



**VERBAND DEUTSCHER
PFANDBRIEFBANKEN**
Association of German Pfandbrief Banks

Berlin, February 16, 2009
vdp release no. 4

Pfandbrief market revival is evident

- vdp sees issuing activity pick up at the start of the year
- Perceptible rise in issuing volume for 2008 – despite financial market crisis
- Study confirms the Pfandbrief's superiority to Mortgage Backed Securities (MBS)

On the Pfandbrief market, the signs of a sweeping recovery are growing. In the month of January of this year, according to surveys conducted by the Association of German Pfandbrief Banks (vdp), Pfandbriefe were issued with an aggregate volume of more than 8 bn euros. Of that total, Mortgage Pfandbriefe and Public Pfandbriefe accounted for about 4 bn euros each. Sales in December had still been below the 7 bn euros mark. And with a sales volume of 3.6 bn euros, the first calendar week of February confirmed the positive trend observed at the beginning of the year.

“The two large-volume Pfandbriefe issued at the start of February – the first since late summer of last year – have been very well received by investors in Germany and abroad. This makes us optimistic about the rest of the year,” said Henning Rasche, President of the Association, in Frankfurt on Monday when the vdp met the press. “Demand for German Pfandbriefe, the benchmark product in the international Covered Bond market, is currently developing satisfactorily despite the wave of government-guaranteed bank bond issues. Our member institutions expect the positive trend of recent weeks to endure during the course of the year – provided the banking industry is stabilized further and investor confidence continues to strengthen,” Henning Rasche went on.

The positive development is driven by the Mortgage Pfandbrief, which has been able to expand its role as a favorable funding instrument for real estate financiers in the financial market crisis, and for which investors have high regard as a safe investment in troubled times. “Thus, the Pfandbrief stands a good chance of getting over its temporary phase of weakness, which followed the collapse of the Lehman Brothers investment bank last September, more quickly than other financial instruments,” remarked Rasche.

Robust development in the previous year

The Pfandbrief also proved to be very robust during much of 2008, the year that was overshadowed by the financial crisis. Only towards the end of the year, after Lehman was declared insolvent, did the Pfandbrief become one of the last capital market instruments to be hit by the crisis. Summing up for the year as a whole, the brisk issuing activity in the first three quarters was nevertheless enough to post a rise in issuing volume by approx. 13 percent to 153 bn euros. Growth was driven by a powerful increase in Mortgage Pfandbrief issuing activity, with sales more than doubling to surge by 131 percent to 63.4 billion euros (2007: 27.5 bn euros). The strong increase is explained above all by the fact that other ways to fund property loans, such as securitizations for example, were closed after the financial crisis erupted, and have remained so to date. By contrast, the consolidation of Public Pfandbriefe continued. As a total for this Pfandbrief category, the issuing volume was a respectable 90 bn euros (2007: 108 bn euros), declining by 17 percent.

The robustness of the Pfandbrief is also reflected in the development of Pfandbrief spreads. Unlike securitizations and Pfandbrief-similar products from other countries, Pfandbrief spreads have widened only moderately – evidence that investors' confidence has remained unbroken by the crisis. "Though it took some light knocks, the Pfandbrief proved its stability once again in 2008. It is and remains a guarantor of quality and safety," vdp President Rasche pointed out.

The Pfandbrief's success is based, on the one hand, on its impeccable history – never during its more than 200-year history has a Pfandbrief ever defaulted – and on the other, on the high quality of the cover pools and the stringent statutory regulations which guarantee its quality. With the first amendment of the Pfandbrief Act, deliberated by the Bundestag (German parliament) last week in the third reading, the acknowledged quality standards will be improved further. At the suggestion of the vdp, the extension of the liquidity reserve (from 90 days as originally envisaged in the legislation procedure) to 180 days has been included in the recommendation by the German parliament. A heightening of transparency by way of a more detailed representation of the maturity structure of the cover pools has likewise been approved. "If the changes which have now been adopted by the Bundestag pass the Bundesrat (upper house), the result will be a distinct further enhancement of the high legal standards of the Pfandbrief Act. Prospects will then be excellent of a stronger-then-before Pfandbrief emerging from the crisis," explained Dr. Louis Hagen, General Manager of the vdp.

Scientific study provides evidence of Pfandbrief's safety advantages

The view taken by the Association and its member institutions, namely that the Pfandbrief is going to further bolster its superiority over MBS and other funding instruments with regard to safety, also has the backing of a scientific study. The research in question was conducted jointly by Professor Markus Rudolf, Dresdner Bank Chair of Finance at the WHU Otto Beisheim School of Management in Koblenz, and Professor Anthony Saunders, John M. Schiff Professor of Finance at the Stern School of Business, New York University.

On the basis of these findings, the two professors infer that risks of default and credit risks under a Pfandbrief are strikingly lower compared with Triple-A rated CDOs and MBSs. According to one model calculation, the interest markup for MBS ought to be 4.2 times greater than for Pfandbriefe to make up for the higher risk. In the case of CDOs, the corresponding interest markup should be 3.8 times higher.

The authors of the study see clear indications that the Anglo-Saxon world in which the securitization model predominates is undergoing a shift towards the German Pfandbrief system. “The Pfandbrief model will probably grow more attractive still for investors – in the USA and elsewhere in the world,” Professor Saunders concluded.

The professors call for the resolution of system faults that caused the crisis. For example, they suggest that financial instruments which do not appear in balance sheets be backed by capital, thereby making them less attractive. As for the political implications of the financial crisis, the professors question the suitability of the capital adequacy requirements set forth in Basel II and are agreed that they ought to be reviewed. Professor Rudolf said, “The current version of Basel II leads to an inadequate capital endowment at banks. This, combined with the procyclical effects of Basel II on the own funds of credit institutions, is alarming. The rules need to be revised quickly.”

Press contact:

Dr Helga Bender, Tel. +49 (0) 30 20915-330
E-mail: bender@pfandbrief.de

Christian Walburg, Tel. +49 (0) 30 20915-340
E-mail: walburg@pfandbrief.de