

Henning Rasche

NYC Pfandbrief investor conference

ML World Financial Center

31 May 2007

Dear Harold, Ladies and Gentlemen!

It is a great pleasure for us to be here in downtown Manhattan next to Wall Street the world's leading financial center. On behalf of Germany's Pfandbrief Banks let me extend a warm welcome to all of you meeting here today!

Today's debate is centered around one of Germany's major exports. In this context one tends to think of Porsche, Mercedes, Audi or BMW. But Germany has more to sell than cars. One of these other unique German bestsellers is the topic of today's event – it's the Pfandbrief.

If you want to introduce yourself properly to somebody who doesn't know you, you should tell him

- where you come from,
- why you are here, and
- where you go from here.

And that is exactly what I am going to do. Of course not about myself but the Pfandbrief.

So where does the Pfandbrief come from?

CHART 2

Some five years ago the Wall Street Journal ran the following headline “Will Pfandbriefs, whatever they are, play in Peoria?”

Reading this article we asked ourself, what’s Peoria? We have to learn, that Peoria is a city in Illinois, which represents the average American city. This fact in mind market researchers often ask “Will it play in Peoria?” This has become a metaphor for wether something appeals to the American public or not.

The article went on inquiring “What’s the pfuzz about all this Pfandbrief stuff?”

Well, the phuzz began some 238 years ago when Frederick the Great of Prussia authorized the issuance of Pfandbrief as per Cabinet Order to help finance the country’s rebuilding after the Seven Years’ War. The concept was as simple as it was successful. If you want to raise funds at reasonable rates you have to offer security. The only security available after the overwhelmingly expensive war was land. So he allowed the Prussian earls and counts to issue bonds backed by land. The idea worked so well that it continued to be used even after reconstruction was finalized and Prussia became part of the German State. The Pfandbrief proved its robustness in wars, recessions and currency reforms without a single default ever.

Almost two and a half centuries later Pfandbrief has developed into one of Europe’s largest homogeneous asset classes: With a volume outstanding of 950 bn Euros at year end 2006 it is Germany’s second largest bond market, second only to German Government bonds, and Europe’s largest Covered Bond market, making up almost 50% of the entire asset class.

One of the more recent developments in Pfandbrief history is the export of the Pfandbrief idea throughout the world and the internationalisation of the investor community. How did that happen?

CHART 3

In 1995 Pfandbrief issuers inaugurated the liquid Jumbo format adapted to international capital market standards with a view to tapping the international investor base.

The Jumbo format is a standardized large volume Pfandbrief with a minimum size of 1 billion €, its bullet structure and bookbuilding phase with fixed price reoffer procedure is issued by at least five syndicate banks that are committed to market making, too. Since then Pfandbriefbanks have invested heavily and marketed the Pfandbrief outside Germany to foster knowledge and develop an investor base – and this with great success!

Thanks to its outstanding credit quality and superior liquidity, Jumbo Pfandbrief has embraced investors worldwide. Today, Central Banks in Europe and Asia figure prominently on the distribution ranks of Jumbo Pfandbrief issues. Other investor groups are insurance companies, banks, pensions and investment funds. For example, Pimco, the US firm, through its Germany based office is reported to hold a Covered Bond portfolio of 75 billion €!

With the success of the Jumbo Pfandbrief issuers paved the way for the emergence of an entire new asset class known as Covered Bonds today: Because of the appeal of the Jumbo Pfandbrief among international institutional investors many products

modelled on the Pfandbrief concept followed - the Covered Bond family grew and prospered.

What sort of diet (gesprochen: deiät) is Pfandbrief? The Pfandbrief – thanks to its Aaa quality based on a rock solid legal framework – and also its respectable liquidity – is widely regarded as a proxy for government-, agency- or supra-national-exposure. In times of volatility and distress Pfandbrief offers a safe haven to investors.

So, why are we here today?

Since the late 90ies Pfandbrief issuers and their association had a dream that one day US buyers would become a prominent part of the Pfandbrief investor community. We therefore conducted several Pfandbrief conferences and regularly informed investors on new developments. But investors in general and US-investors in particular prove to be shy as deer.

It needs time and patience to build trust. How does the famous line run? “It is often darkest just before dawn.” Ever since the issuance of Covered Bonds by Washington Mutual and Bank of America the Pfandbrief technology seems to have become more familiar to US-markets too, where securitizations and agency bonds have ruled so far and continue to do so. In addition some USD transactions have surfaced recently, too, in the Covered Bond market that were targeted at and warmly welcome by US accounts. We therefore think it is worthwhile bringing the original,

the Pfandbrief, to town again and explain it in greater detail which is the reason why we are here today.

To this effect let me now quickly browse through some figures of Pfandbriefbanks:

CHART 4 – Germany’s fixed income market

Out of the entire almost 3500 billion € German fixed income market, Pfandbrief with 949 billion € outstanding is second only to government debt with 1300 billion € outstanding. vdp member banks account for 1058 bn € outstanding or almost one third of all securities in the German fixed income market. And at the moment they cover 88% of the German Pfandbrief market.

CHART 5 – The European Covered Bond market

The Covered Bond market displayed outstandings in excess of 1800 bn € at the end of 2006. Almost half of it was Pfandbrief. Despite of all dynamics in recently established Covered Bond markets the Pfandbrief is still by far Europe’s biggest Covered Bond market.

CHART 6 – Pfandbrief vs. Covered Bonds

Looking at gross issuance on the right hand side of the graph the result is similar, although by smaller margin: In 2006 non-Pfandbrief Jumbo Covered Bonds close to 140 bn € were issued. Total issuance in Pfandbrief including Jumbo, traditional and registered bonds reached 167 bn €!

CHART 7– Jumbo Pfandbrief vs. Swap

Where does Pfandbrief trade in the Euro-universe? Euro Swap spreads of Jumbo Pfandbrief have come in and trade through swaps since end of 2005.

CHART 8 – Jumbo Pfandbrief vs. Bund

Jumbo Bund spreads have widened in parallel and currently amount to over 15 bp in the 5 year and above 20 bp in the 10 year tenor.

CHART 9 – Jumbo Pfandbrief vs Jumbo Covered Bonds

Taking a look at spread levels in the Covered Bond universe one can clearly see that most Jumbo Pfandbrief issues quote at the tighter end of the Covered Bond spectre. Some might say: “This is expensive.” This may or may not be the case, depending on one’s perspective. As an issuer I am inclined to note that it is the market that bids high Pfandbrief quality up.

So, where do we go from here?

CHART 10 – a greenback market

In Germany Pfandbrief has always been among the preferred asset classes for clients with long dated liabilities such as insurance companies and pension funds. Today, US-Americans do not yet constitute a significant share among Pfandbrief banks’ clients. This is bound to change. With a view to currency, traditional Pfandbrief has already been issued in Swiss Franks, Danish Kroner, British Pound, Japanese Yen, Australian Dollar and Canadian Dollar as well as US Dollar. Unlike in the other currency markets, in the US Dollar market Pfandbrief has been issued in benchmark size already. To us, it is clear that now the time has come for Pfandbrief along with other Covered Bonds to add to and complement the USD investment universe. There are several reasons why this will be so:

From the investors' perspective

- diversification away from agencies' debt is a welcome option to pursue;
- exposure to Pfandbrief allows to benefit from the dynamic development of the Covered Bond asset class;
- credit quality of Pfandbrief backed by long tradition, robust regulatory support and supervision of Pfandbrief Banks make it a highly attractive rates product;
- Mortgage Pfandbrief offers additional supply of AAA paper
- looking at the Euro market, Pfandbrief offers attractive currency diversification

From the issuers' perspective benefits of USD issuance will be

- diversification away from Euro investor base.
- Secondly, US Dollar issuance will serve as a natural hedge for US Dollar loan business.

Expectations for outstanding US Dollar Covered Bonds vary between 50 bn US Dollar in 2008 and 100 bn US Dollar by 2010.

I may conclude that with the recent debut of a US originated Covered Bond the stage has therefore been set for the completion of the US Dollar investment universe!

CHART 11 – thank you & further information

Ladies and Gentlemen, I would like to thank you once again for joining us this morning – I hope you will find the conference proceedings interesting. Thank you to our hosts at Merrill Lynch today, too, who have lent their dedicated support to make this event come true.

We don't know, whether this will help the Pfandbrief to play in Peoria. But we are convinced, that with the development of the US-Dollar Covered Bond market NOW the time has come for the US fixed income investment universe to be completed.

I do hope that by the end of the conference everybody will be able to decide to which of the German cars the Pfandbrief likens most. To help you in this process we have brought along a choice of toy cars. You'll find them at the vdp stand. Please do make your choice and take one home with you.

While this may still pose a difficult decision, investing in Pfandbrief is much easier given that there is only one of its kind!

(Now let's switch to Tim Skeet, who will moderate the first panel discussion – the Issuer Showcase.)