



Verband deutscher
Hypothekenbanken
Association of German Mortgage Banks

UN-Habitat-United Nations Human Settlements Programme European Federation of Building Societies

Housing Finance in Emerging Markets – Experiences and Challenges

Berlin, 22nd - 24th September 2004

- The Covered Bond in Central and Eastern Europe -

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- **What is a Covered Bond?**
- **Economic Point of View**
- **The German Example**
- **Legal Point of View**
- **Legislation on Covered Bonds in Europe**



I. What is a Covered Bond?



What is a Covered Bond?

A debt instrument

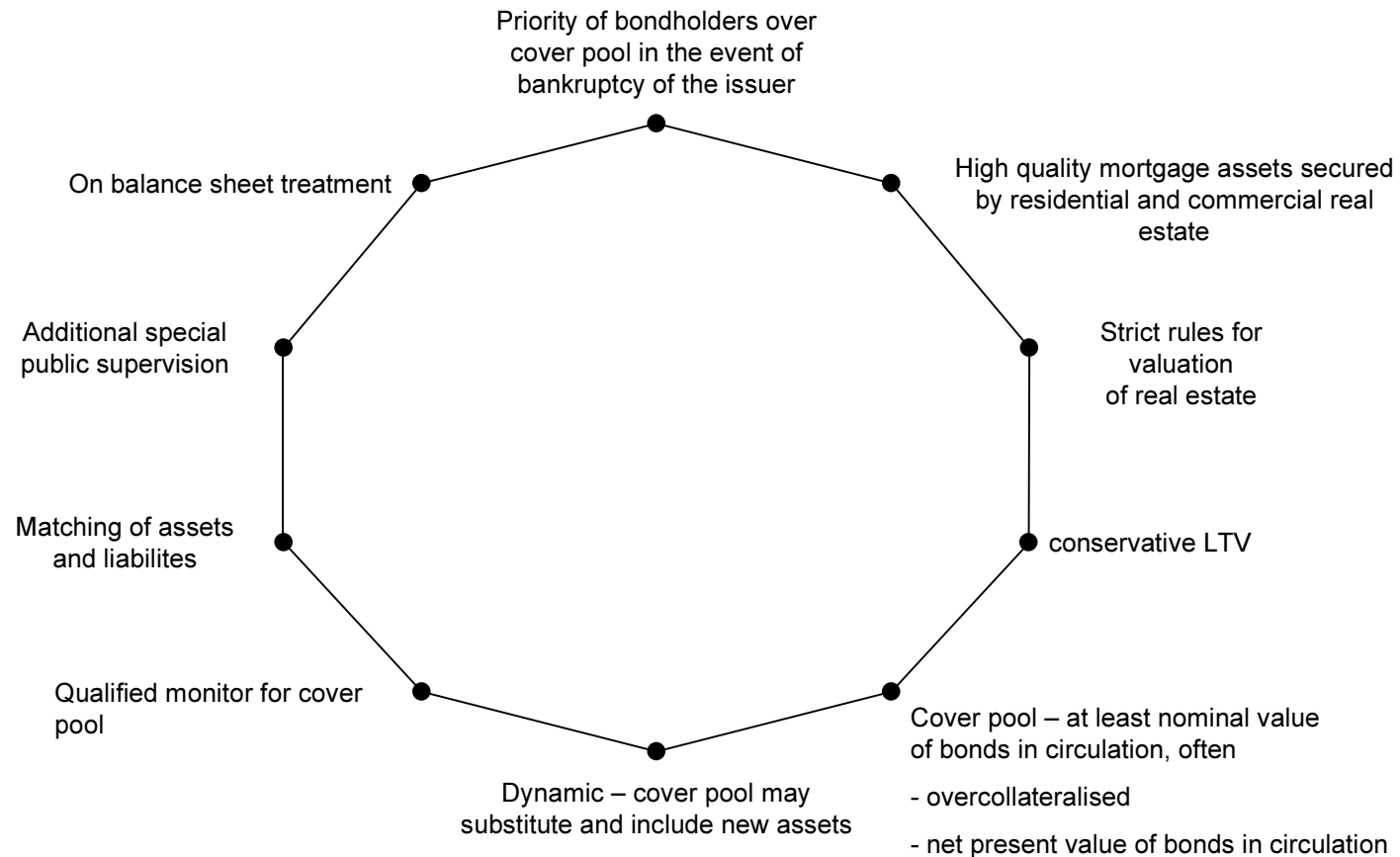
secured against a

**pool of specifically identified,
eligible mortgage / cover assets**

**issued by a bank on the balance
sheet of a bank**



Characteristics of a Covered Bond





II. Economic Point of View

Covered bond sees a renaissance in Europe

West

improve or renew systems

EMU (Euro)

different systems of mortgage banks and mortgage bonds

Central and East

mortgage banks and mortgage bonds have to be established

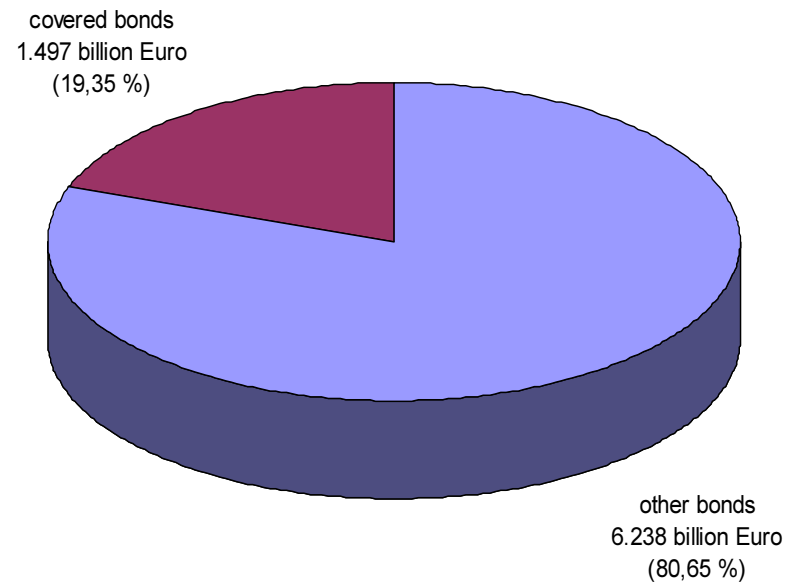
historic development and actual situation in Europe

problems in housing ⇒ financing required

The European Bond Market: 7.735,7 billion Euro (end of 2002, EU-accession countries not included)

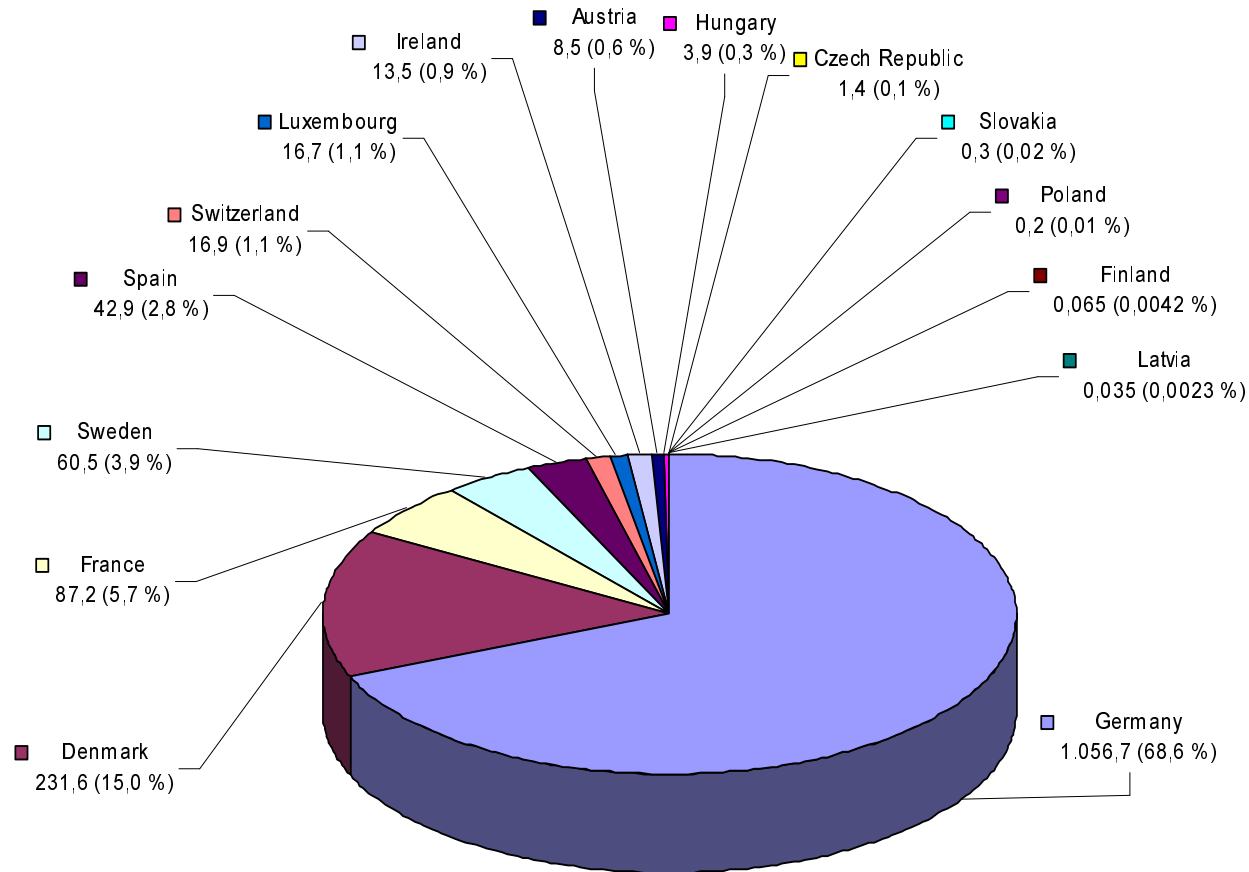


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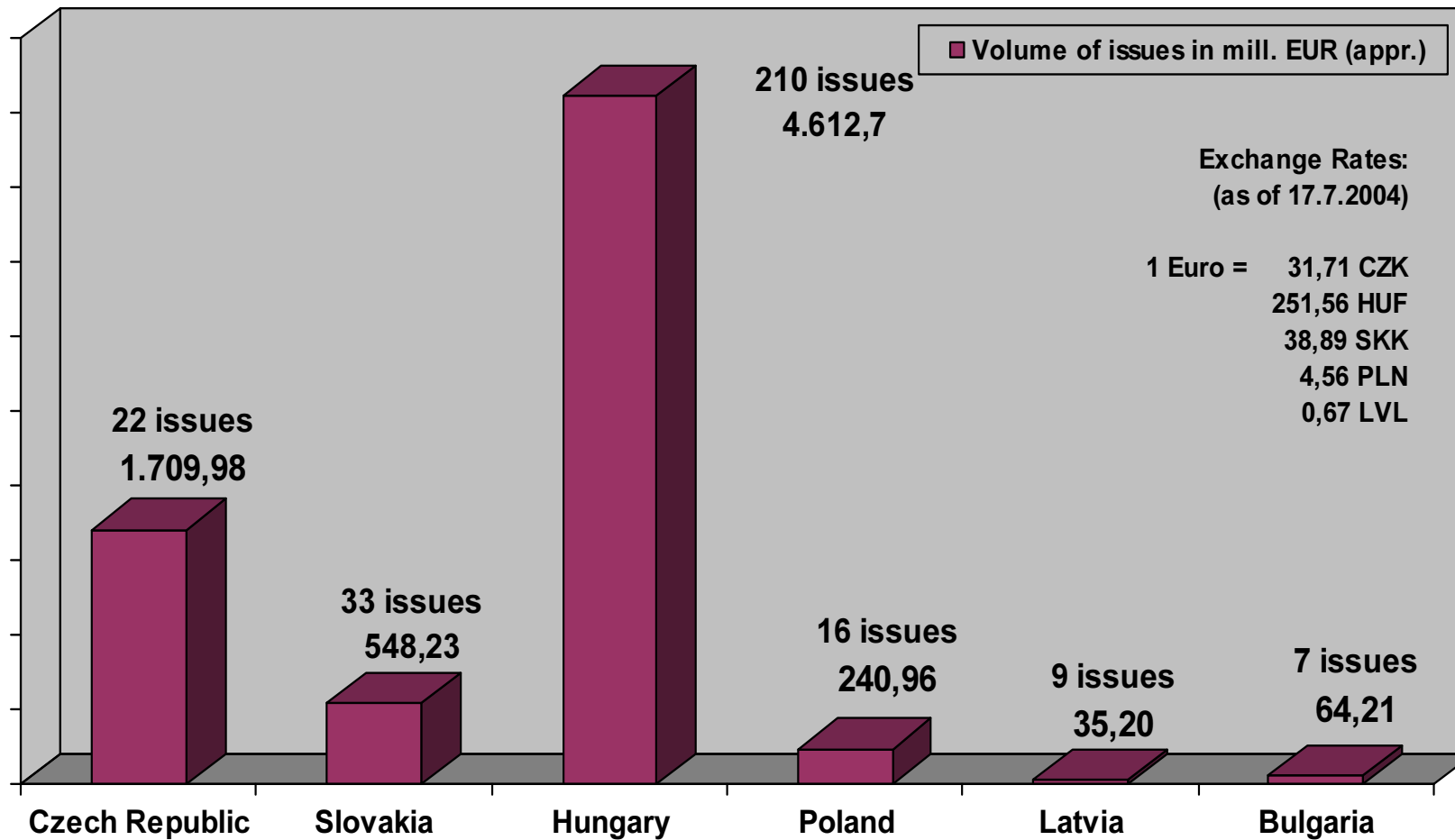
**(bond market – total of all covered bonds, government bonds included,
only Euro-denominated bonds)**

Market Share of the European Covered Bond Countries in the European Covered Bond Market (end of 2003): 1.540 bn €



for comparison: UK "covered bonds" = 11 bn €

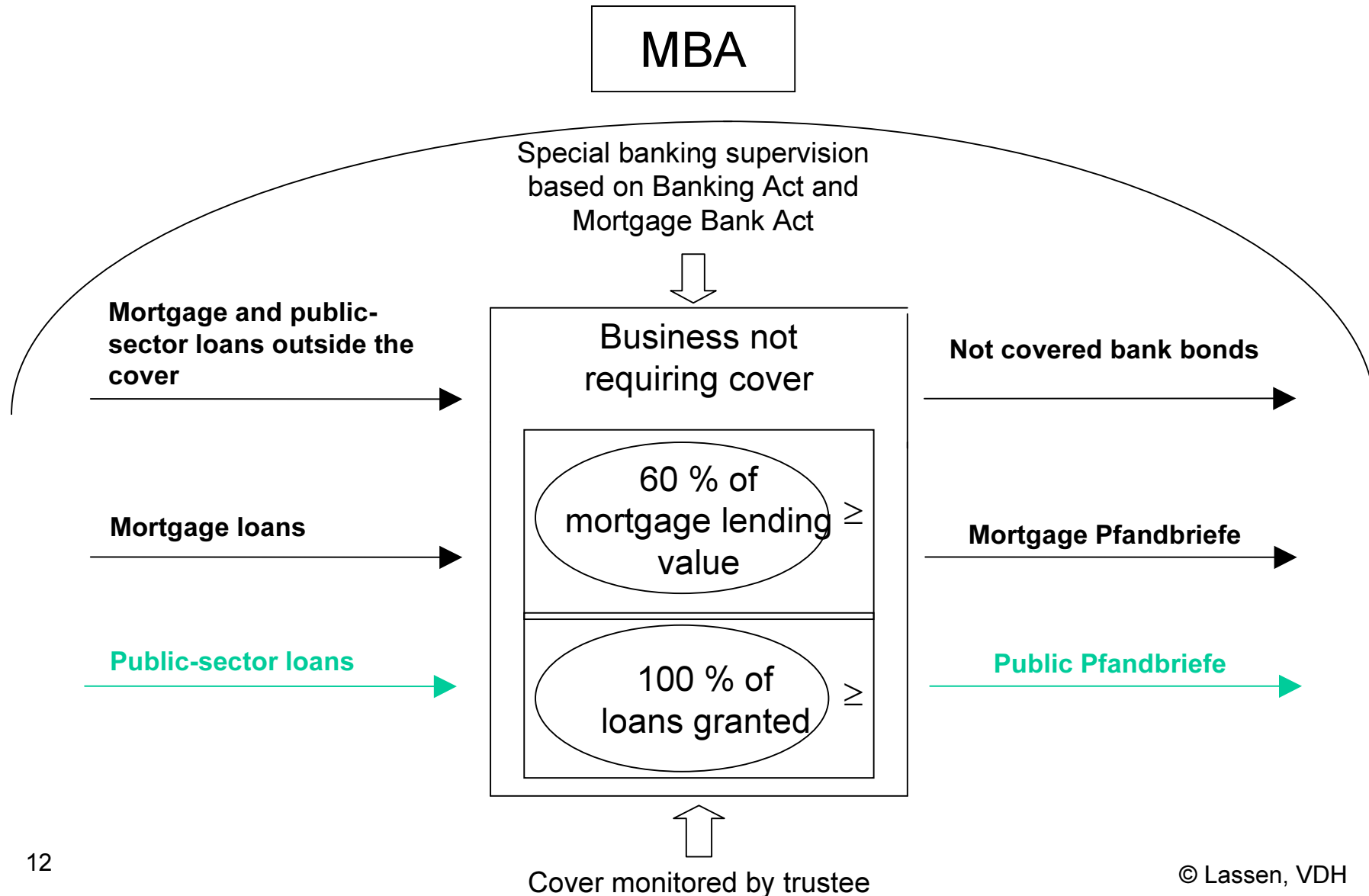
Covered bonds outstanding in central Europe since 1996: Czech Republic, Slovakia, Hungary, Poland, Latvia, Bulgaria, as of 6.9.2004





III. The German Example

Structure of a German Mortgage Bank





Important Features of the Mortgage Bank System

Business by banks

- same regulations as for other banks
- same capital adequacy ratios

but:

- additionally special supervision
- trustee for coverage
- limitations of business (specialisation)
- matching of assets and liabilities
- Mortgage lending value



Security of the German covered bond I

Mortgage Lending Value

- the value that can be expected with a high level of surety
- derived from the historic perspective of market events at the time of valuation,
- on the basis of durable characteristics
- and which will be achieved in normal property transactions over a lend period in the future

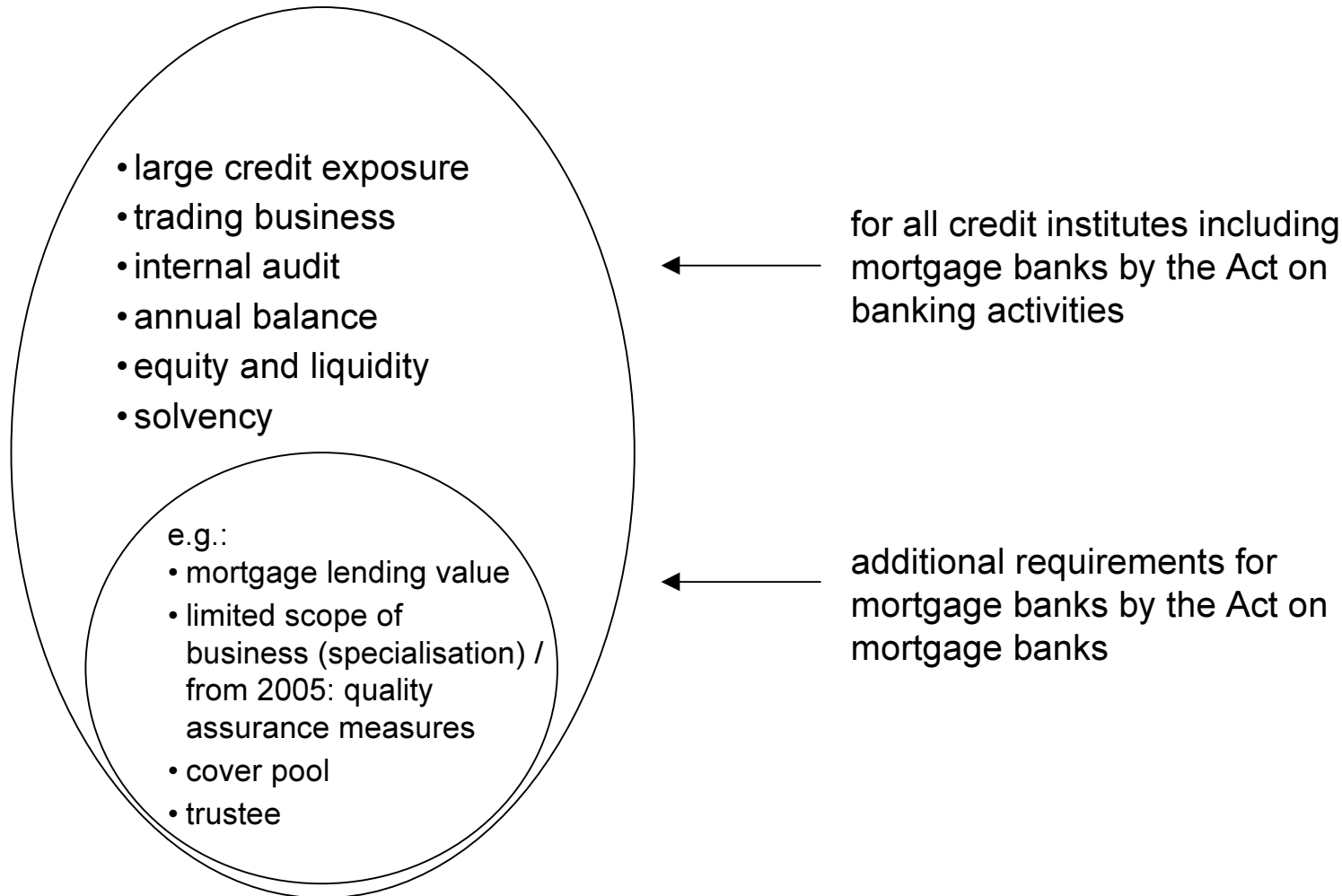
Sustainability

- exclusion of all speculative elements
- stabile value components, derived from the market events of the past
- only proven secured characteristics and income streams
- careful estimation of the future marketability of the particular property
- adaptability for various uses or adequate functionality to third parties

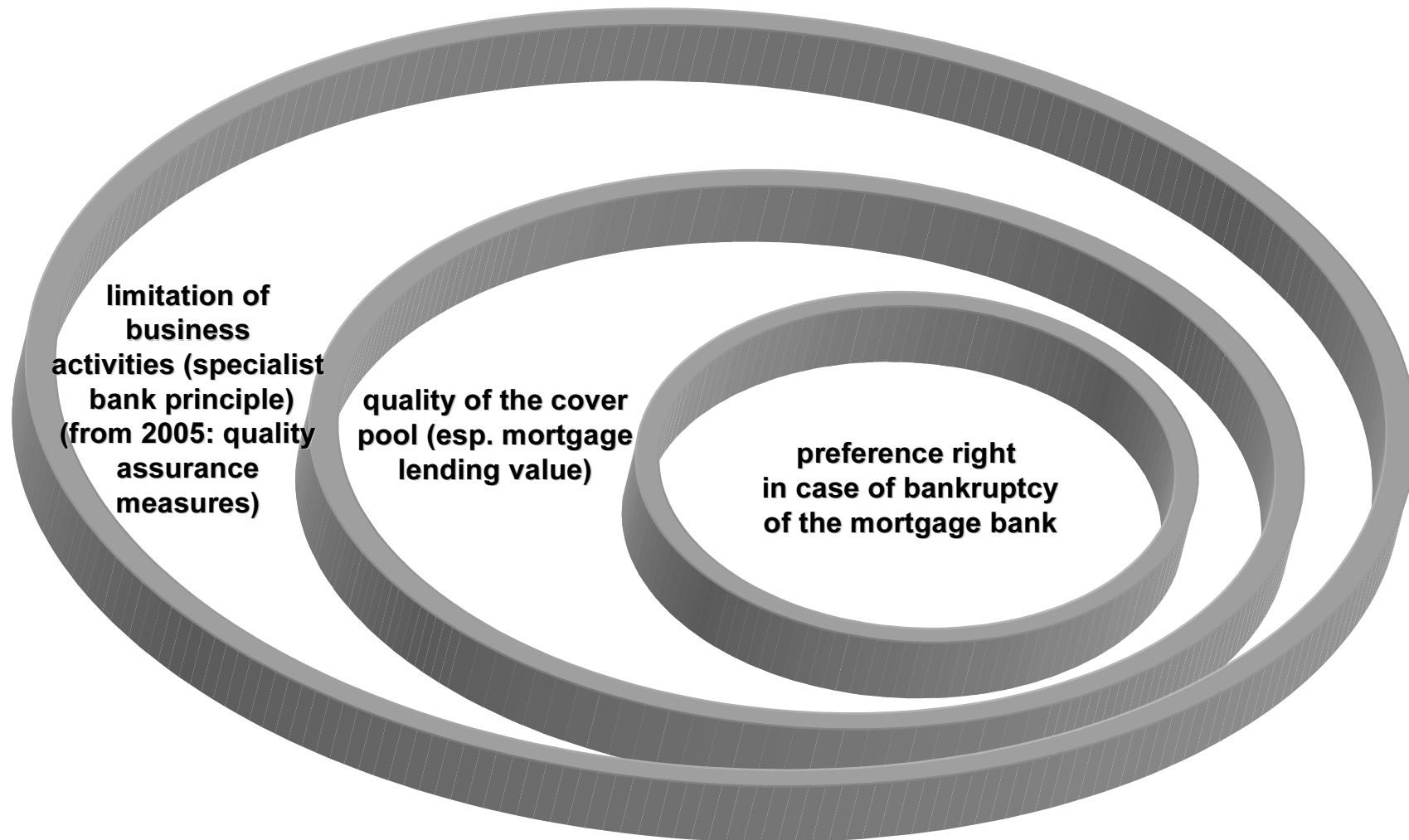
Security of the German covered bond II Supervision on mortgage banks in Germany



- special public supervision -



Protective walls around the covered bond

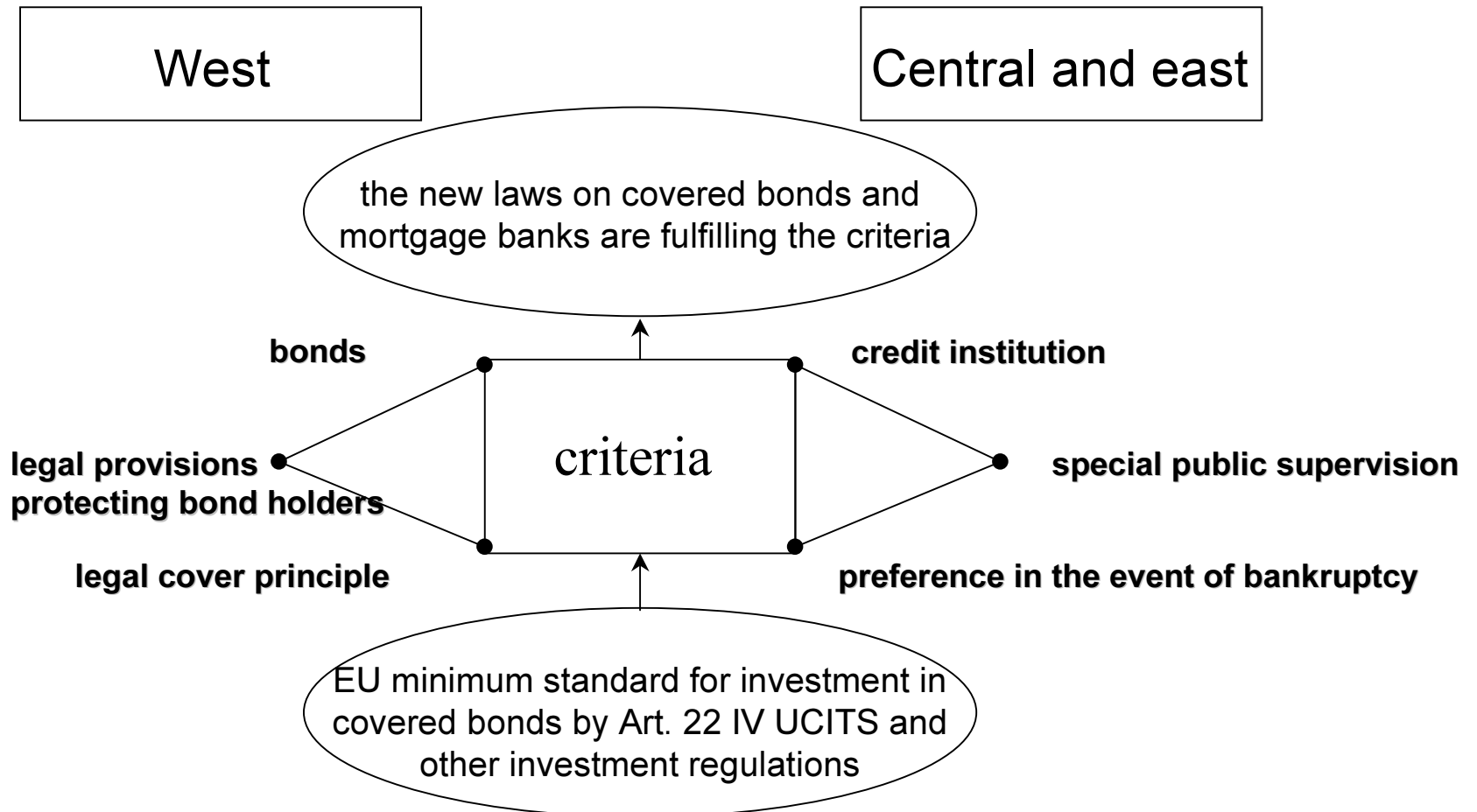




IV. Legal Point of View

Legal point of view

What are the Benchmarks?





EU-law for covered bonds

- **Art. 22 (4) UCITS-Directive (Investment Directive)**
- **Art. 49 (1) letter I); Art. 63 (2) of the Consolidated Banking Directive**
- **Art. 22 (4) of the 3rd Directive on life insurance companies**
- **Art. 22 (4) of the 3rd Directive on other insurance companies**
- **Art. 11 (2) of the Directive on capital adequacy for investment firms**
- **Art. 1 No 1 (3) of the Directive on deposit insurance**
- **EZB: Tier 1 (eligible as collateral)**

Meaning of Art. 22 IV UCITS-Directive → „Mortgage bond“ as privileged investment instrument

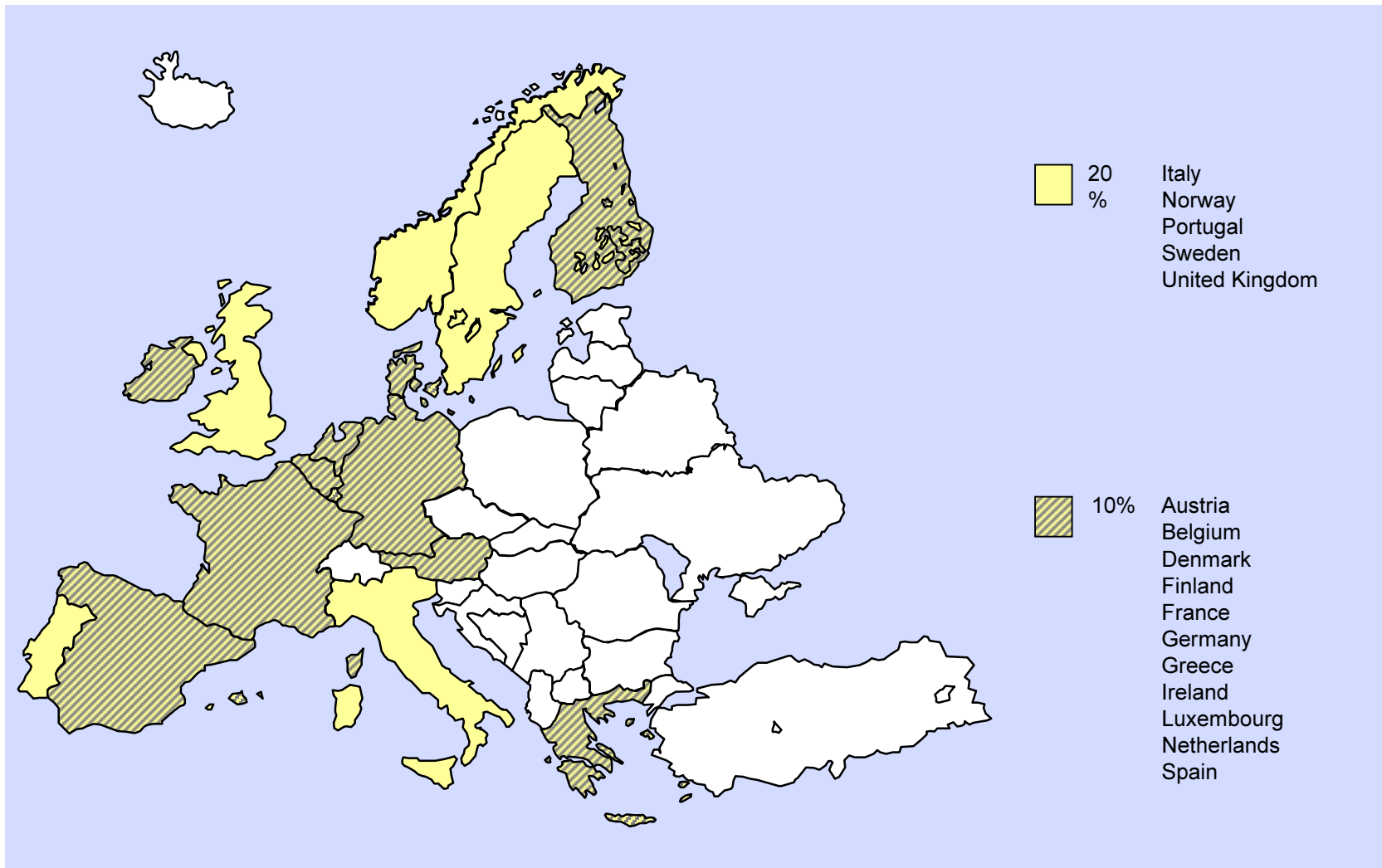


Investment funds	Directive on life insurance companies	Directive on large exposure credits	Directive on capital adequacy	Directive on deposit insurance
<p>funds may be invested in covered bond/ bonds according to Art. 22 IV UCITS:</p> <p>25% instead of 5-10% in securities of one issuer</p>	<p>„bound assets“ may be invested in covered bond / bonds according to Art. 22 IV UCITS:</p> <p>40% instead of 5 % in securities of one issuer</p>	<p>covered bond/ bonds according to Art. 22 IV UCITS:</p> <p>are not included in the calculation of the upper limit</p>	<p>covered bonds / bonds according to Art. 22 IV UCITS:</p> <p>have to be covered only with half of the equity</p>	<p>covered bonds / bonds according to Art. 22 IV UCITS:</p> <p>are excluded from the term of „deposit“</p>

**Weighting of covered bonds complying with
Art. 63 (2) Consolidated Banking Directive 2000/12/EC
(former Art. 11 II Solvency Ratio Directive), as of 12/2002**



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Covered bond = 22 IV UCITS Directive?

- **no Europe-wide uniform definition of the covered bond**
- **but minimum standard for a particular safe type of a bank's bond, taken into account in 7 directives and in Tier I of the ECB**



Definition of minimum standards of covered bonds

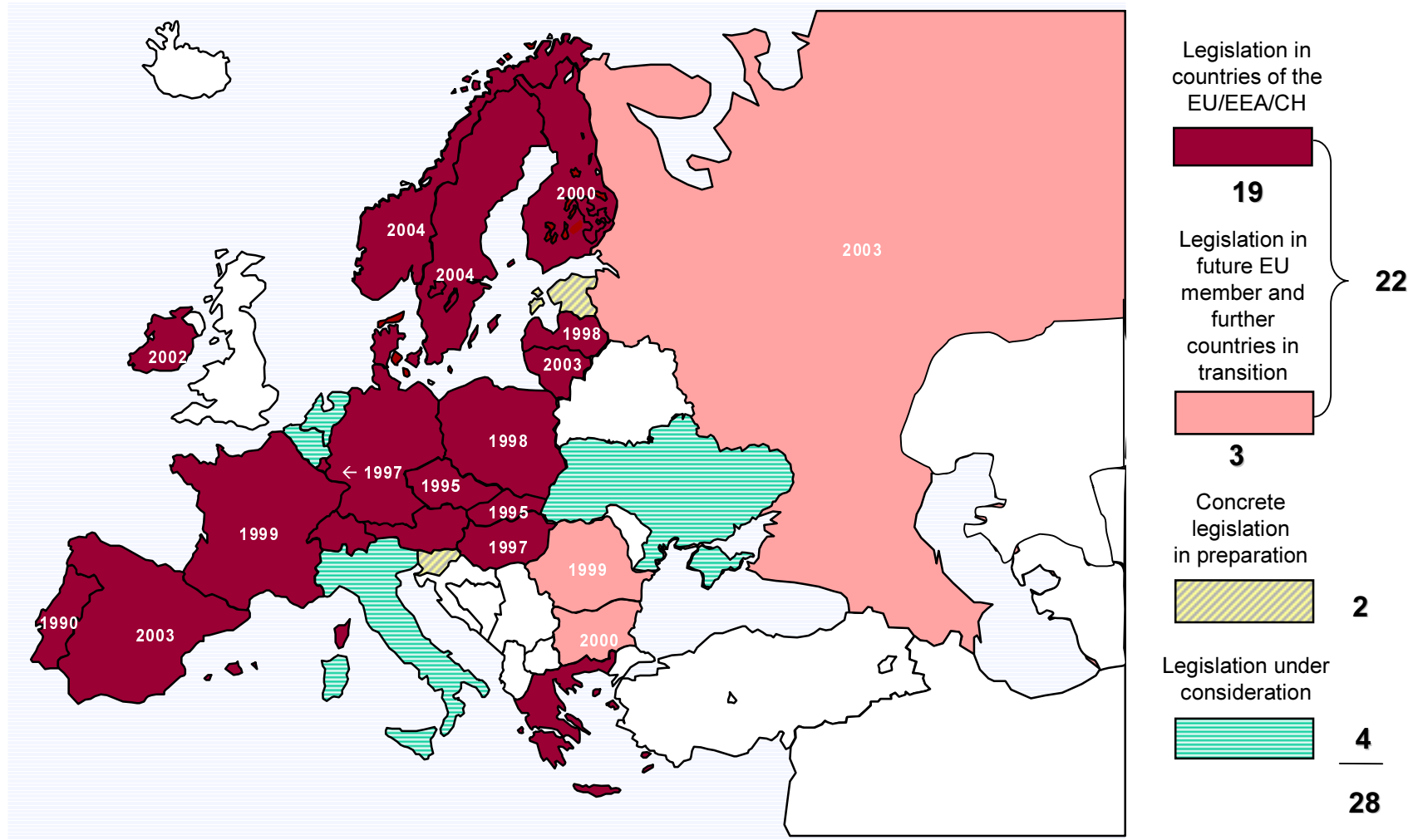
EU-Commission's Consultation Paper 3 defines covered bonds as
bonds
fulfilling

- Art. 22 (4) UCITS +
 - definition of eligible assets
 - public sector loans
 - mortgage loans (residential 80 % LTV, commercial 70 % LTV on basis of market value)
 - loans to banks as substitution (only up to 5 % of volume of cover pool)
- ⇒ first legal definition of covered bonds in future capital adequacy rules

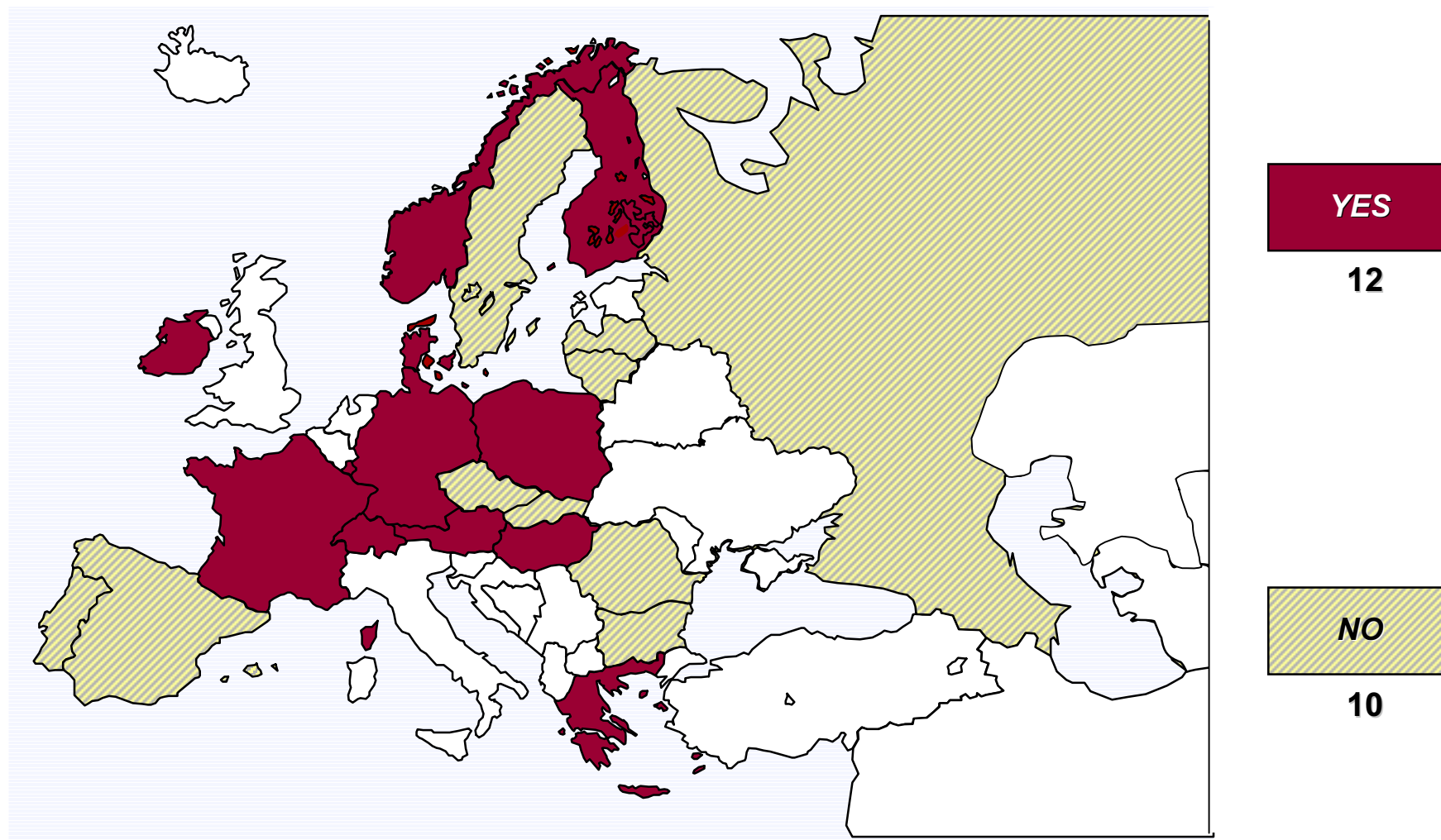


IV. Legislation on Covered Bonds in Europe

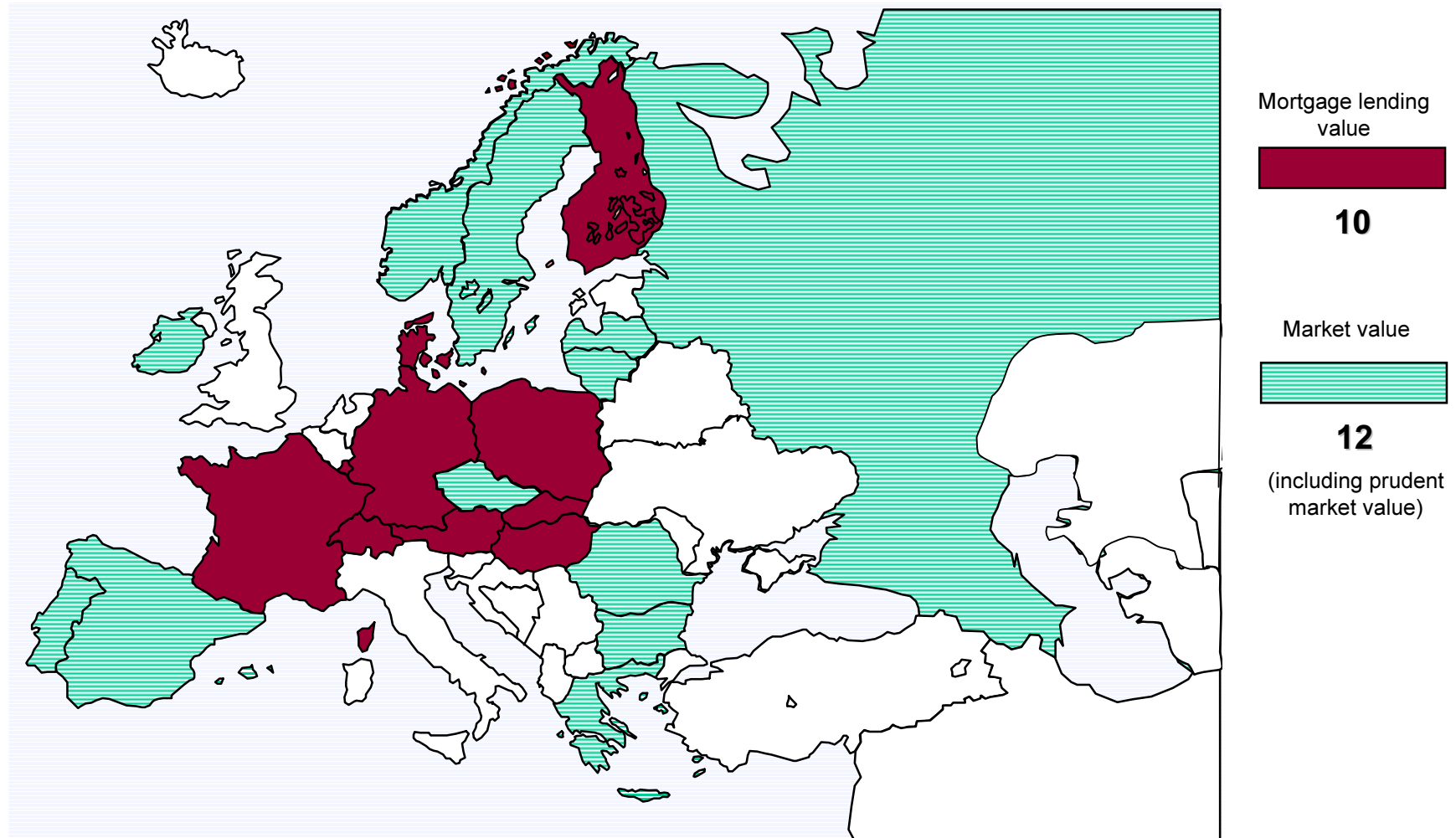
Geographical Overview Covered Bond Legislation in Europe (as of May 2004)



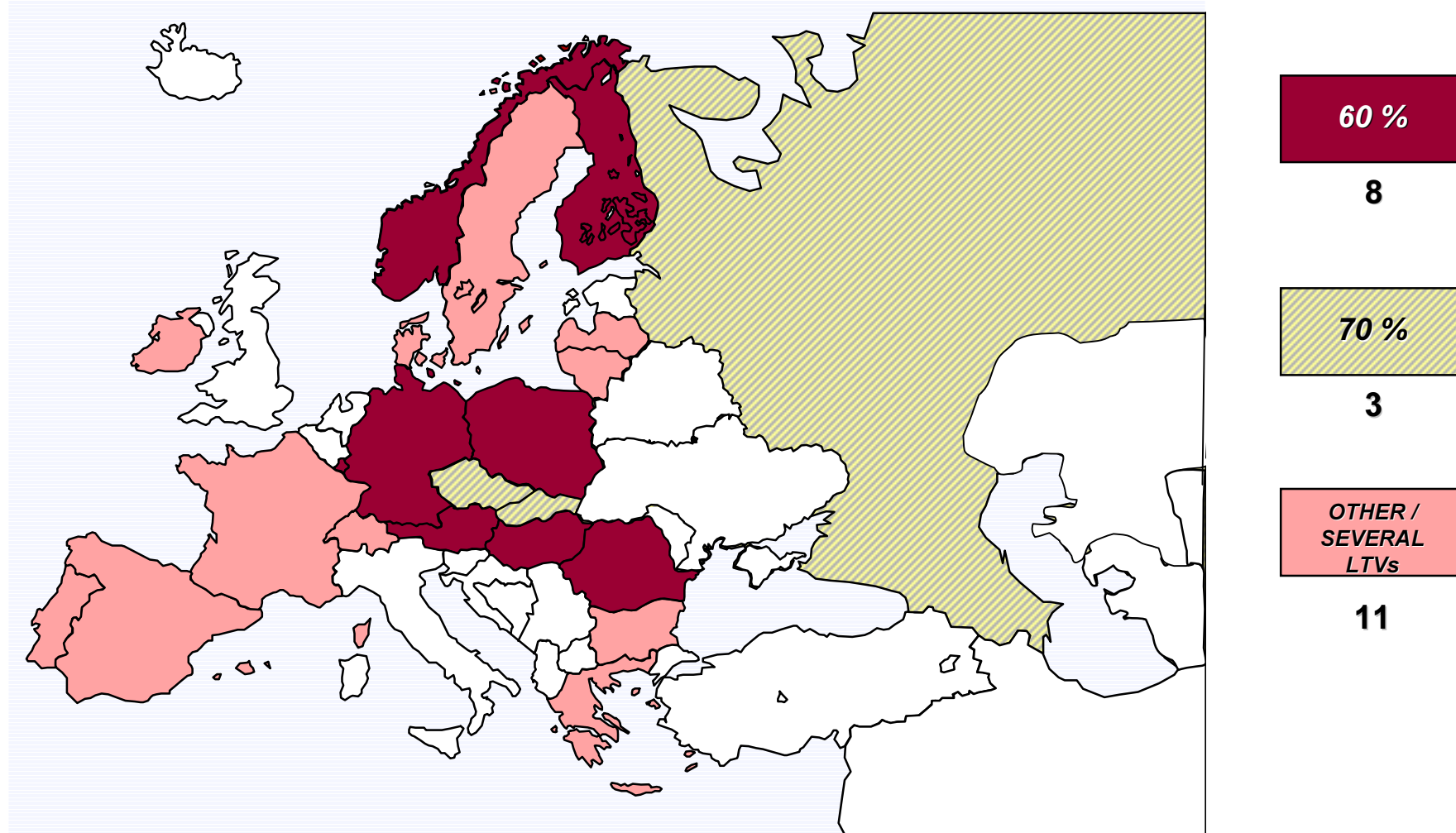
Important Differences of Covered Bond Regulations - specialist bank principle -



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



Important Differences of Covered Bond Regulations - loan to value ratio as basis of eligibility criteria for cover mortgages -



Comparison of Covered Bond Legislation in Europe (8.7.2004) (1)



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	Denmark	Germany	Greece	Switzerland	Austria	Spain	Portugal
Entered into force	1850 / 1989	1.1.1900	1924	1.2.1931	1.1.1939	5.5.1981	16.4.1990
Specialist bank principle	yes	yes	yes	yes (central issuing entities)	yes	no	no
Term protected by law	yes (realkredit-obligation)	yes (Pfandbrief)	unclear (Καθαρεύουσα: κτηματολόγια - Transcr.: ktimatika omologies - Translit.: ktematika omologies Demoliki: κτηματολόγια - Transcr.: ktimatika omologies - Translit.: ktematika omologies)	yes (Pfandbrief, lettre de gage, obbligazione fondiaria)	yes (Pfandbrief)	yes (cédulas hipotecarias, cédulas territoriales)	unclear (obrigações hipotecárias)
Refinanceable through covered bonds	mortgage loans	mortgage and public sector loans	mortgage loans	mortgage loans	mortgage and public sector loans	mortgage and public sector loans	mortgage loans
Cover register	no	yes	yes	yes	yes	no	yes
Legally anchored preferential right in bankruptcy	yes	yes	yes (but uncertain)	yes	yes	yes	yes
Valuation regulations for mortgage covered bonds	yes	yes	yes	yes	yes	yes	yes
(Relative) lending limit for funding through mortgage covered bonds	40/60/70/80/84 % of mortgage lending value	60 % of mortgage lending value	75 % of market value	2/3 of mortgage lending value	60 % of mortgage lending value	70/80 % of market value	80 % of market value
Absolute lending limit for mortgage covered bonds	yes	basically no (100 % of market value)	75 % of market value	no	no	no	no
Limit for lending beyond the cover (volume above the relative lending limit) for mortgage covered bonds	not permitted	20 %	not permitted	no	no	no	no
Trustee	no	yes	no	no	yes	no	no
Substitute collateral	no	yes	yes	no	yes	no	no
Limit for substitute collateral	no	10 %	unclear	no	no	no	no
Public-sector bond	no	yes	no	no	yes	yes	no
Special public supervision	yes	yes	yes	yes	yes	yes	yes
Art. 22 (4) UCITS directive fulfilled	yes	yes	yes (but uncertain)	yes	yes	yes	yes

Comparison of Covered Bond Legislation in Europe (8.7.2004) (2)



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	Czech Republic	Slovak Republic	Hungary	Luxembourg	Poland	Latvia	France
Entered into force	1.7.1995	1.3.1996	7.6.1997	19.12.1997	1.1.1998	29.9.1998	27.7.1999
Specialist bank principle	limited licences	limited licences	yes	yes	yes	no	yes, but no staff permitted
Term protected by law	yes (zástavní list)	yes (záložný list)	yes (jelzaloglevél)	yes (lettre de gage, Pfandbrief, mortgage bond)	yes (list zastawny)	yes (hipotekārā) ķīlu zīme)	yes (obligation foncière)
Refinanceable through covered bonds	mortgage loans	mortgage and mortgage secured public sector loans	mortgage loans	mortgage and public sector loans	mortgage and public sector loans	mortgage loans, loans guaranteed by the state or municipalities	mortgage and public sector loans and loans guaranteed by banks or insurances
Cover register	„independent declaration“	yes	yes	yes	yes	yes	no
Legally anchored preferential right in bankruptcy	yes	yes	yes	yes	yes	yes	yes
Valuation regulations for mortgage covered bonds	no	yes	yes	yes	yes	yes	yes
(Relative) lending limit for funding through mortgage covered bonds	70 % of market value	70 % of mortgage lending value	60 % of mortgage lending value	60 % of mortgage lending value	60 % of mortgage lending value	60 / 75 % of market value	60 / 80 / 100 % of mortgage lending value / market value
Absolute lending limit for mortgage covered bonds	no	no	70 % of mortgage lending value	basically no (market value?)	100 % of mortgage lending value	no	60 / 80 / 100 % of mortgage lending value / market value
Limit for lending beyond the cover (volume above the relative lending limit) for mortgage covered bonds	no	10 %	no	no	30 %	no	no
Trustee	no	yes	yes	yes	yes	no	yes
Substitute collateral	yes	yes	yes	yes	yes	yes	yes
Limit for substitute collateral	10 %	10 %	20%	20 %	10%	20 %	20 %
Public-sector bond	no	yes	no	yes	yes	yes	yes
Special public supervision	yes	yes	yes	yes	yes	yes	yes
Art. 22 (4) UCITS directive fulfilled	yes	yes	yes	yes	yes	yes	yes

Comparison of Covered Bond Legislation in Europe

(8.7.2004) (3)



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	Romania	Finland	Bulgaria	Ireland	Lithuania	Russia	Sweden	Norway
Entered into force	9.12.1999	1.1.2000	13.10.2000	22.3.2002	15.10.2004	18.11.2003	1.7.2004	probably 2004
Specialist bank principle	unclear	yes	no	yes	no	no	in praxi: yes	yes („kreditforetak“)
Term protected by law	unclear (obligatiunile ipotecare)	yes (kiinteistövuokaudellinen joukkovelkakirjeslaina, julkisyhteisöva-kuudellinen joukkovelkakirjeslaina)	yes (ипотечна облигация ипотечна obligaciya)	yes (mortgage credit covered security, public credit covered security)	yes (hipotekinės obligacijos)	yes (облигация с ипотечным покрытием – obligatsiya s ipotečnym pokrytiem) (ипотечное покрытие – ipotečnoye pokrytiye)	yes (säkerställda obligationer)	no (obligasjonslån med porteføljepant obligasjonslån sikret ved pant)
Refinanceable through covered bonds	mortgage loans	mortgage and public sector loans	mortgage loans	mortgage and public sector loans	mortgage loans	mortgage loans	mortgage loans and public sector loans	mortgage loans and public sector loans
Cover register	no	yes	yes	yes	yes	yes	yes	yes
Legally anchored preferential right in bankruptcy	no	yes	yes	yes	yes	yes	yes	yes
Valuation regulations for mortgage covered bonds	no	yes	yes	yes	yes	no	yes	yes Regulations made by the supervision
(Relative) lending limit for funding through mortgage covered bonds	60 % of value of portfolio	60 % of mortgage lending value	60 / 80 % of market value	60 / 75 % of the prudent market value	30/40/50/70 % of mortgage value (prudent market value)	70 % of market value	60 / 70 / 75 % of value of the property	60 % of market value
Absolute lending limit for mortgage covered bonds	no	basically no (market value?)	no	yes (80 % of the prudent market value)	no	no	no	60 % of market value
Limit for lending beyond the cover (volume above the relative lending limit) for mortgage covered bonds	unlimited	1/6	no	yes (10 %)	no	no	no	not permitted
Trustee	no	no	basically no	yes	no	yes	yes	yes
Substitute collateral	no	limited in time	yes	yes	yes	yes	yes	yes
Limit substitute collateral	no	no	30 %	20 %	10 %	20 %	yes	proposal: 30 % Regulations made by the supervision (substitute collateral and derivatives)
Public-sector bond	no	yes	no	yes	no	no	no	yes
Special public supervision	no	yes	unclear	yes	yes	yes	yes	yes
Art. 22 (4) UCITS directive fulfilled	no	yes	unclear	yes	yes	yes	yes	yes



**Further information and material
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in German:

**www.hypverband.de
„Europa + G7“**

in English:

**www.pfandbrief.org
„Europe + G7“**