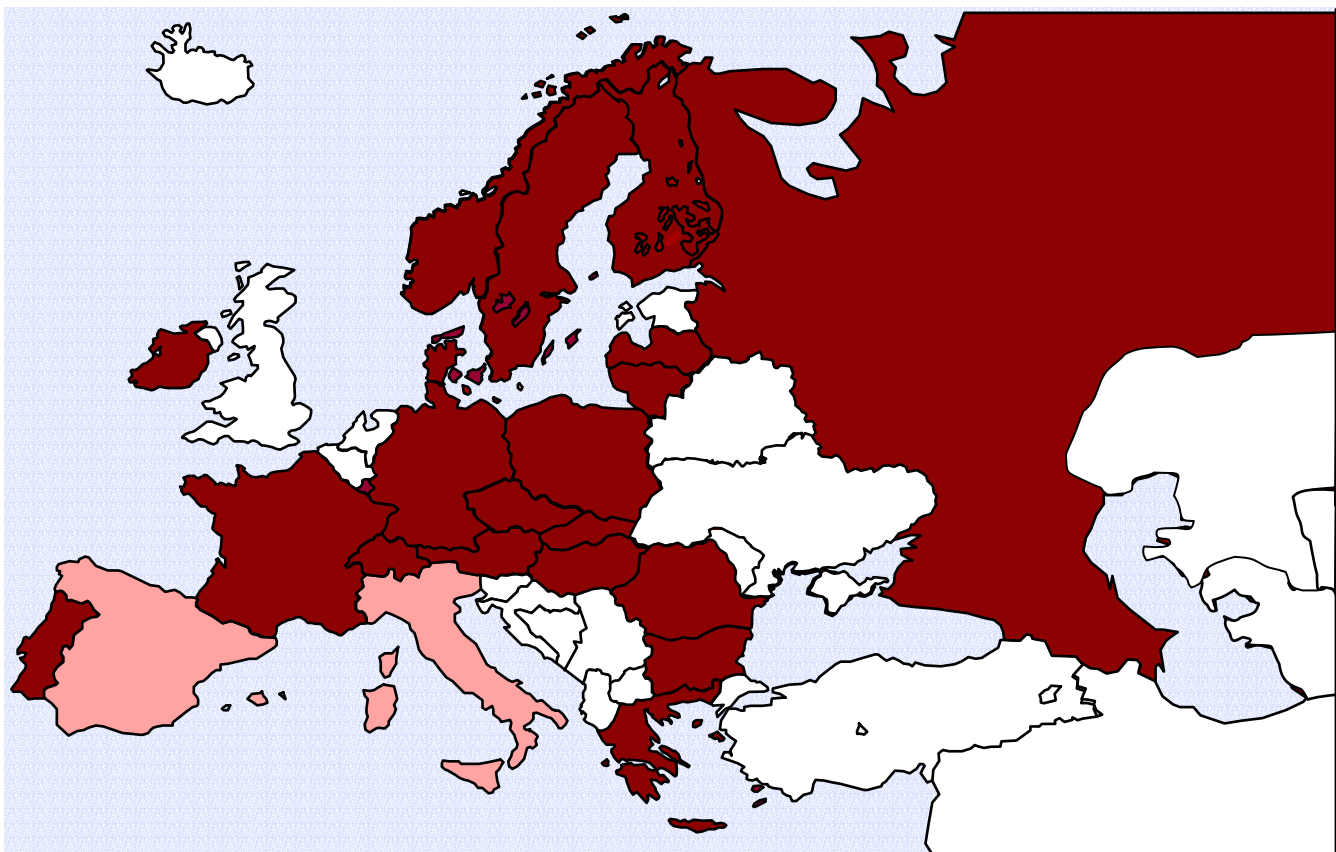
V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



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1. How to identify the cover? (1)

- Is there a cover register? → prerequisite for a clear and quick segregation of cover assets from bankruptcy estate possible



YES

21

DK: implicit register

NO

2

as of 12.10.2005

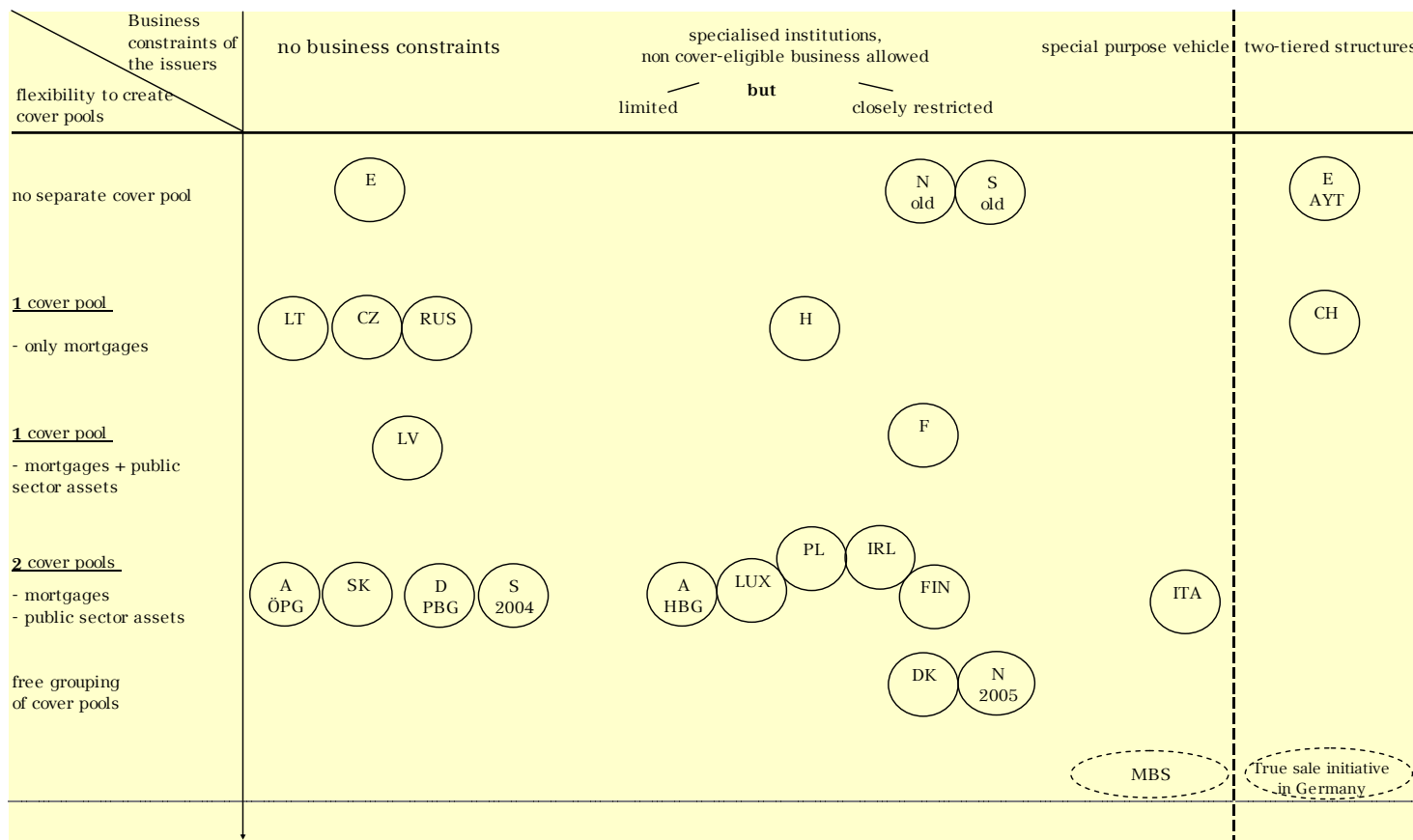


V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



1. How to identify the cover? (2)

- Is there a cover register?



Big differences in legislation and supervisors' rules regarding structure and administration of cover registers!



V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



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1. How to identify the cover? (3)

- What is registered?
- What is the legal effect of registration?
- Who manages the cover register and who checks and supervises it?



V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



2. How to segregate the cover assets from the insolvency's estate? (1)

Questions:

- Any legal or administrative action necessary or automatically by law?
- Who administers the cover assets from then on? A special cover pool administrator or the normal insolvency administrator, who also is in charge of the issuer's assets? *(CHART)*
- Do the cover assets form a separate legal estate, a pool administered in favour of the covered bond holders or are they held in (legal) trust? *(CHART)*



special cover pool
administrator

or

general bankruptcy
administrator?

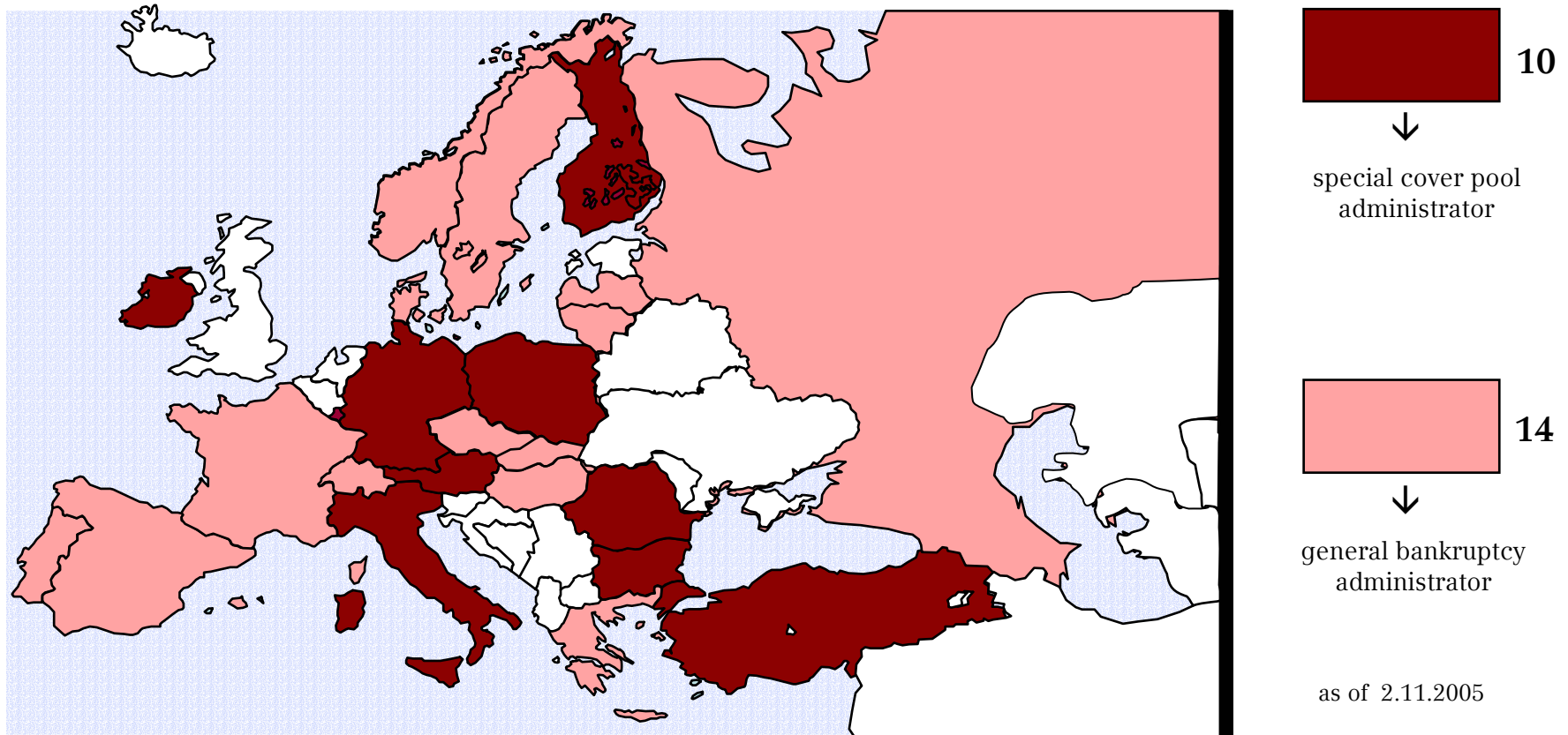


V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



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2. How to segregate the cover assets from the insolvency's estate? (2)
 - Who administrates the cover assets from then on? A special cover pool administrator or the normal insolvency administrator, who also is in charge of the issuer's assets?

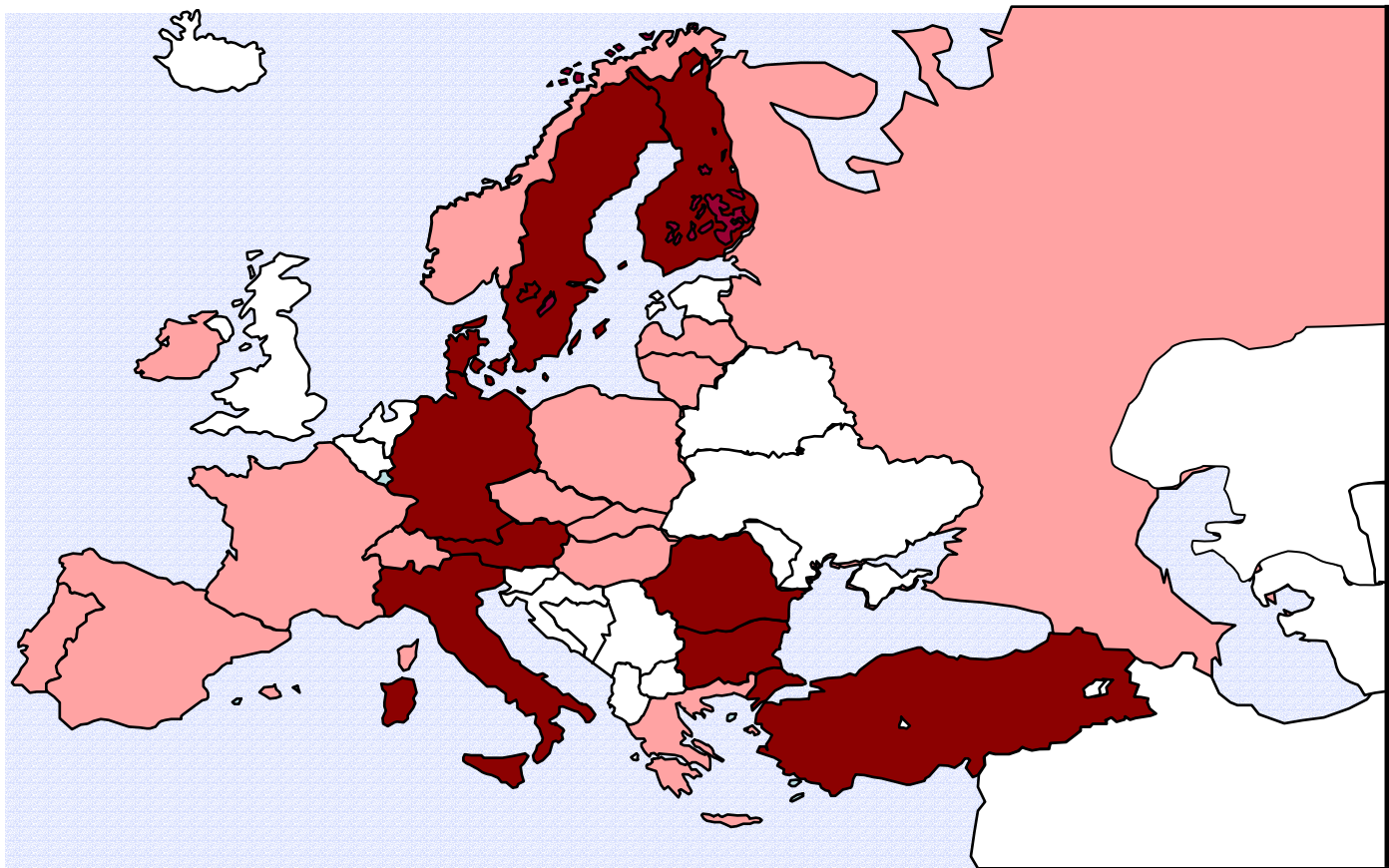




V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?

2. How to segregate the cover assets from the insolvency's estate? (3)

- Do the cover assets form a separate legal estate?
Is there only an insolvency privilege?



When issuer is insolvent, cover assets are:



legally separated (trust)



part of insolvency estate, but holders of covered bonds have insolvency privilege



V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



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3. Are covered bonds touched by the insolvency procedure?

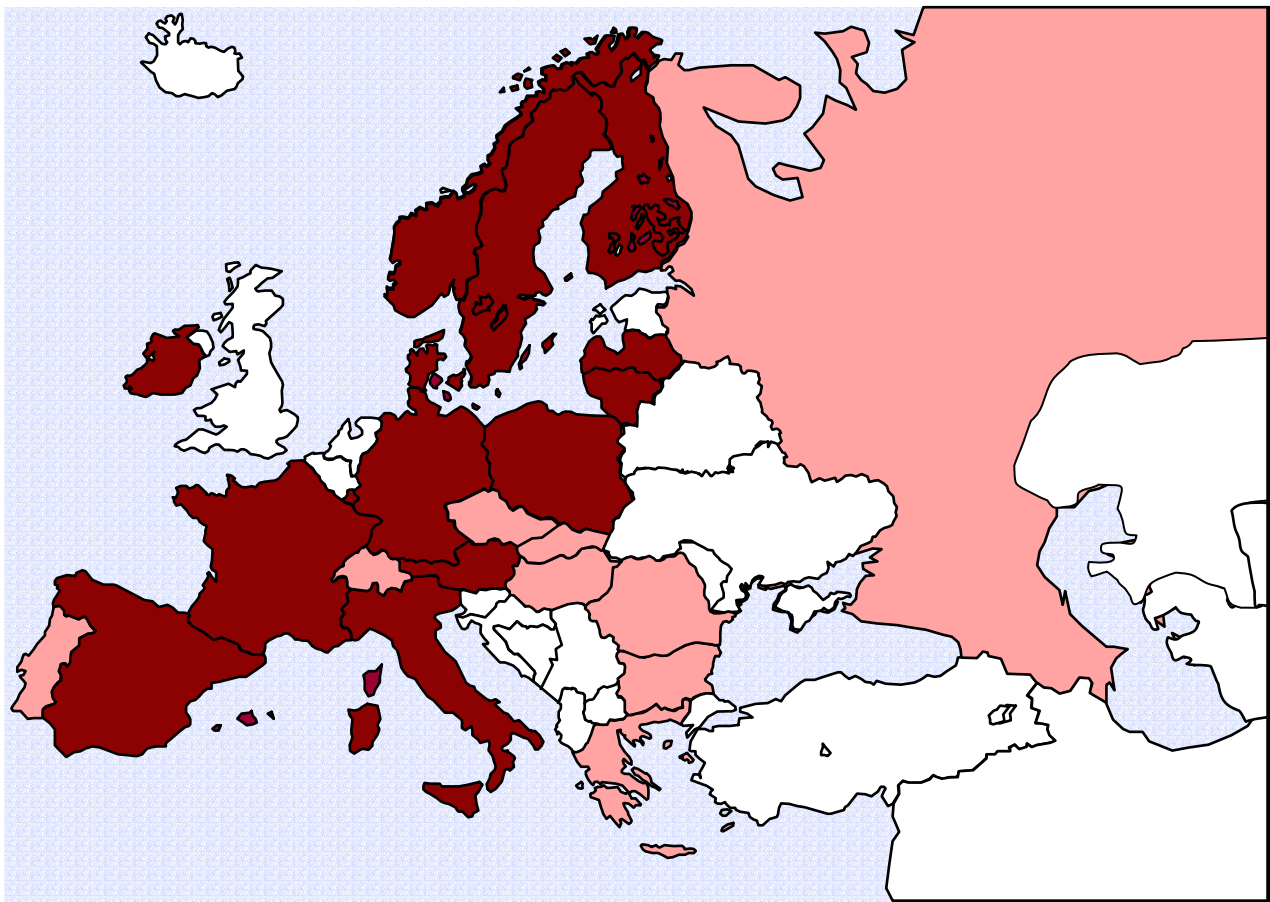
- Do covered bonds accelerate automatically, when the issuer goes insolvent? (*CHART*)
- What is the legal consequence of the insolvency of the issuer for the derivatives (and respective collateral), which are part of the cover?
- Do covered bond holders get a preferential treatment in the insolvency of the issuer? Are they restricted to this preferential treatment?
- Could a judicial stay (moratorium) on the insolvency's estate delay the cash flows from the cover assets and, therefore, endanger the timely payment of interest and the principle on covered bonds?



V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?

3. Are covered bonds touched by the insolvency procedure?

- Do covered bonds accelerate automatically, when the issuer goes insolvent?



14

NO



Do derivatives accelerate, which are part of the cover pool? (netting) → **NO = ok**
→ **YES = problem**

9

YES

↖ cash flow for investor not foreseeable over whole maturity of covered bond



Do cover assets accelerate?

YES

NO

liquidity problems of the debtors/clients of the insolvent bank estate

liquidity problems of the bankruptcy estate



V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



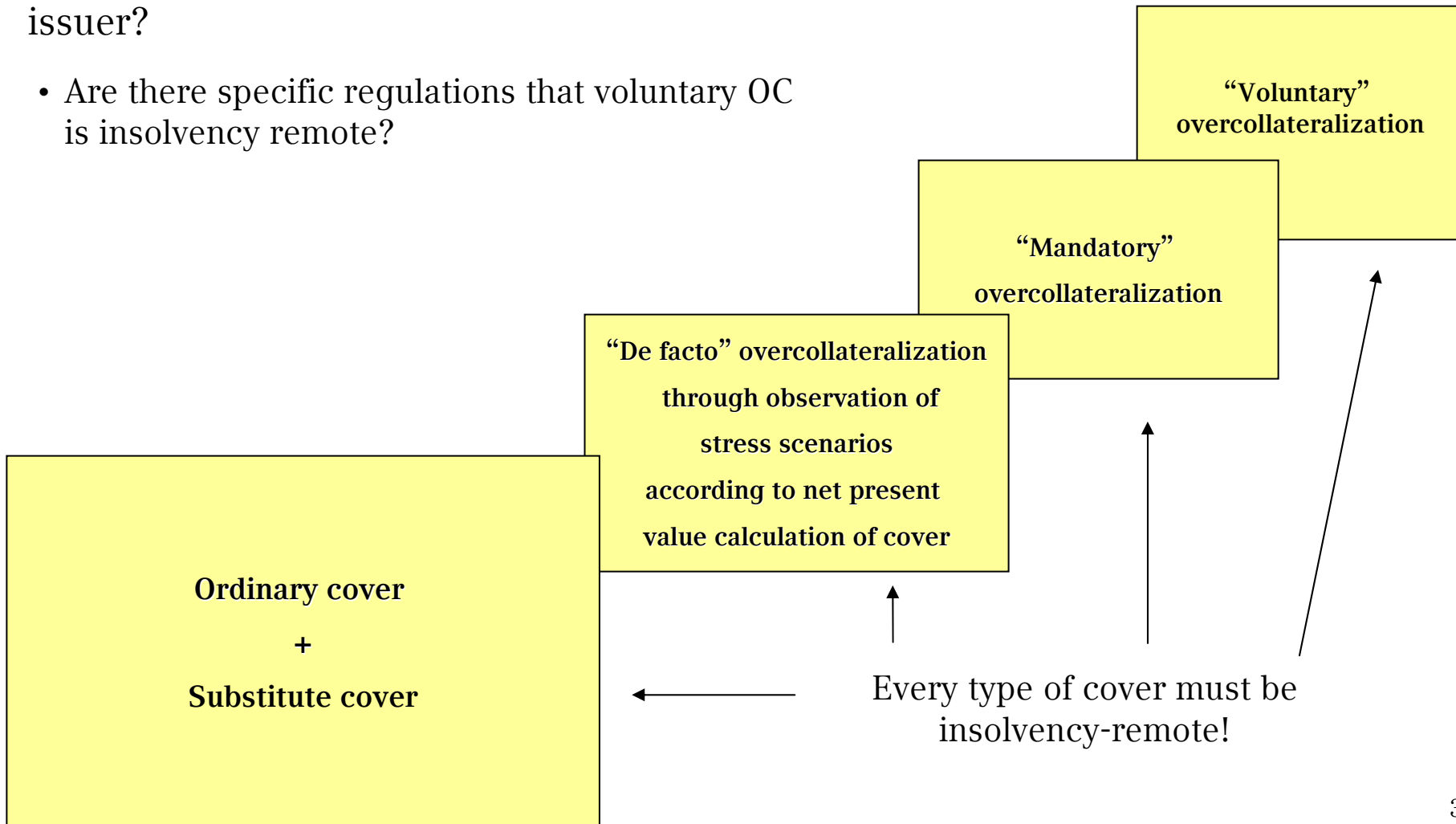
4. How to ensure liquidity in case of insolvency of the issuer?
- Who is entitled to the cover assets?
 - Who has the first access to the cash flows on cover assets?
 - Is there a mandatory OC?
 - Are there specific regulations that voluntary OC is insolvency remote? *(CHART)*
 - Are liquid (substitute) cover assets allowed for the cover of mortgage covered bonds?
 - Can the (special) administrator of the cover pool take a loan to get liquid assets? Would this loan rank pari passu with the covered bonds?
 - Are there any specific regulations for the sale and transfer of mortgages respectively to other issuers? How easy is the sale of mortgage cover assets? *(CHART)*



V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?

4. How to ensure liquidity in case of insolvency of the issuer?

- Are there specific regulations that voluntary OC is insolvency remote?



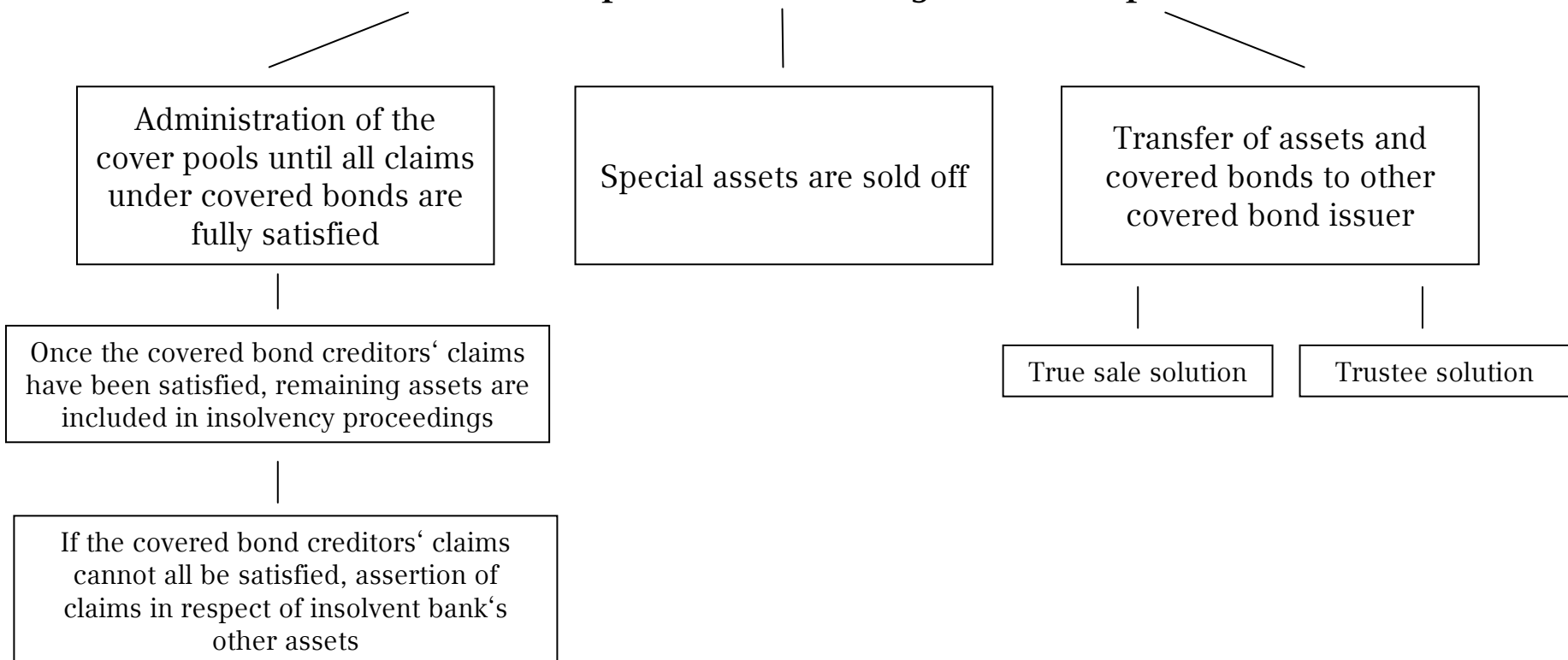


V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?

4. How to ensure liquidity in case of insolvency of the issuer?

- Are there any specific regulations for the sale and transfer of mortgages respectively to other issuers? How easy is the sale of mortgage cover assets?

Alternative modes of procedure with regard to the special assets

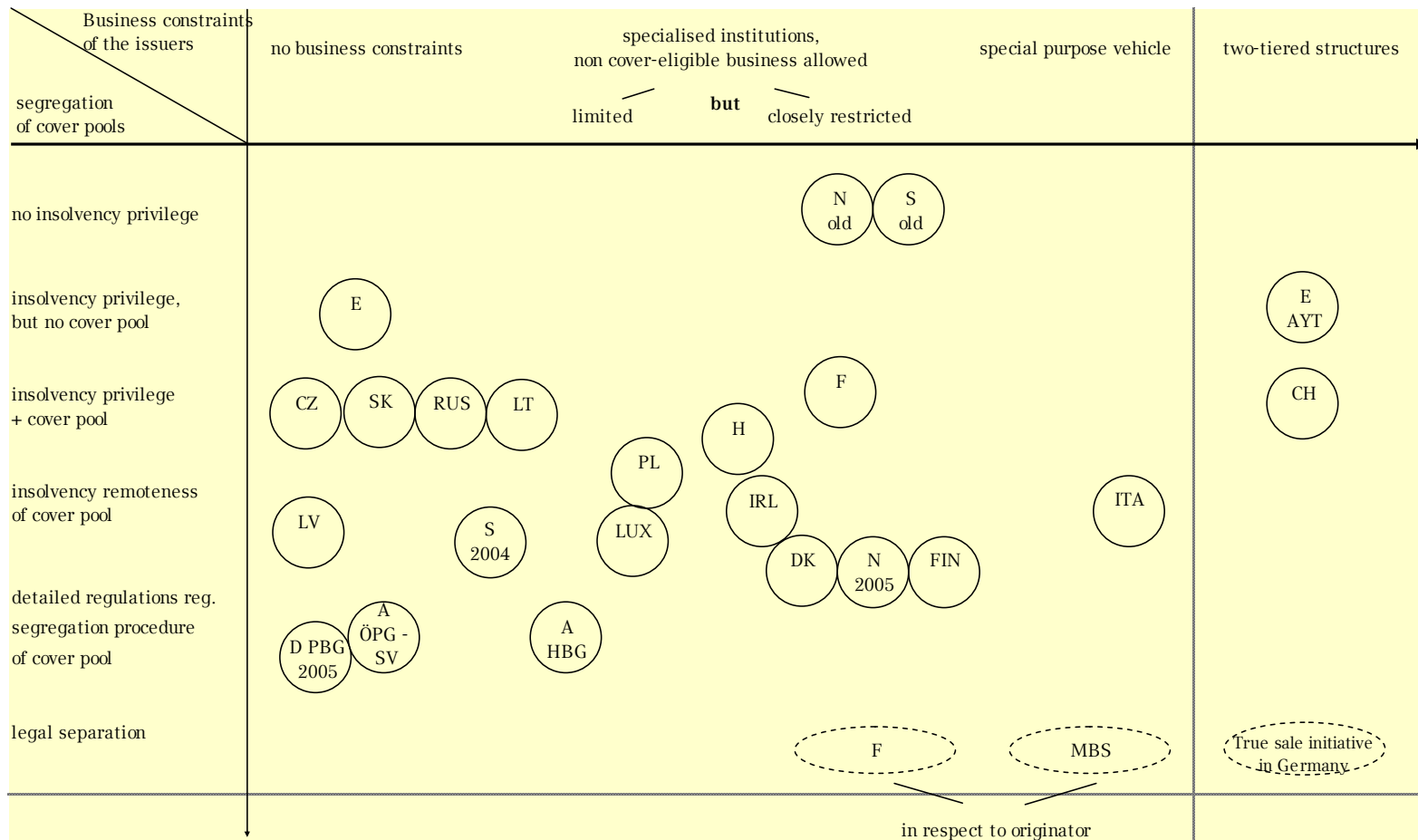




V. How are segregation of cover assets and bankruptcy remoteness of covered bonds regulated?



Final Overview





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