

## European Covered Bonds Expand and Get Attention

**R**ecent woes in the European asset backed market do not appear to be contaminating the covered bond market, according to analysts and ratings agencies. In fact, the market is growing so strong that England will see its first, dedicated covered bond conference hosted by Information Management Network the last week of January at Clifford Chance headquarters in London.

In addition, Fitch Ratings said in a report published recently that covered bonds continued to grow over the last 10 months, despite slowdowns in other areas.

In August 2007, at the height of the Europe's market woes, the amount of Fitch-rated outstanding debt was more than €1 trillion (\$1.41 trillion), compared to €975 billion from the same period last year. The introduction of new deals from the US, Portugal and Norway have helped to push the numbers up and the proportion of German issued covered bonds also dropped to less than half of the 48 institutions included in the ratings agency analysis.

The most recent covered bonds have also come from France and Denmark, according to analysts at Dresdner Kleinwort, and the covered bond structures continue to evolve. According to Fitch, a growing trend is for institutions to issue outside their dedicated legislative covered bonds framework and issue deals on a contractual law basis, these deals done outside specific legislation are often referred to as structured covered bonds. Fitch said that so far this year 12 institutions issued covered bonds outside a dedicated legislative and regulatory regime compared with six at mid-2006.

For potential issuers still waiting on their respective countries developing

covered bonds legislation, issuing structured covered bonds offers or contractual covered bonds allows quicker access to the benefits of issuing these vehicles. But issuers in countries with dedicated laws are finding that launching deals on a contractual basis offers some flexibility.

"The novelty in the past year has been that some financial institutions incorporated in a country with an established covered bonds framework, such as France, have chosen to issue contractual covered bonds," explained Fitch analysts. "This enabled the issuers to define eligibility criteria that suited their own underwriting criteria." For these French banks its has meant the ability to grant housing loans that benefit from a mutual insurance guarantee in excess of the 35% limit imposed by the legislation for French covered bonds (obligations foncieres).

Among the 61 covered bonds programs monitored by Fitch, 36 are collateralized by mortgage loans and 25 by public sector debt. Contractual covered bonds programs accounted for 60% of new entrants.

"Covered bonds have recently come out of the States, from Washington Mutual and Bank of America, as well as Canada, from Royal Bank of Canada," said Andy Melvin, a senior vice president at IMN.

But despite these new entrants some market players believe the hype over growth in the sector may be over inflated. "In general, there isn't much movement in covered bonds, and covered bonds have bankruptcy remoteness," said one London based covered bond analyst. "In my opinion, the investors in covered bonds current deals right now are the same as the ones before: banks, insurance companies, and treasury departments."

"There are no new investors in cov-

ered bonds," she added, "except maybe for the, well, freaky investor who suffered loses in the asset-backed market and is looking to go into covered bonds."

Another covered bond analyst at a German bank disagreed, saying that long gone are the days when only banks and treasuries invested in these vehicles. In his estimation, only around 30% to 35% of covered bond investors in Europe are central banks and now that Europe is adopting more and more legislation designed to improve market conditions, it's going to keep enticing new investors to no end.

Pending legislation in the United Kingdom, for instance, will likely have little or no negative impact on covered bonds, according to Fitch. Currently, covered bonds are not formally regulated in Britain, but after the legislation, the market will be supervised by the Financial Services Authority.

But there are still some kinks that need working out before the U.K. legislation works, said Fitch analysts. "The implementation of an integrated model, whereby cover assets will not be transferred to an outside SPV guaranteeing the debt issued by a recognized financial institution leaves some question marks open regarding asset segregation in an insolvency situation and will need to be addressed by issuers choosing this option," reported analysts.

According to Melvin, the pending U.K. legislation is why IMN chose a London venue, as a symbolic measure of how the market is on the cusp of change. The new rules will turn out to be a good thing for European covered bonds, he added, as well as a similar law passed in Italy this year which he expected would stimulate issuance of Italian covered bonds in 2008. — JG