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# **8<sup>th</sup> Central European Covered Bond Conference**

**18<sup>th</sup>/19<sup>th</sup> October 2004 in Copenhagen**

## **Legislation in Europe - An Update-**

Dr. Otmar Stöcker, Managing Director  
Association of German Mortgage Banks



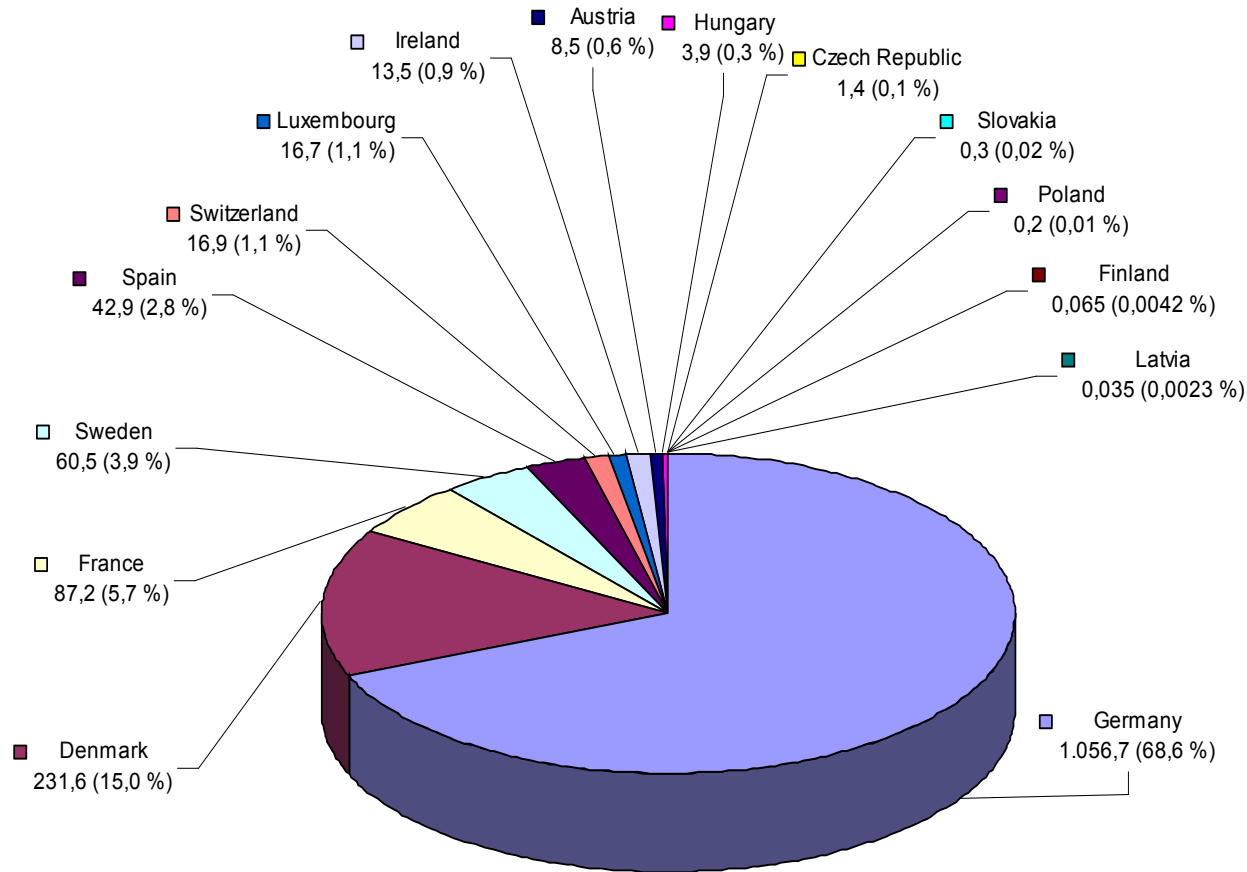
- I. Covered Bond Market in Europe**
- II. Covered Bond Legislation in Europe**
- III. Segregation and Bankruptcy Remoteness of Cover Assets and of Covered Bonds**



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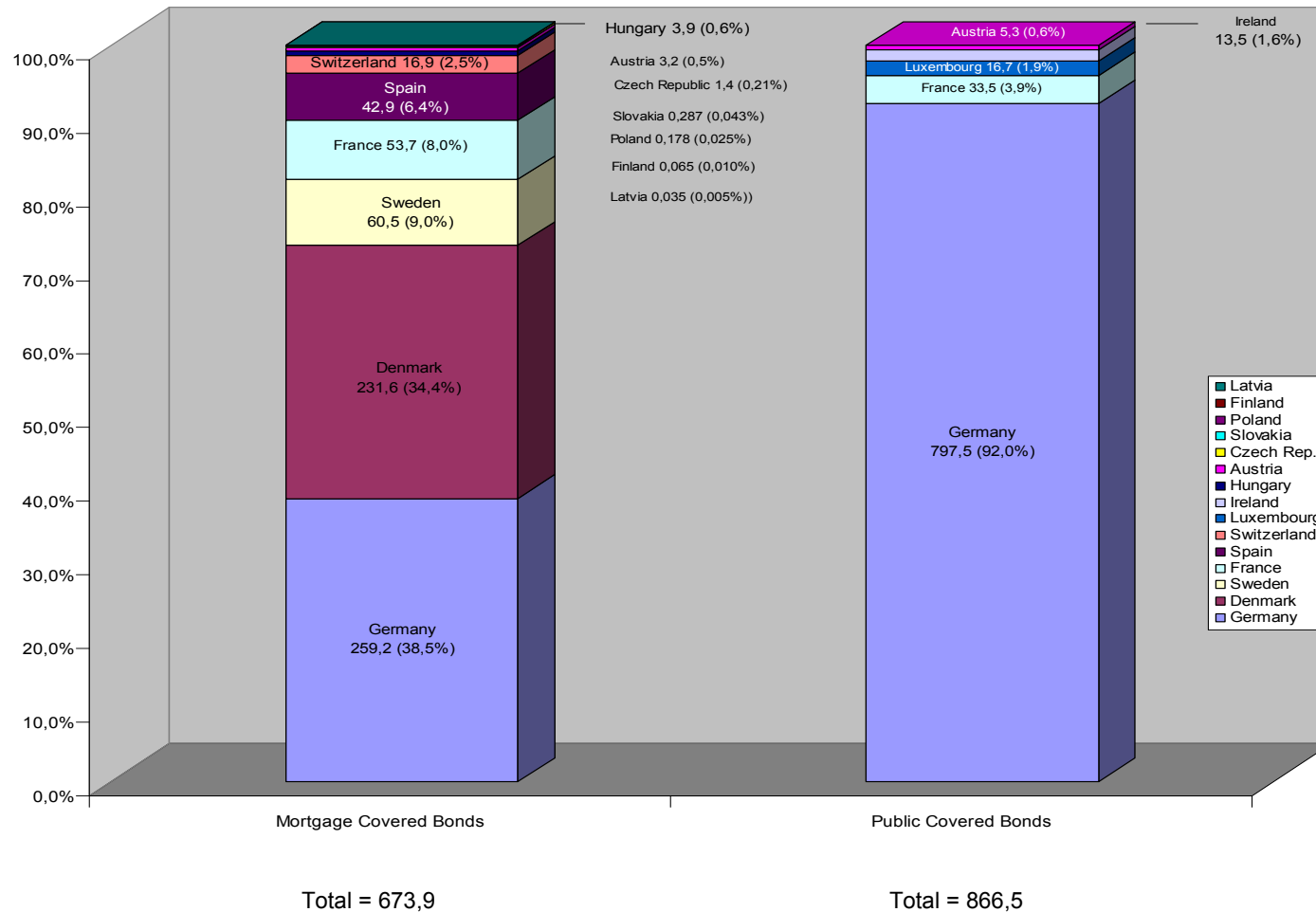
## **I. Covered Bond Market in Europe**

# 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 €  
(09/2004 = 14 bn €)

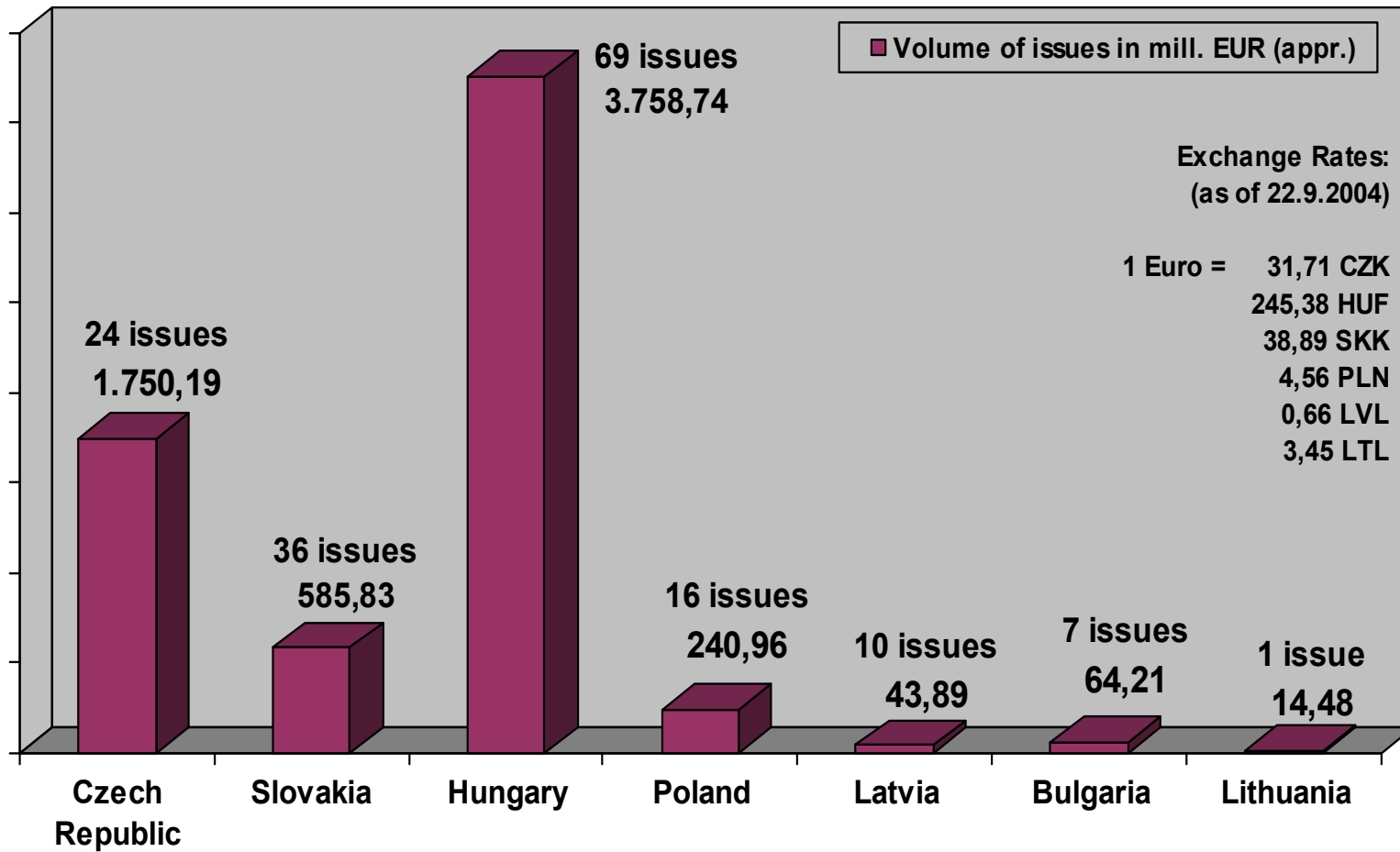
# Public Covered Bonds in the EU, compared with Mortgage Covered Bonds (end of 2003, in bn. EUR)



**Covered bonds outstanding in central Europe since 1996: Czech Republic, Slovakia, Hungary, Poland, Latvia, Bulgaria, Lithuania as of 22.9.2004**



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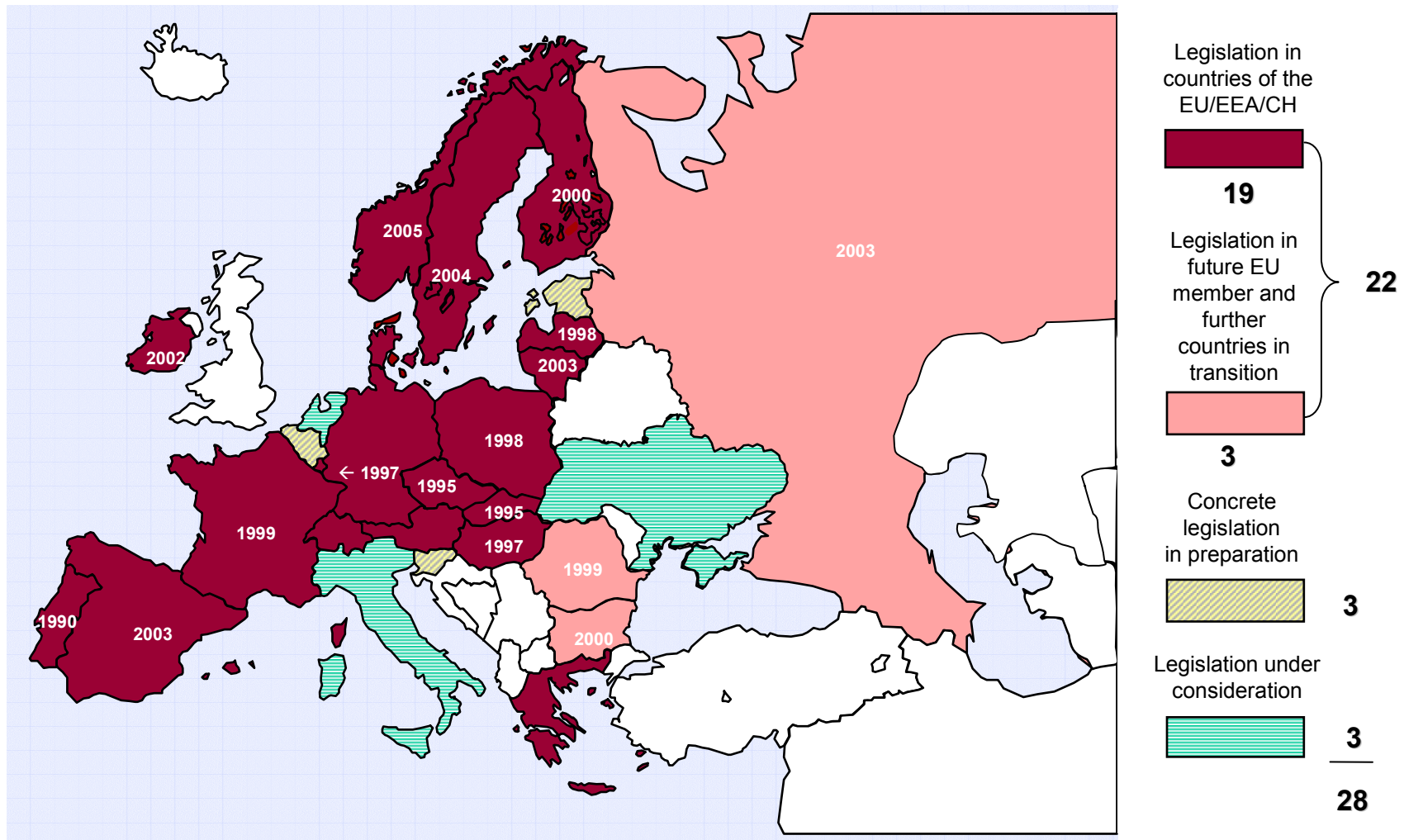
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## **II. Covered Bond Legislation in Europe**

# Geographical Overview Covered Bond Legislation in Europe (as of Sept. 2004)



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## **New Steps in Covered Bond Legislation in Europe since the 7th Central European Covered Bond Conference in Berlin**



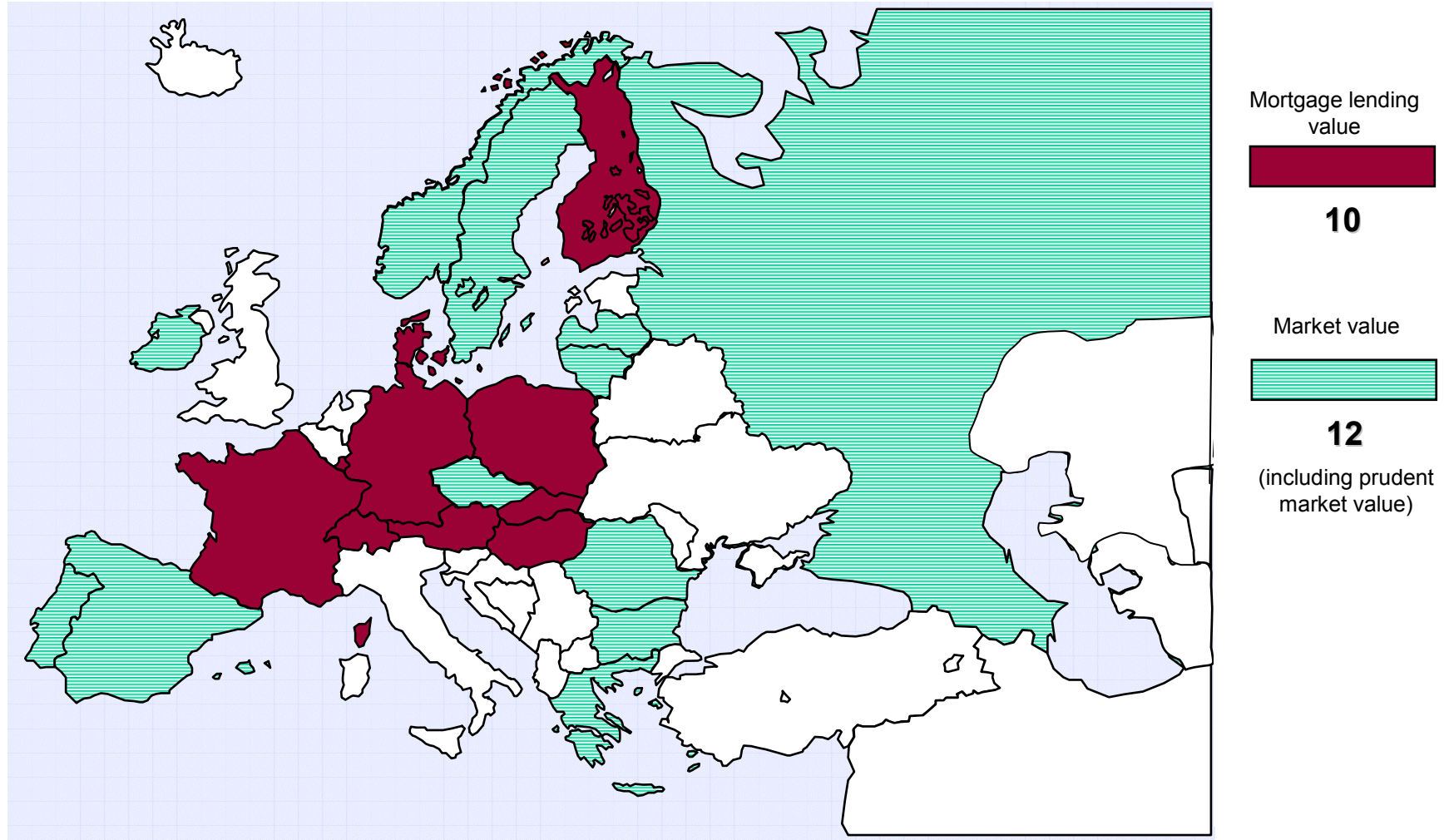
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- **new legislation in**
  - ✓ **Lithuania (15.10.2003)**
  - ✓ **Russia (18.11.2003) – lecture: Mr. Budakov**
  - ✓ **Sweden (1.7.2004)**
  - ✓ **Norway (2005?) – lecture during 7th Conference 2003**
- **new insolvency regulation in**
  - ✓ **Latvia (2002) – lecture: Mr. Gibeiko**
  - ✓ **Poland (2003) – lecture: Mr. Bielicki**
  - ✓ **Germany (2004) – lecture: Mr. Hagen**
  - ✓ **Spain (2004)**
- **improvements in**
  - ✓ **Czech Republic (2004) – especially cover register**

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



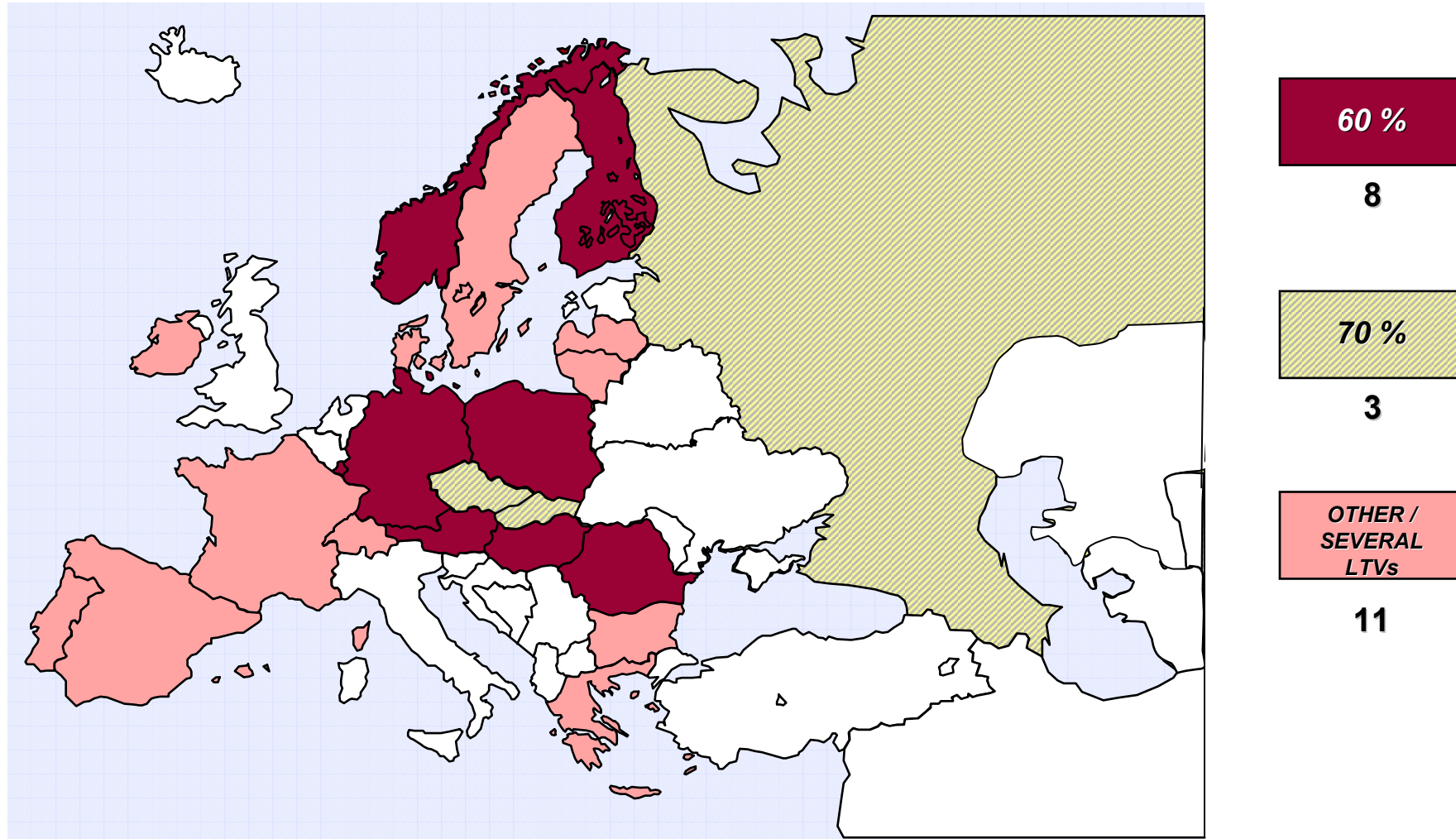
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# Important Differences of Covered Bond Regulations - loan to value ratio as basis of eligibility criteria for cover mortgages -



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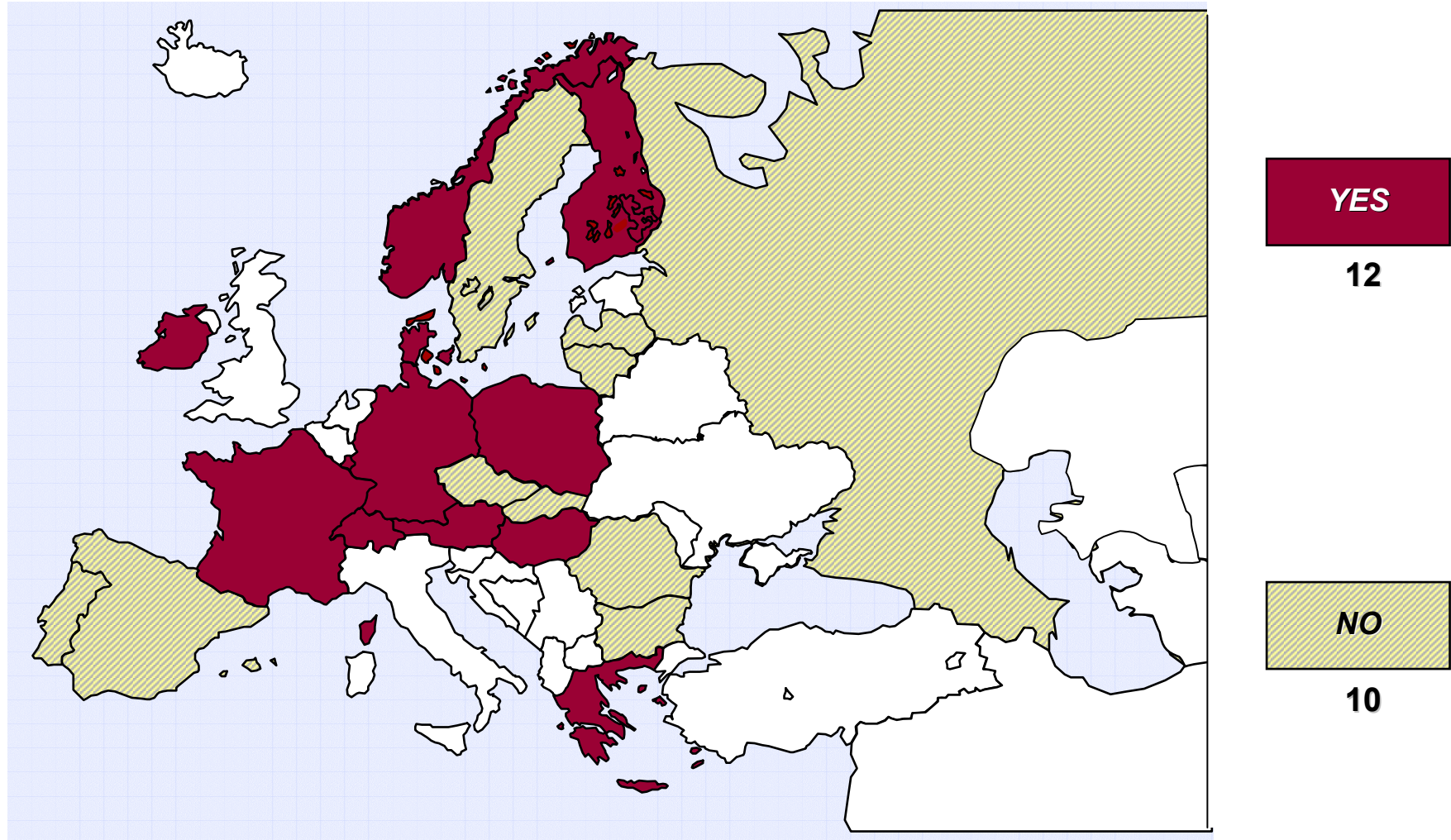


# Important Differences of Covered Bond Regulations

## - specialist bank principle -



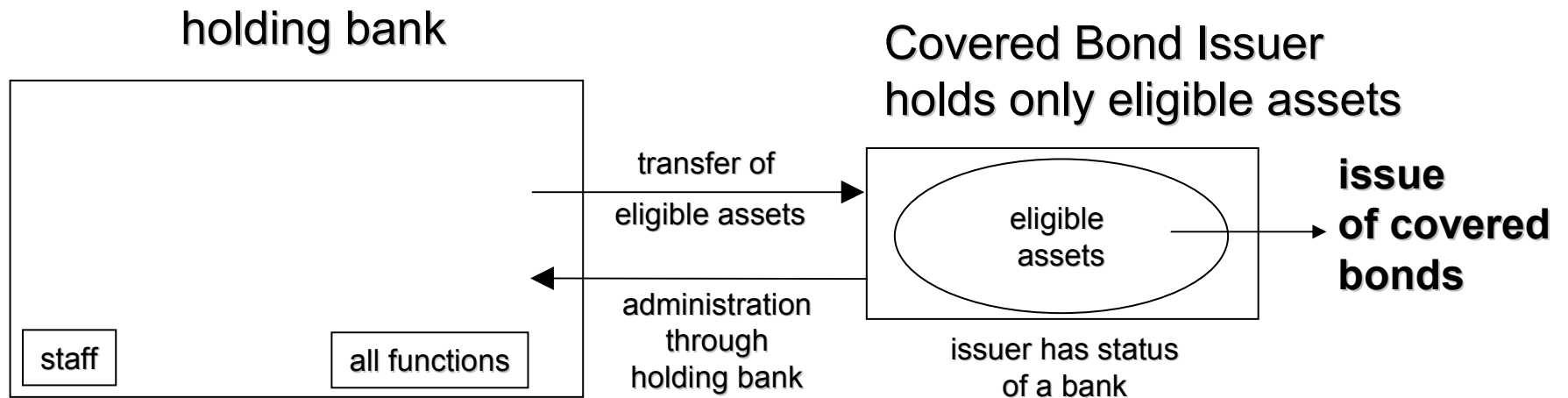
4 basic models of specialisation of the issuer



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



Finland, France, Ireland, Norway, partially Sweden

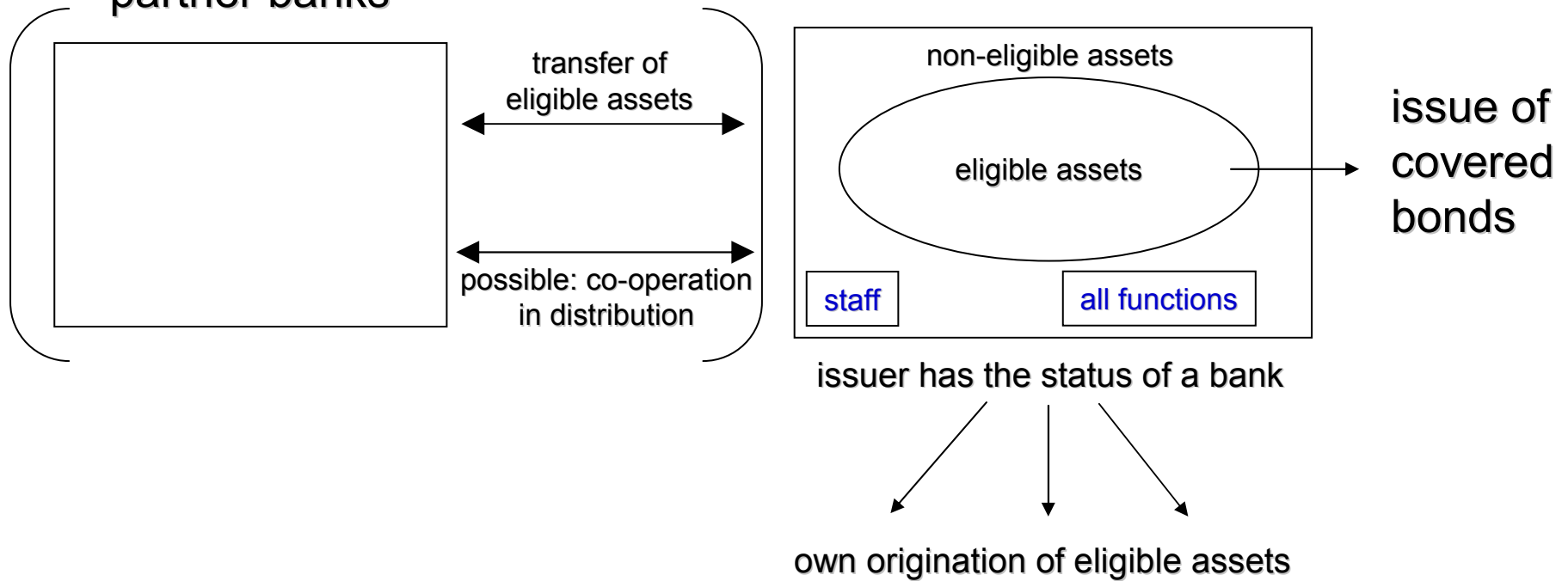


## (2) Specialised banks without/with non-eligible business



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

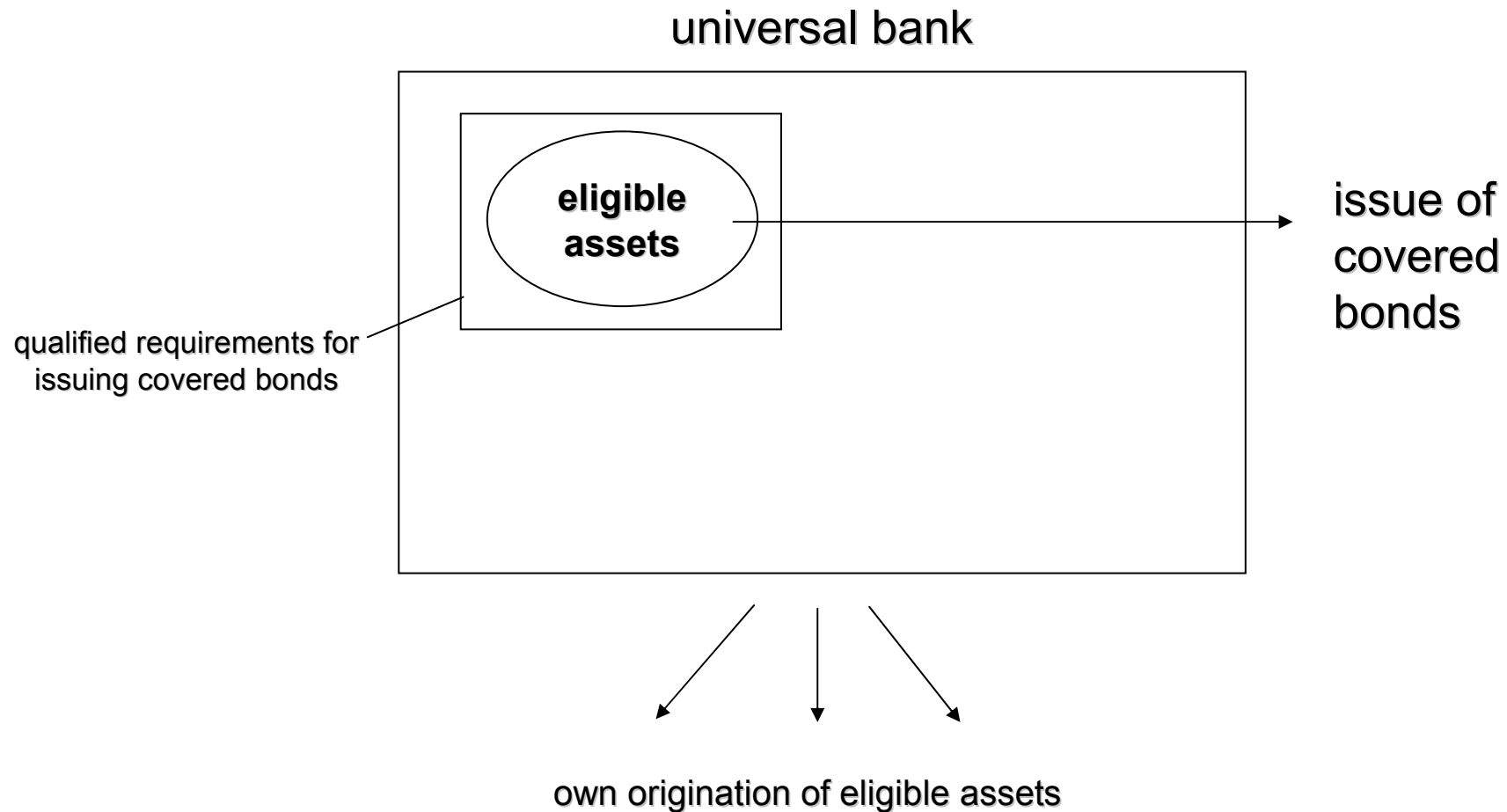
possibly holding bank / partner banks



### (3) Universal bank with qualified covered bond license



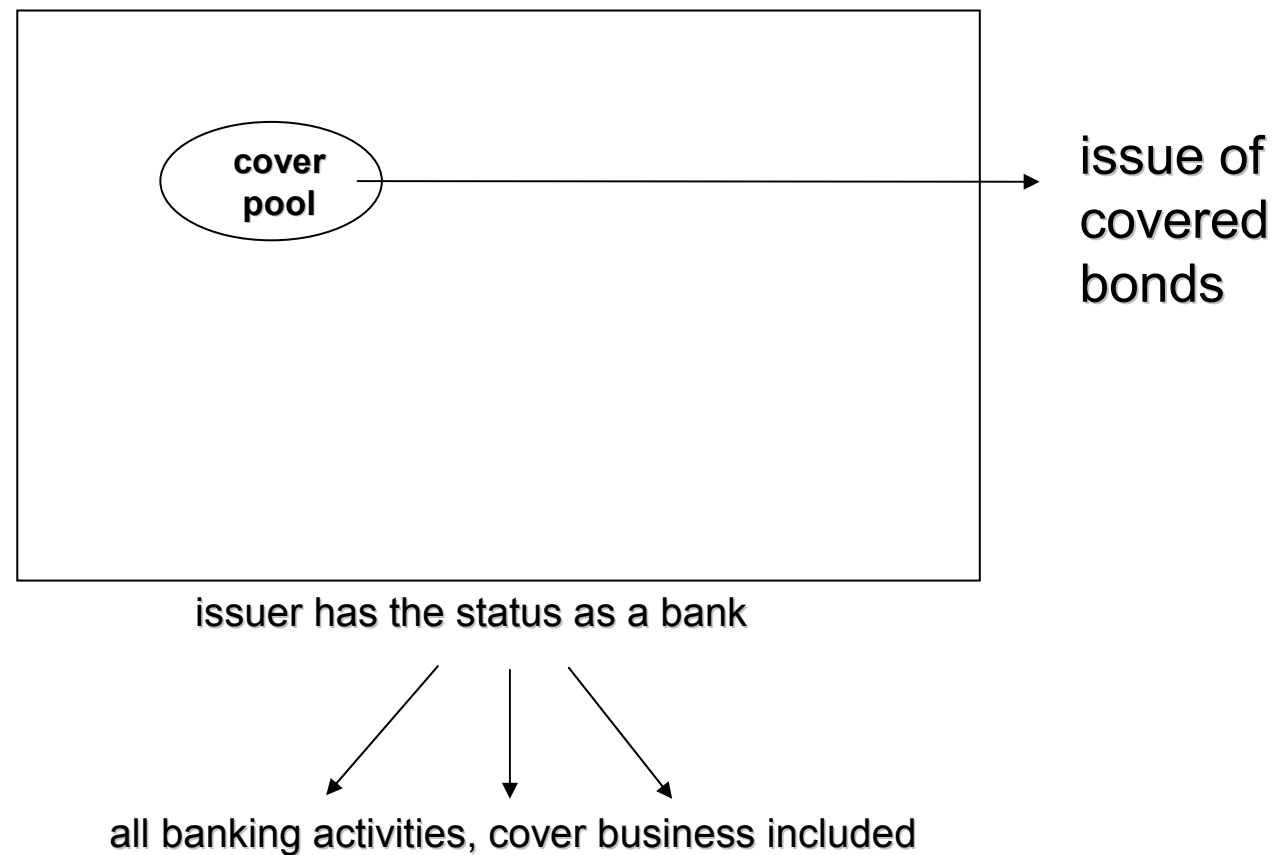
Germany (draft law), Latvia, Russia, Slovenia (draft law)



**(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**







## **Basic issues, which should be thought about, before making the decision pro or contra specialization of the issuer of covered bonds:**

### **I. Supervision Issues**

- **Efficient and intensive supervision**
- **LTV limits for funding through covered bonds**
- **Security through institutional barriers or through over-collateralization**

### **II. Autonomous Risk Management Issues**

- **Responsibility for risk and asset/liabilities management**
- **Own risk awareness of the issuer**
- **Freedom of the issuer to decide, which assets to take into the cover pool**
- **Generating of assets by the issuer himself / only funding vehicle**
- **Dependency of a specialised issuer on mother bank**



## **Basic issues, which should be thought about, before making the decision pro or contra specialization of the issuer of covered bonds:**

### **III. Priority Issues**

- **"Ring fencing": Relation between covered bond creditors and unsecured creditors**
- **Possibility to place other creditors of the issuer at a disadvantage when starting to issue covered bonds (deposits, bonds with pari passu- or negative pledge-clauses)**

### **IV. Sustainability and Market Issues**

- **Diversification of products**
- **Avoidance of opportunistic issues - sustainable issues necessary**
- **Commitment to create and develop a covered bond market**

### **V. Profitability Issues**

- **Costs for creating a specialised issuer**
- **Operational costs of originator and issuer**
- **Volume of eligible business in home country**



### **III. Segregation and Bankruptcy Remoteness of Cover Assets and of Covered Bonds**

**= pillar of security!**

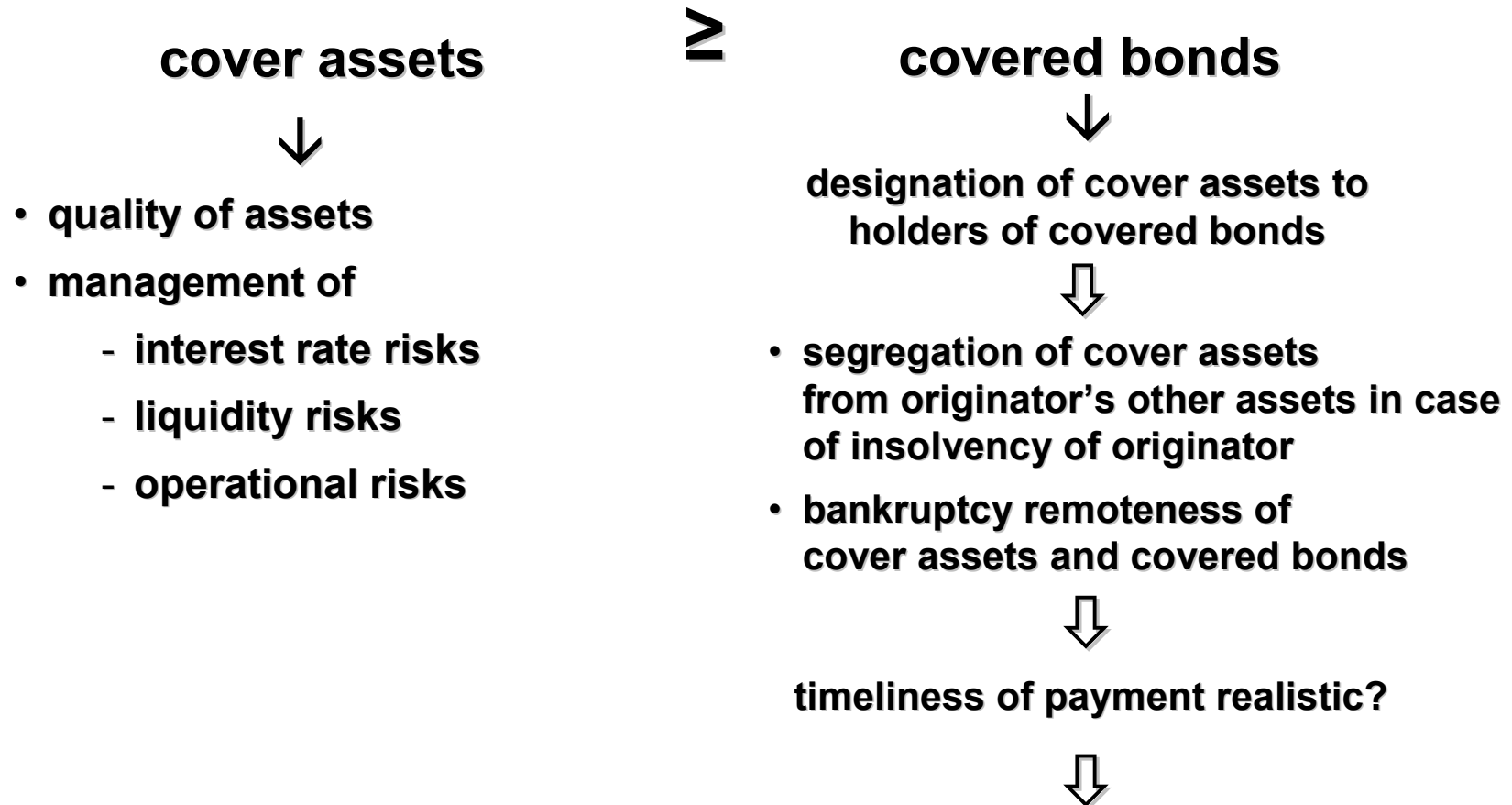


## **Questionnaire in order to check the level of segregation and bankruptcy remoteness of cover assets and of covered bonds:**

- 1. What does “covered” mean?**
- 2. How to identify the cover?**
- 3. How to segregate/separate the cover from the bankruptcy estate?**
- 4. Are covered bonds bankruptcy remote?**

## 1. What does „covered“ mean?

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

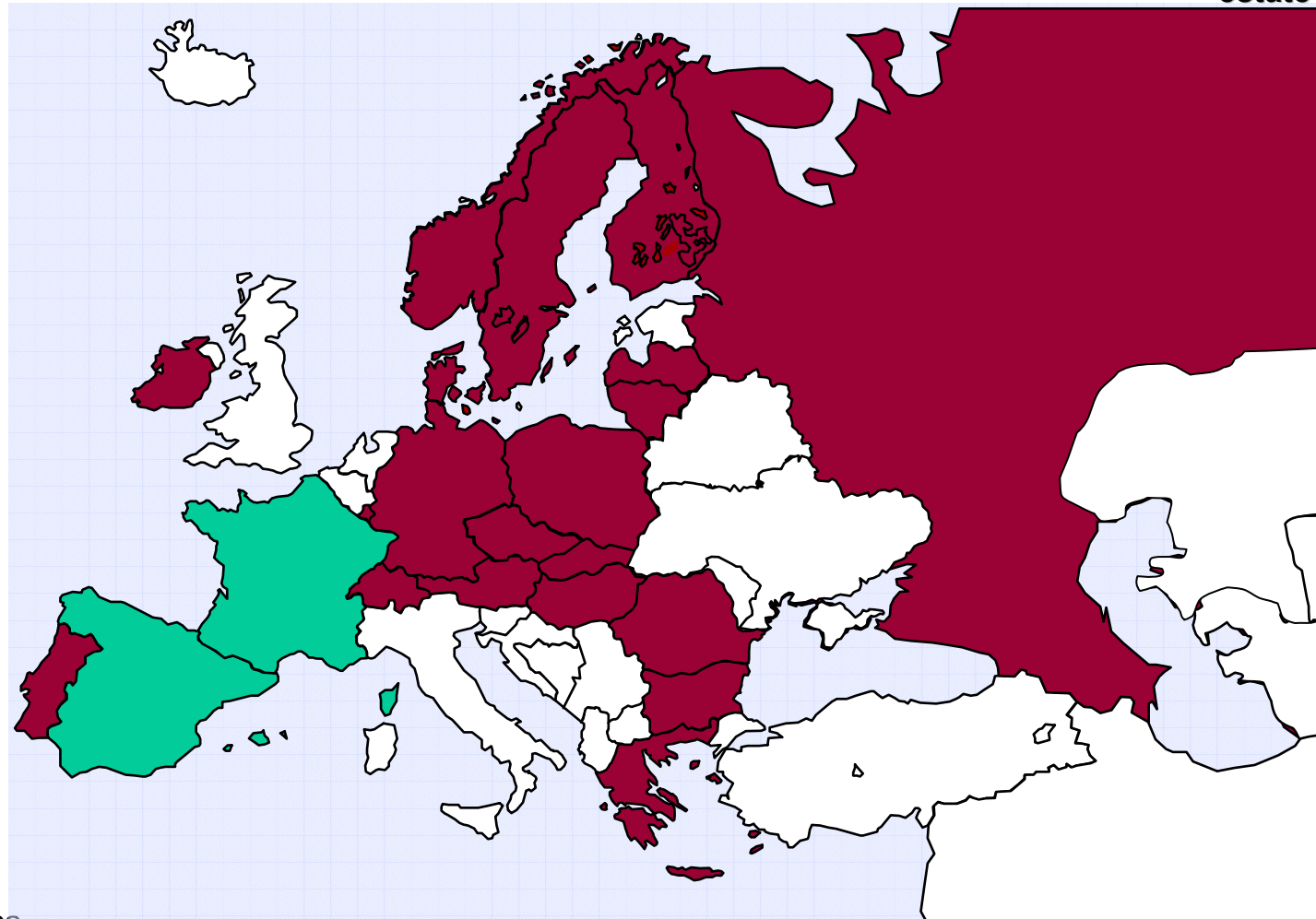


The less covered bond issuers are legally specialised, the more and detailed regulations their covered bonds need in order to achieve clear segregation and bankruptcy remoteness and to convince capital markets of it.

## 2. How to identify the cover? (1)

Which covered bond legislation prescribes special register?

prerequisite for a clear and quick segregation of cover assets from bankruptcy estate possible



**YES**

**20**

DK: implicit register

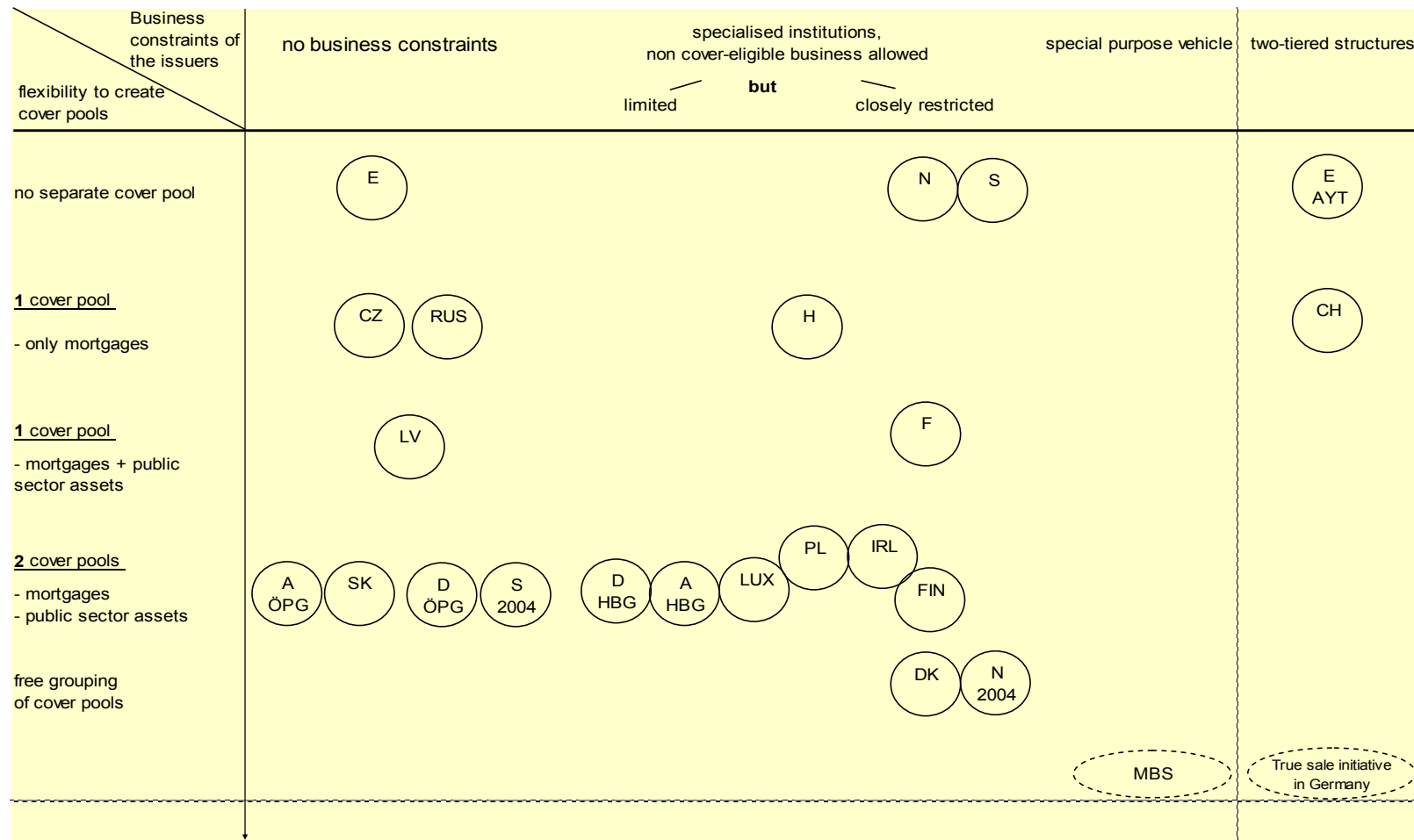
**NO**

**2**

as of 22.9.2004

## 2. How to identify the cover? (2)

- specialisation of the issuer and flexibility to create cover pools -



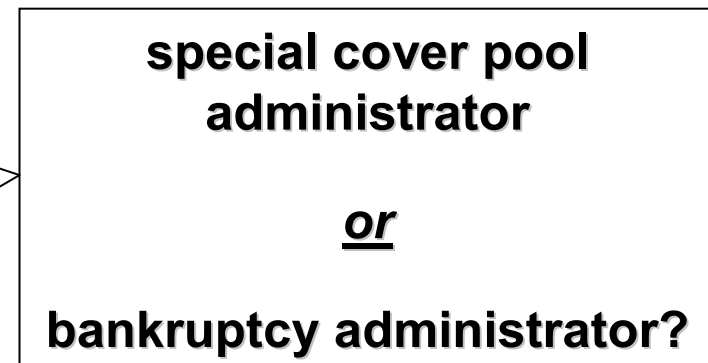
Big differences in legislation and supervisors' rules regarding structure and administration of cover registers!

### 3. How to segregate / separate the cover from the bankruptcy estate? (1)



#### Questions:

- Any legal or administrative action necessary or automatically by law?
- Who administrates the cover assets?
- Who receives the cash flows on cover assets, when insolvency procedure is started over issuer?

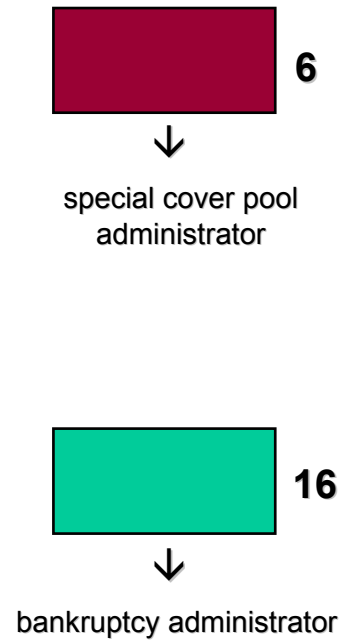
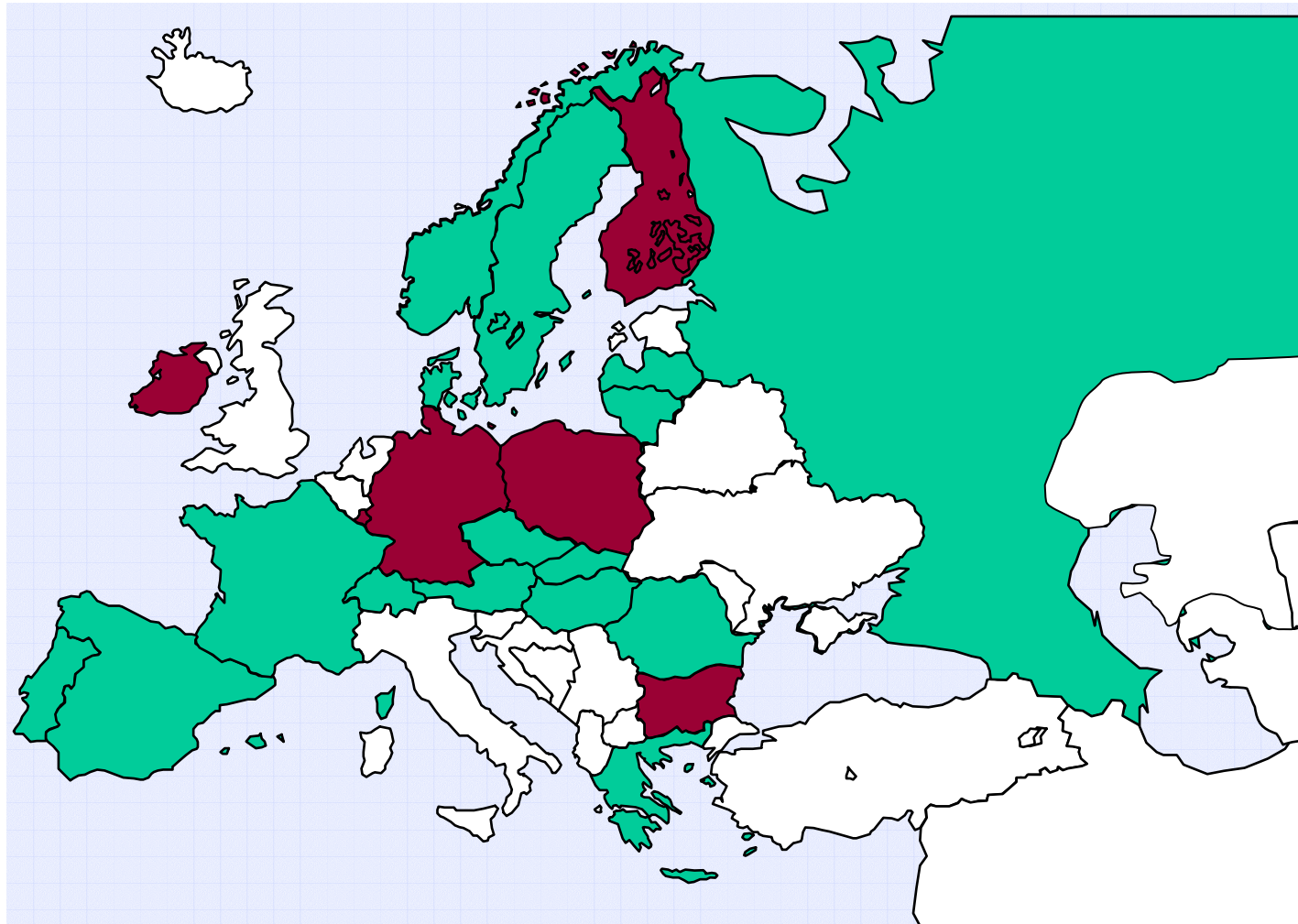




### 3. How to segregate / separate the cover from the bankruptcy estate? (2)



- Who administrates the cover assets?





## 4. Are covered bonds bankruptcy remote?

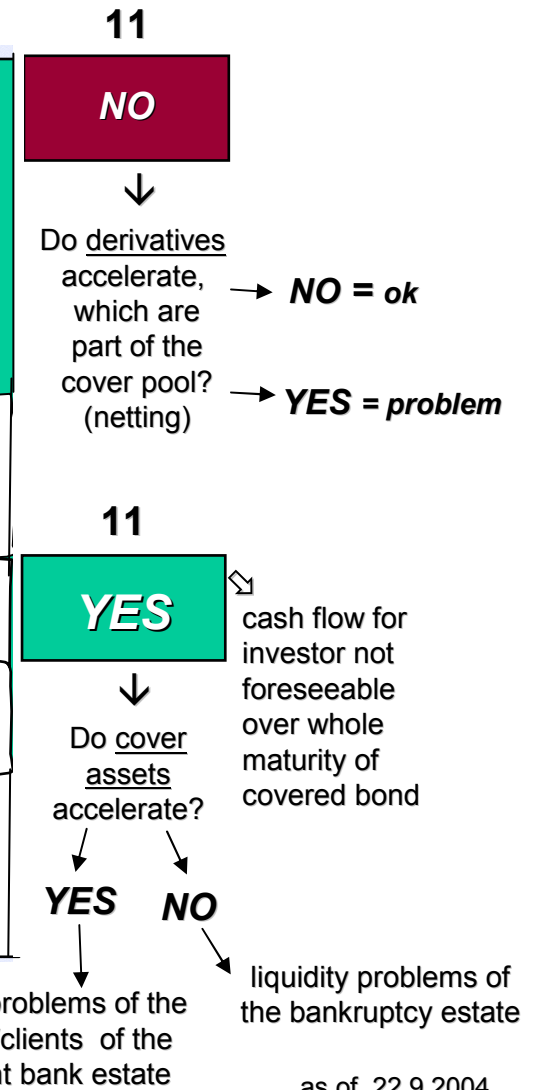
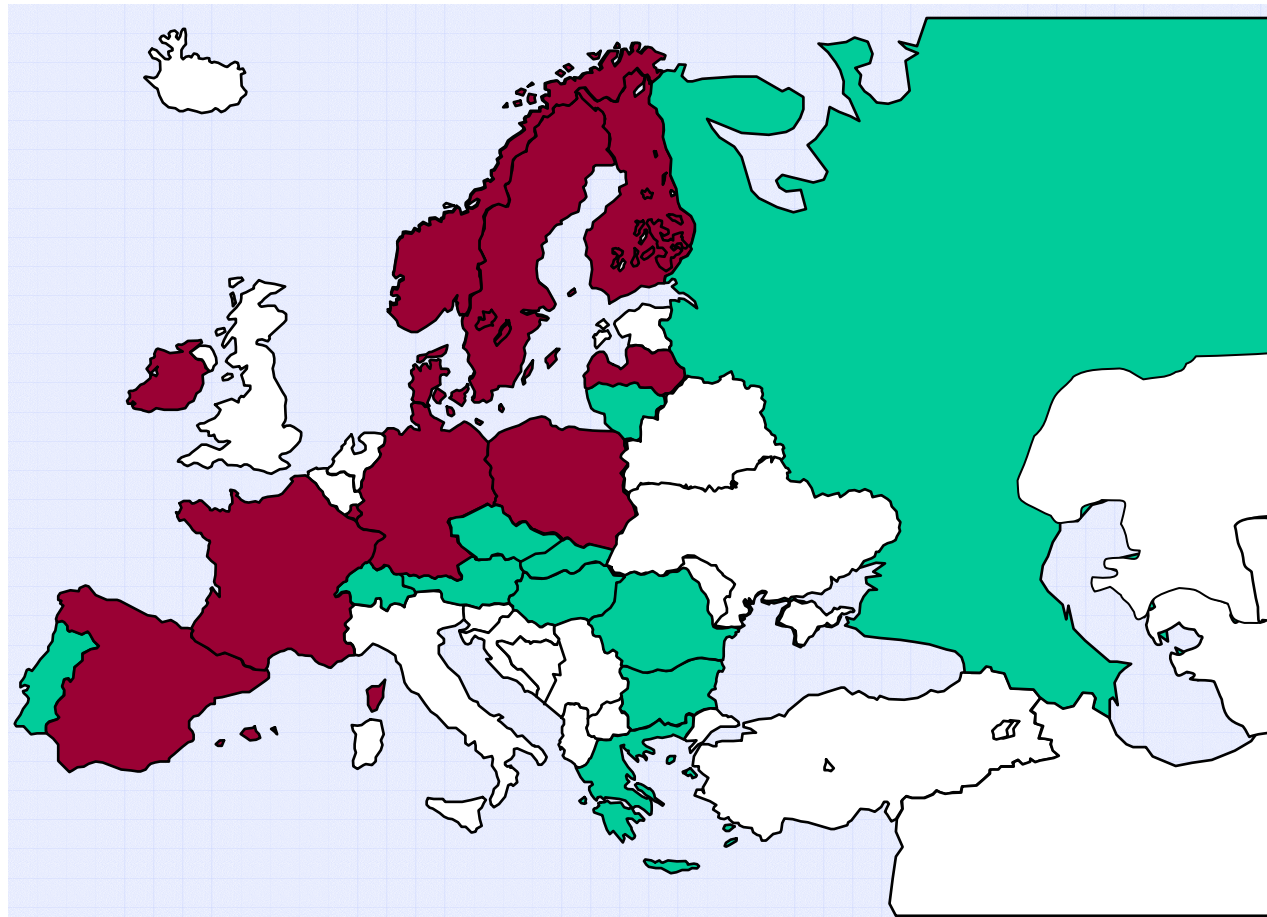
### Questions:

- (1) Do covered bonds accelerate, when the issuer goes in insolvency?**
- (2) Will cover assets be legally part of the bankruptcy estate or form a legal separate estate (trust)?**
- (3) How to ensure liquidity of the cover pool, when the issuer is bankrupt?**
- (4) How to ensure timely payment for covered bonds?**

# 4. (1) Do covered bonds accelerate, when the issuer goes in insolvency?



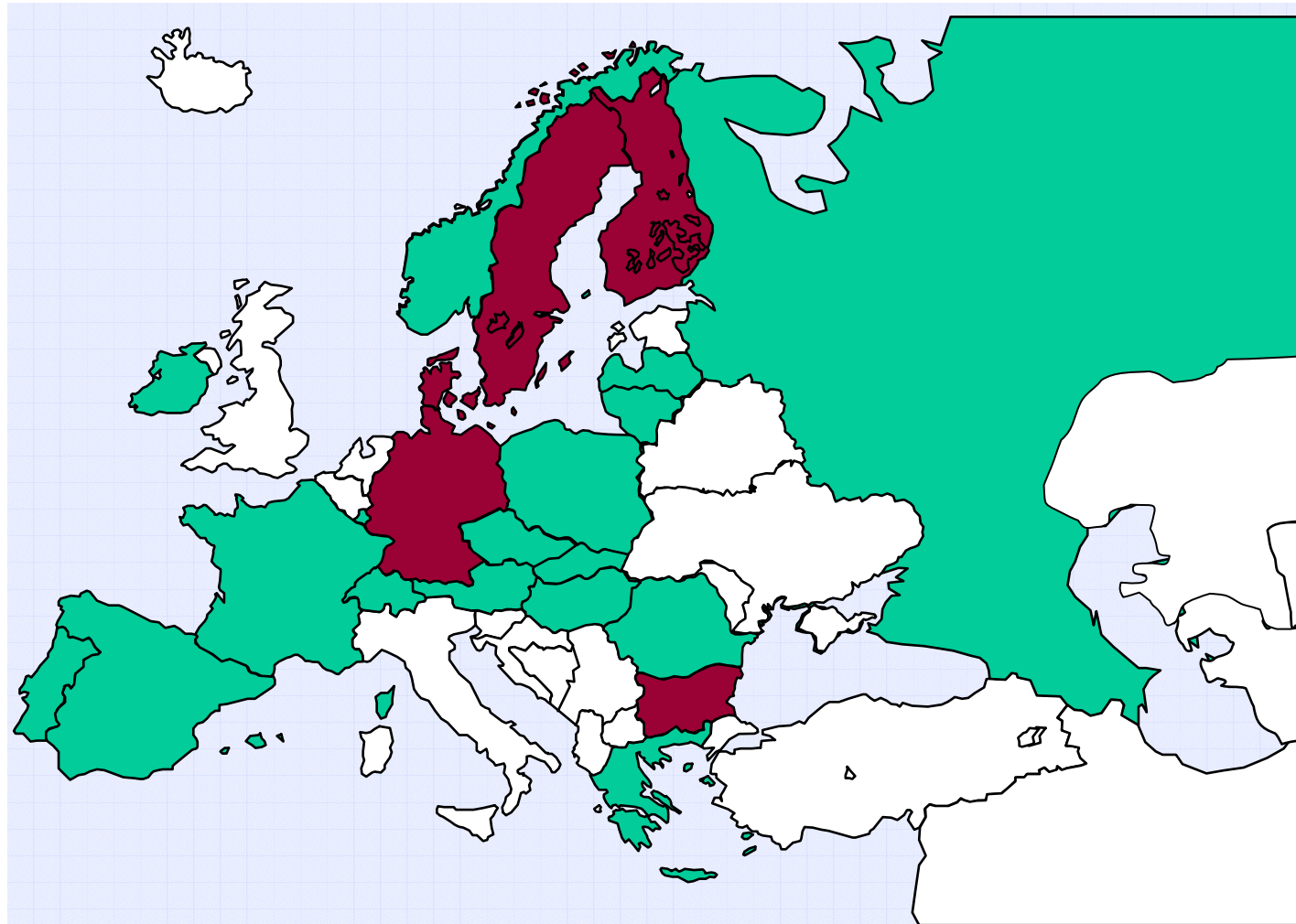
**Draft !**



#### 4. (2) Will cover assets be legally part of the bankruptcy estate or form a legal separate estate (trust)?



**Draft !**



**When issuer is insolvent, cover assets are:**



legally separated (trust)

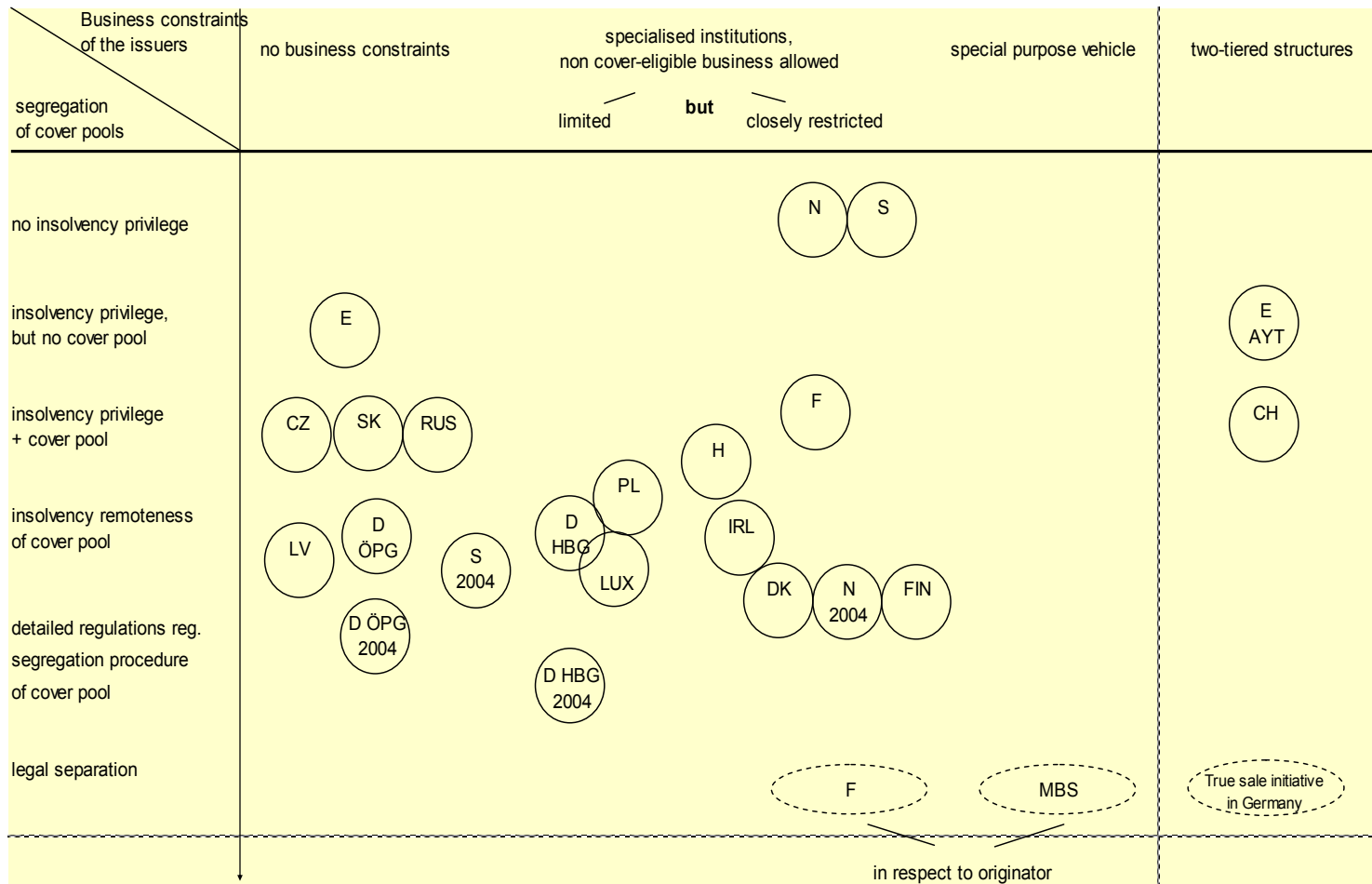


part of insolvency estate, but holders of covered bonds have insolvency privilege

# 4. (3) Will cover assets be legally part of the bankruptcy estate or form a legal separate estate (trust)?



- specialisation of the issuer and segregation of the cover pool from the issuer -





**Further information and material  
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**in German:**

**[www.hypverband.de](http://www.hypverband.de)  
„Europa + G7“**

**in English:**

**[www.pfandbrief.org](http://www.pfandbrief.org)  
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