



**VERBAND DEUTSCHER
PFANDBRIEFBANKEN**

Association of German Pfandbrief Banks

**Speech by
Henning Rasche,
President of the Association of German Pfandbrief Banks
on occasion of ECBC/Euromoney Covered Bond Conference,
20 September 2007, Berlin**

Dear delegates, ladies & gentlemen:

I hope you are enjoying your meal and will continue to do so while I take the opportunity and welcome you on behalf of Germany's Pfandbrief banks. Thank you for being here in Berlin today, the place where the Pfandbrief story began.

It is your attendance which makes this ECBC/Euromoney Covered Bond Congress again a great success.

In brief I would like to touch upon a couple of questions that have moved the market ever since subprime sent its shockwaves to financial markets from a Pfandbrief perspective:

- First, in times of distress – is credit an issue?
- Second, what about liquidity?
- Third, what can be learnt from recent developments?

Let me start with **potential credit aspects**: There is no direct link between subprime and the Pfandbrief. Subprime does not form part of Pfandbrief cover pools, neither directly via loans originated nor indirectly via MBS that are not eligible as cover assets for Pfandbrief cover pools. Investors are able to obtain a clear picture of that because Pfandbrief issuers are required by law to disclose their cover pools on a quarterly basis.

I can therefore only repeat what has been said many times before: The Pfandbrief is built on rock-solid foundations. During the last weeks, the Pfandbrief has proven its credit fundamentals: Yes, spreads have widened some basis points, but only marginally compared to other asset

classes like MBS or unsecured bank bonds. Registered and structured Pfandbriefe – contrary to the Jumbo segment – have met with good demand!

Second, what about **liquidity**?

The market making system has gone through its most difficult days since mid-August, and the question how to react was most difficult for Pfandbrief issuers, too.

The sudden, general re-pricing of risk in fixed income markets caused severe disruptions in our markets. Especially, volatility in money markets and hedging instruments like swap and govie markets affected the pricing of Pfandbriefe. To make it clear – we did not see massive selling by investors. Rather it seems that some investment banks tried to re-balance their books at all costs.

- On the one hand, therefore, interbank market making may have contributed to the volatility of spreads, forcing investors to mark down their portfolios on a day to day basis.
- On the other hand, the market making commitment is a central feature of the Jumbo market and liquidity is promised to investors when the bonds are sold to them.

A suspension of interbank market making, even if limited in time, could therefore be seen as breach of confidence.

It might even convey the impression of a general loss of trust in the Pfandbrief, and this might provoke waves of selling by investors leading to price deterioration.

Therefore after long and hard discussions, Pfandbrief issuers decided not to permit market makers to suspend their market making obligation, meaning that by doing so we were acting in favour of our investors. Of course, we will monitor further market developments closely and review our decision if necessary.

At the end of the day, market making in Jumbo Pfandbriefe and all Covered Bonds cannot be dispensed without severe repercussions for the market's future growth potential. As we say in Germany – you do not cut the branch you sit on!

Third, **what can be learned** from this?

Clearly, as long as the high degree of volatility in financial markets continues to prevail, Pfandbrief banks will carefully contemplate before they return to the Jumbo Pfandbrief market in order for investors not to suffer potential losses.

Looking at Covered Bonds as a whole, we have witnessed their transformation into a global asset class in only a very short time. With almost 80 issuers in the Jumbo segment alone and some 30 market making banks, the market has reached a remarkable degree of complexity. This makes it difficult, but all the more necessary to implement an organized decision-making process in order to safeguard

efficient communication among market participants when the going gets tough!

Therefore in 2006 we established the Market Maker and Issuer Committee (MIC) for the Jumbo Pfandbrief market in Germany.

Since mid of August the MIC is tested by reality. We have to admit, that there are some points to be improved. First of all, I and all of us at the Association of German Pfandbrief Banks would be delighted if the market makers would delegate representatives speaking for both, origination and trading, to the MIC.

The last weeks also showed, that our MIC cannot take any decisions on behalf of the entire Covered Bond market. Therefore the ECBC' decision, to implement an equivalent within the European Covered Bond Council is welcome and must be realised as soon as possible. This quasi "European MIC" should be the forum for questions related to the entire Covered Bond asset class. It should be the platform to discuss all aspects of trading and to jointly devise solutions and communicate with all market participants in a coherent manner!

But let me draw one more conclusion from the experience within the German MIC. The formation of such a group only will make sense if discussions within the group are frank and stay confidential. The indiscretion witnessed in recent discussions was intolerable and in itself a big part of the problem.

Ladies and Gentlemen, thank you for your kind attention. Certainly, throughout the second half of today's agenda you will find workshops and panels as rewarding as this morning's. Among them I would like to

direct your particular attention to the Pfandbrief panel debate due to start this afternoon at 4:15 pm!

I wish everyone a successful conference. Thank you!