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FIXED INCOME STRATEGY RESEARCH | EUROPEAN INTEREST RATES | AAA STRATEGY

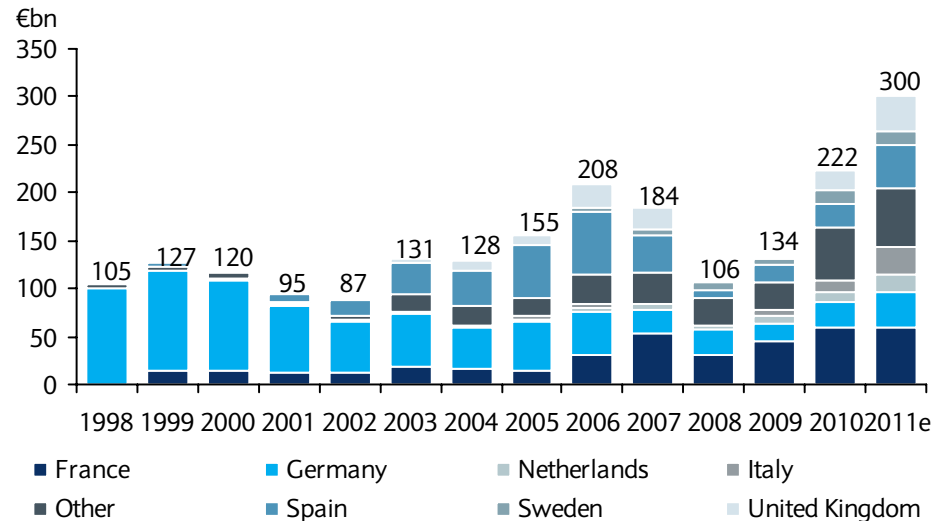
Austrian Pfandbriefe & covered bonds – only a local delicacy?

May 2011

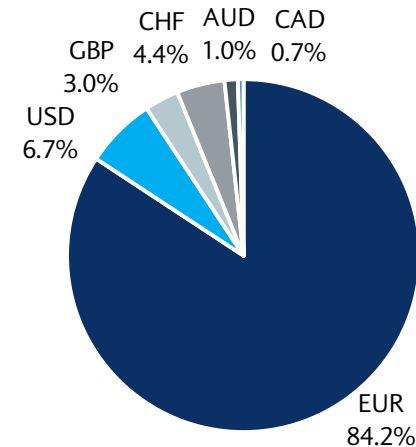
Source for all charts Barclays Capital unless otherwise stated

Covered Bonds - supply trend

Annual benchmark covered bond gross supply



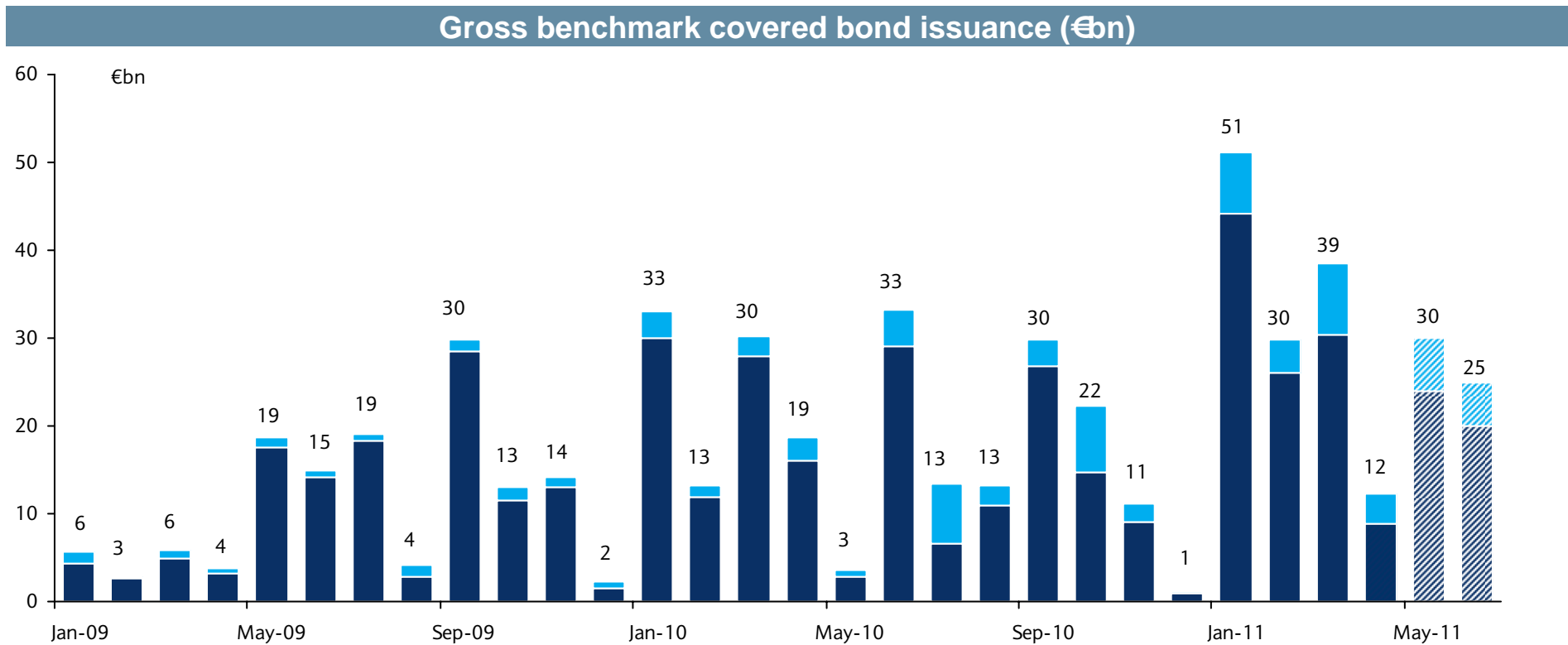
YTD benchmark covered bond supply by currency



- So far, primary market activity in 2011 has been resilient against ongoing volatility in sovereign debt markets. However, issuers from peripheral markets have paid historically wide premiums and partly struggled to place new deals.
- The regulatory environment is generally supportive for covered bonds, particularly compared to ABS/MBS, but also with respect to the discussions surrounding the potential loss participations of unsecured creditors in bank resolution scenarios.
- The number of covered bond issuers is still increasing. In 2010, there were €28bn of benchmark covered bond supply from 18 new issuers. This is an increase from 20 deals (€24bn) in 2009 and 16 (€18.5bn) inaugural deals priced in 2008.
- There is a growing number of non-€ benchmark covered bond transactions. In Q1 11, a total of €100bn of € benchmark covered bonds was issued. Additionally, the equivalent of €19bn of non-€ benchmark, mainly USD, GBP and CHF, covered bonds were launched.

Source: Barclays Capital

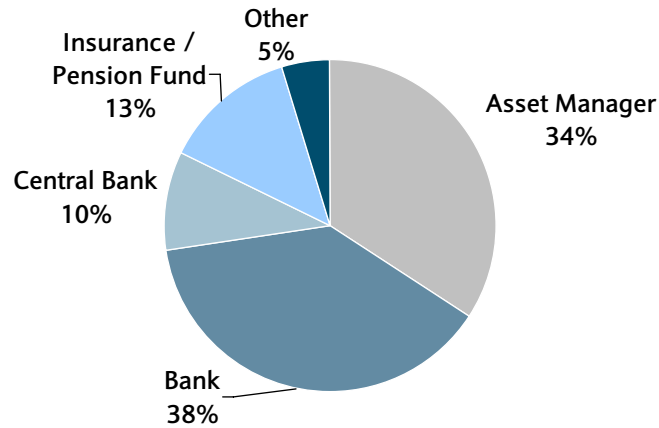
Strong covered bond issuance in early 2011



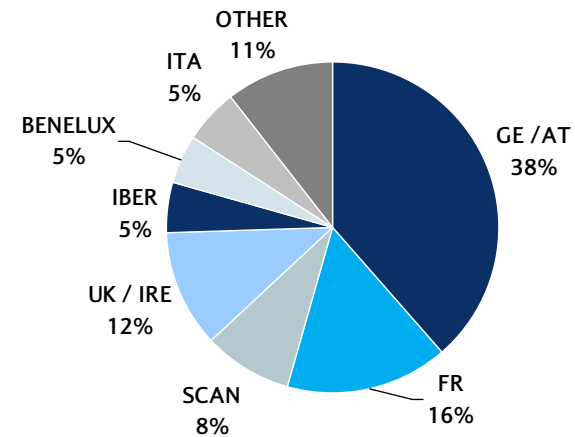
- On the back of strong frontloading of many covered bond issuers, there have been record amounts of covered bond issuance in early 2011.
- Following a seasonal decrease of monthly benchmark covered bond supply in April, we forecast issuance activity will increase again in May and June.

Covered bond investor trends – all countries

Take up of €benchmark covered bonds by investor type (2011 YTD)



Take up of €benchmark covered bonds by geography (2011 YTD)



2011 vs. 2010 change of take up by investor type of €benchmark covered bond primary market transactions

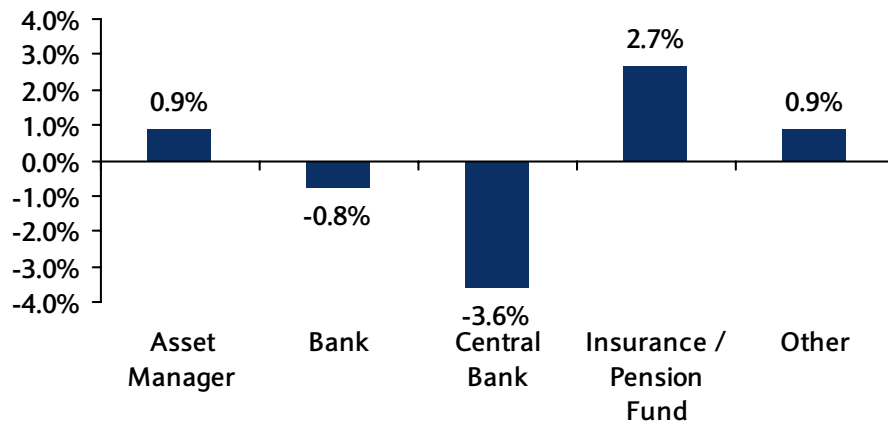
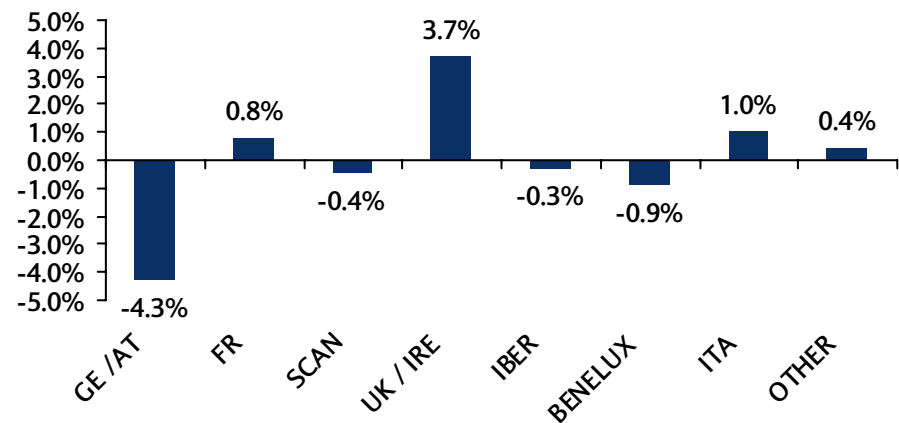


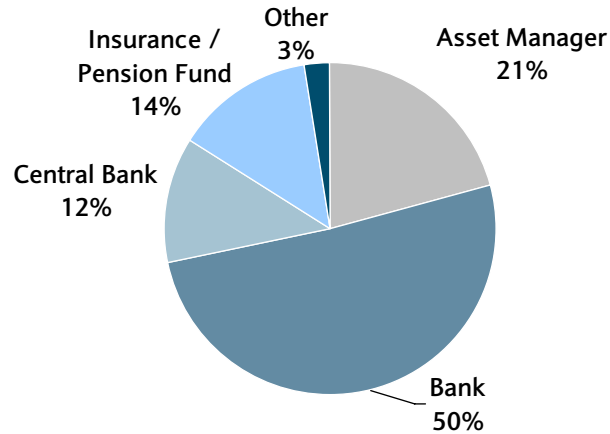
Figure 2: 2011 vs. 2010 change of take up by investor region of €benchmark covered bond primary market transactions



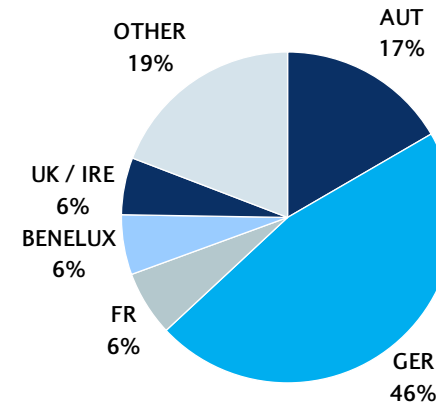
Source: Various News Agencies, Barclays Capital

Covered bond investor trends – Austria

Take up of €benchmark covered bonds by investor type (2011 YTD)



Take up of €benchmark covered bonds by geography (2011 YTD)



2011 vs. 2010 change of take up by investor type of €benchmark covered bond primary market transactions

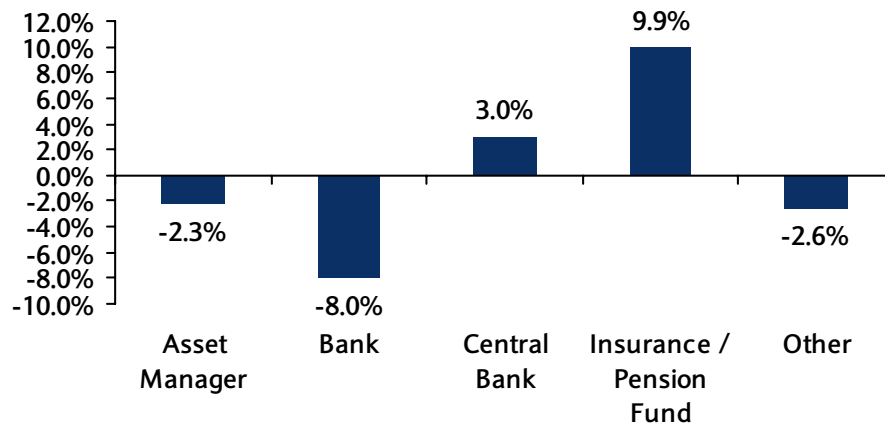
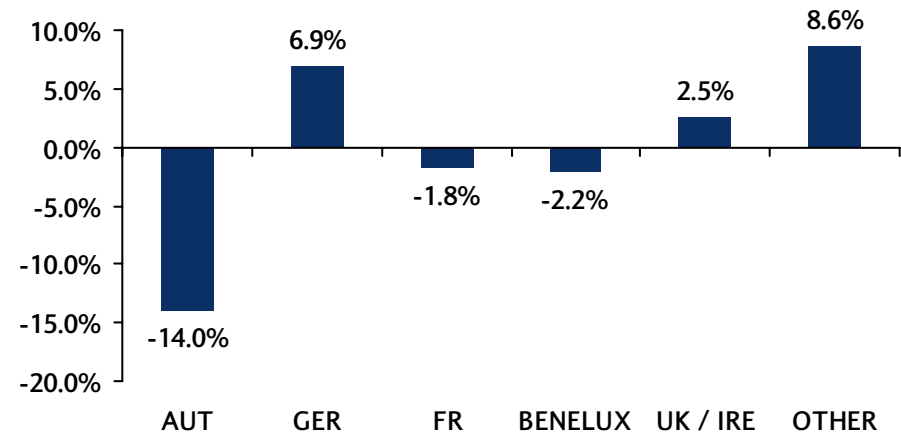


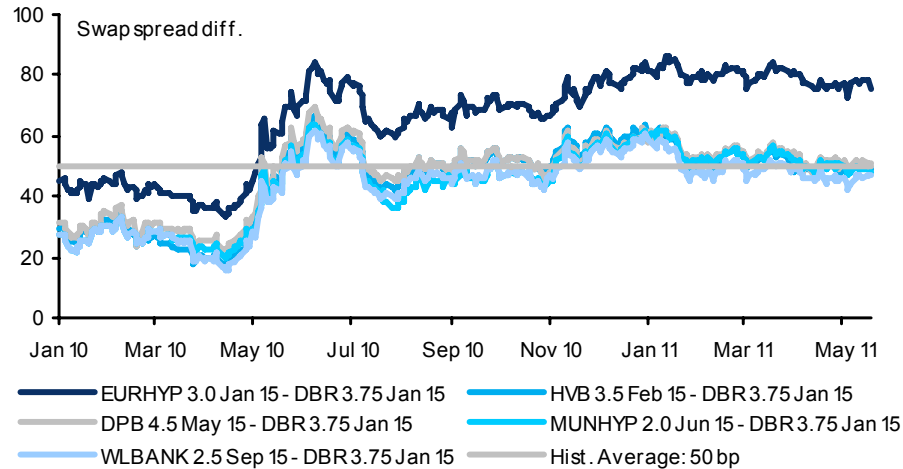
Figure 2: 2011 vs. 2010 change of take up by investor region of €benchmark covered bond primary market transactions



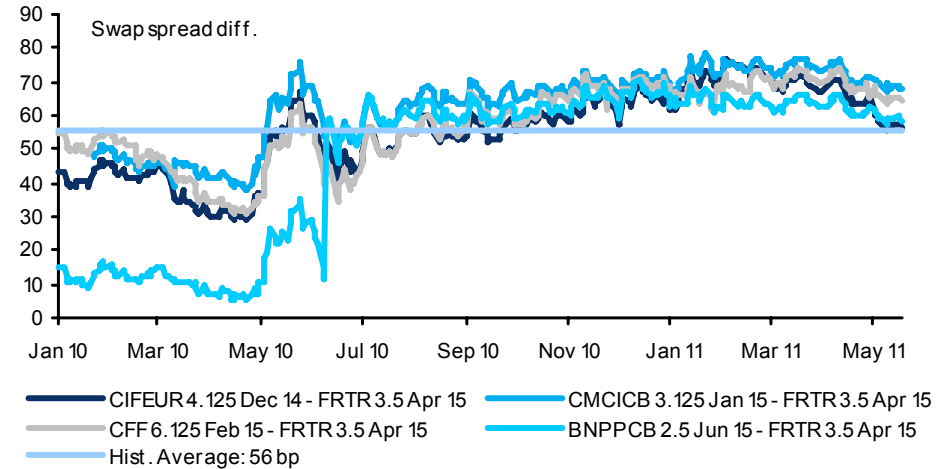
Source: Various News Agencies, Barclays Capital

Covered bonds vs. underlying government bonds (I)

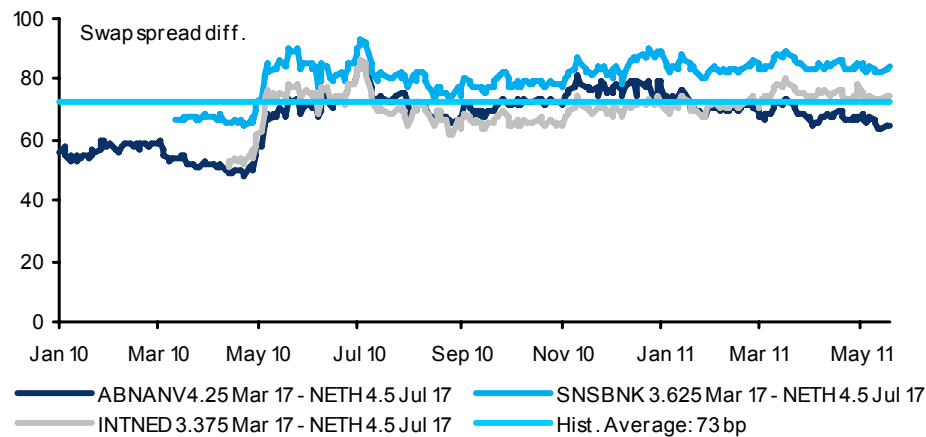
Germany



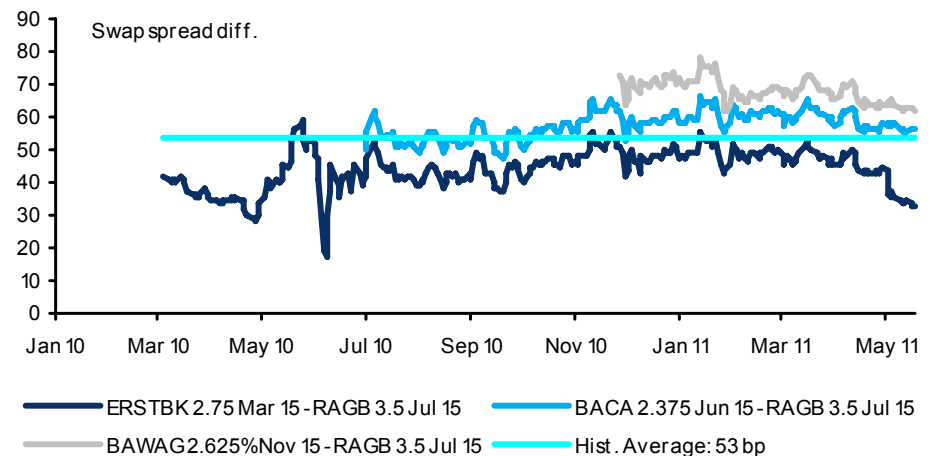
France



Netherlands



Austria

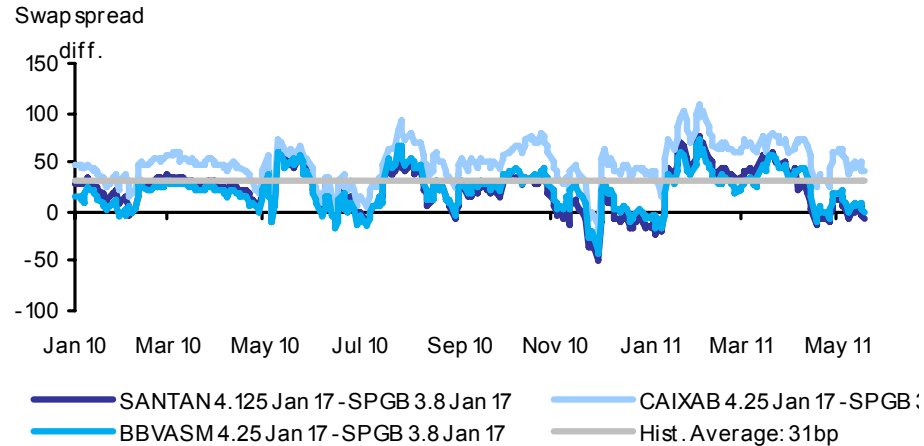


- There are interesting RV opportunities when comparing covered bonds versus underlying government bond markets.
- Spread volatility is largely driven by the overall situation in European sovereign markets.

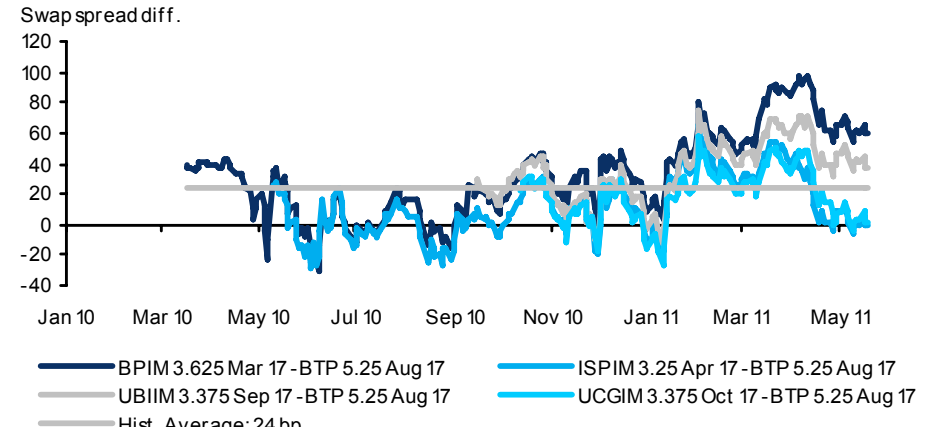
Source: Barclays Capital

Covered bonds vs. underlying government bonds (II)

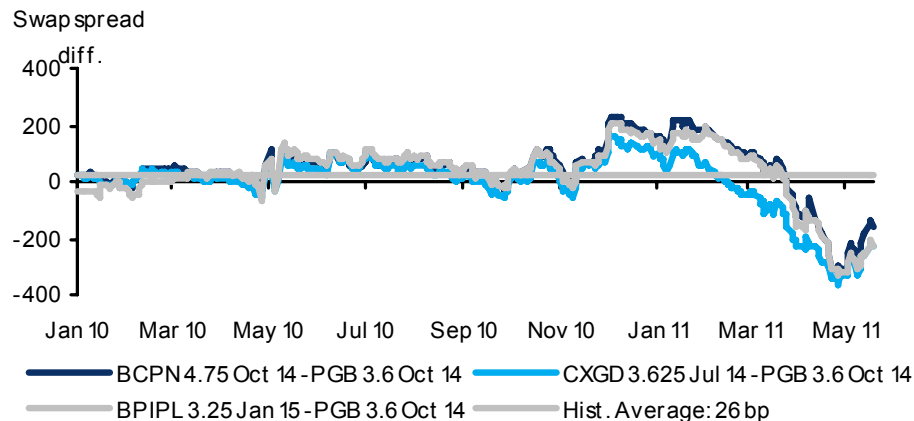
Spain



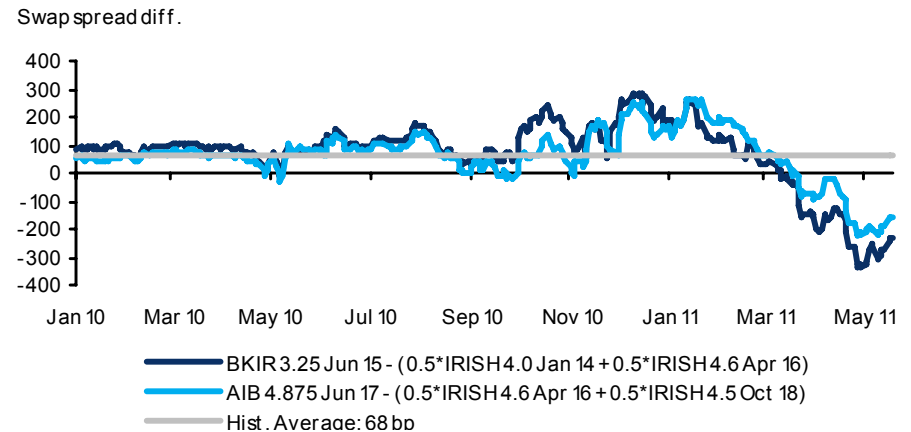
Italy



Portugal



Ireland



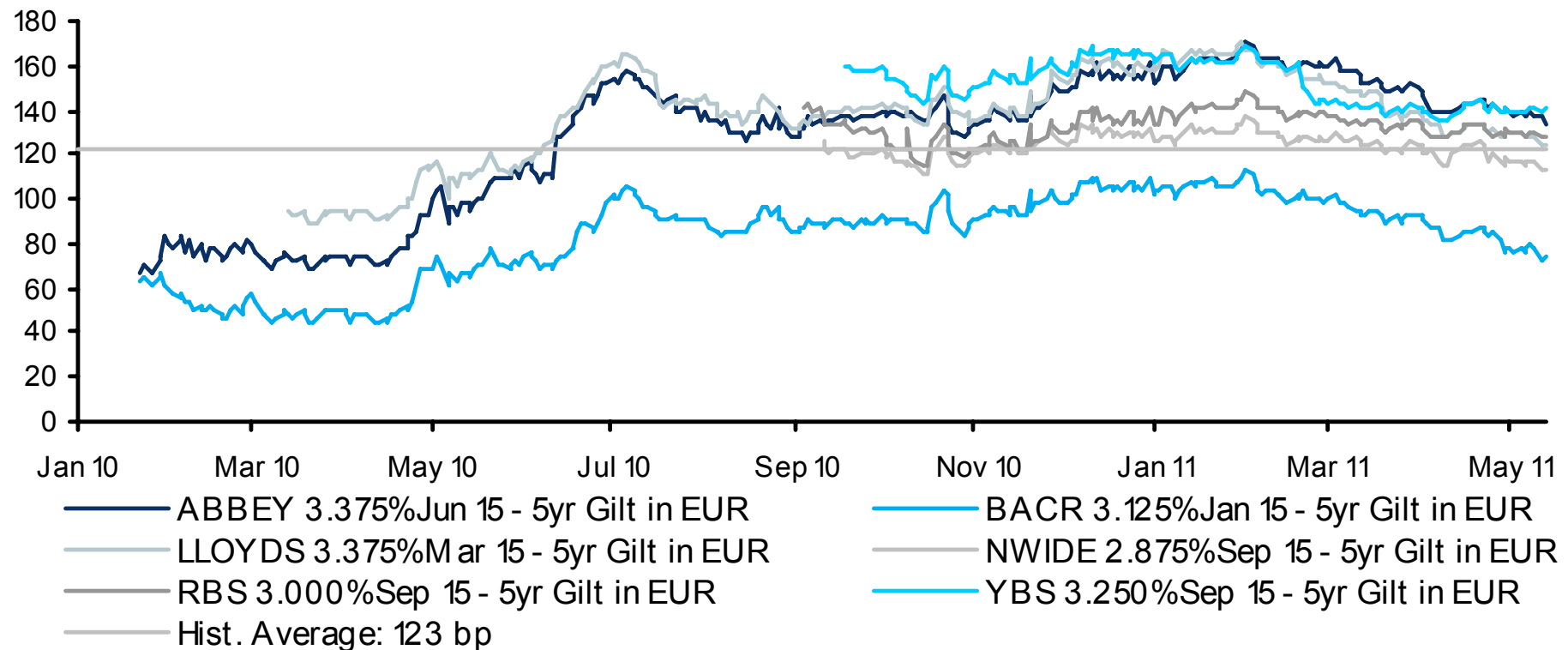
- There are interesting RV opportunities when comparing covered bonds versus underlying government bond markets.
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Source: Barclays Capital

Covered vs. underlying government bonds (I)

United Kingdom

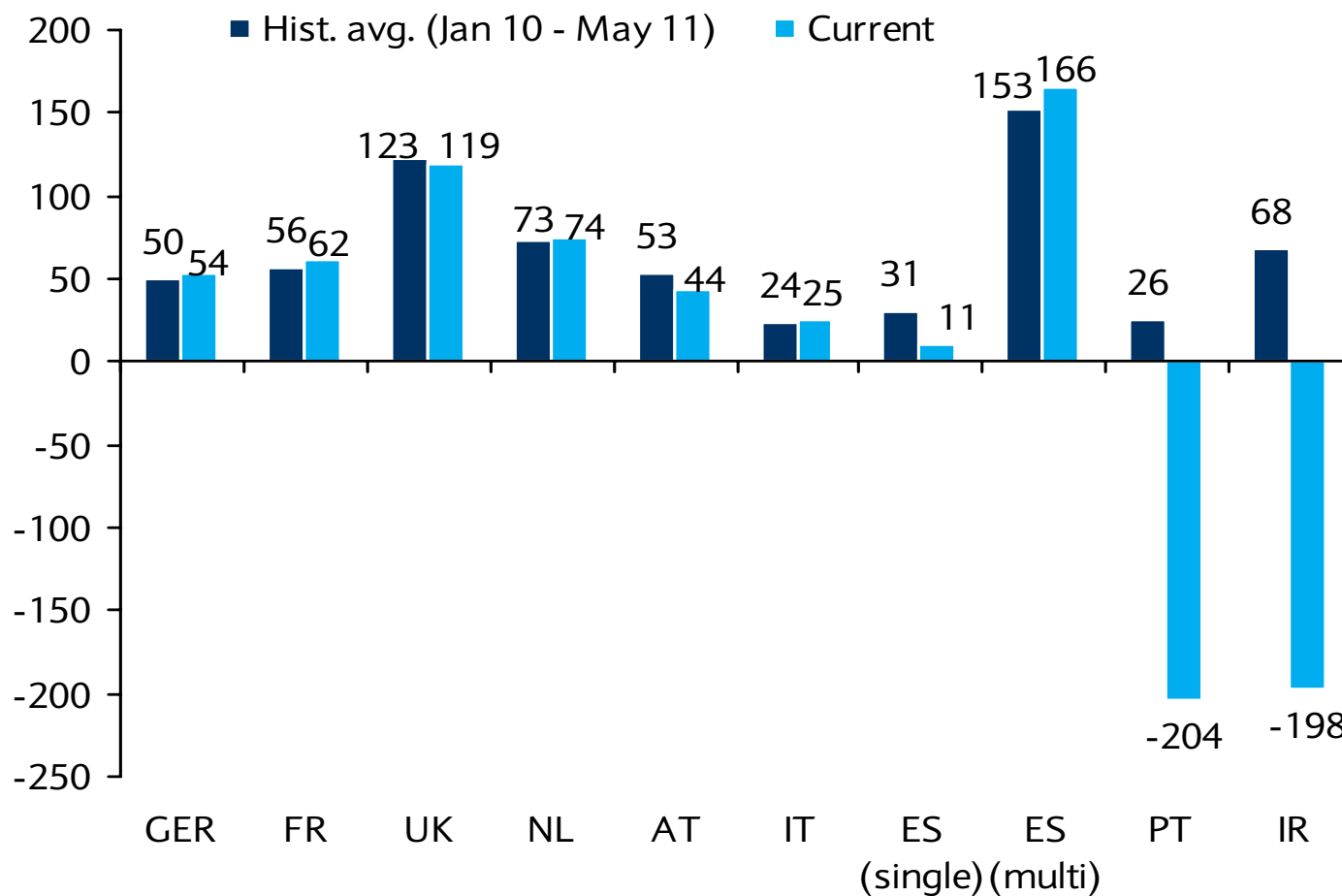
Swap spread diff.



- Over the past 12 months, 5yr €benchmark UK Regulated Covered Bonds were trading on average about 120bp over Gilts swapped into 3M Euribor.

Spread distance between government and covered bonds

Historical average and current swap spread differential between 4-6yr government and covered bonds*



Source: UK= €covered bonds versus Gilts swapped into 3M Euribor, Barclays Capital

Types of credit institutions and covered bonds

	Universal Bank	Specialised Bank	Pure Funding Entity
Correlation of covered bond PD with PD of issuer	▪ low	▪ average	▪ rather high
Seniority of claims versus other debt holders	▪ low	▪ average	▪ very high
Cover pool stability	▪ variable	▪ rather stable	▪ variable
Incentive for strategic commitment in a stress scenario	▪ high	▪ rather high	▪ average

- There are various types of credit institutions acting as covered bond issuers, such as universal banks, specialised banks and credit institutions designed as pure funding entities.
- Default correlation between the bank and cover pool assets, subordination of other debt holders, the stability of cover pool assets and the strategic commitment to covered bond funding all vary substantially across different models.

Covered bond versus unsecured creditors

Bank

Cover Pool	Covered Bonds
Overcollateralization	Retail Deposits
Other non-eligible and/or unpledged assets	Unsecured debt
	Equity

► **Structural subordination through**

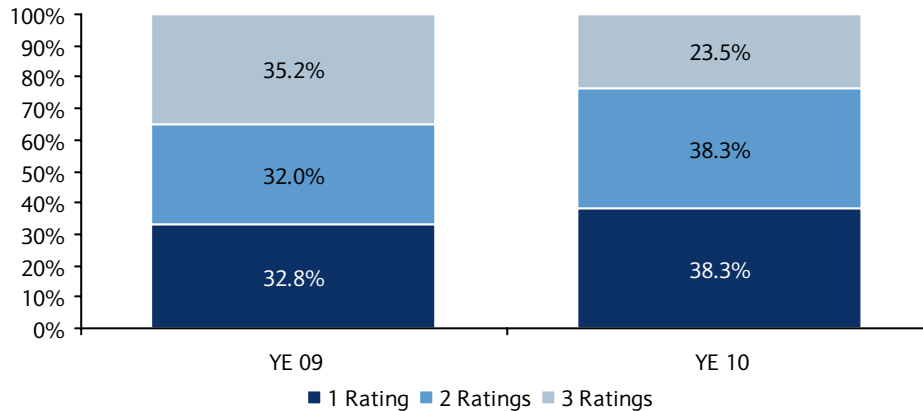
- (a) the amount of collateral segregated from the insolvency estate
- (b) the quality of assets used as collateral
- (c) the release of potential excess collateral only when the last covered bond holder is paid back

► **Reduced default probability through**

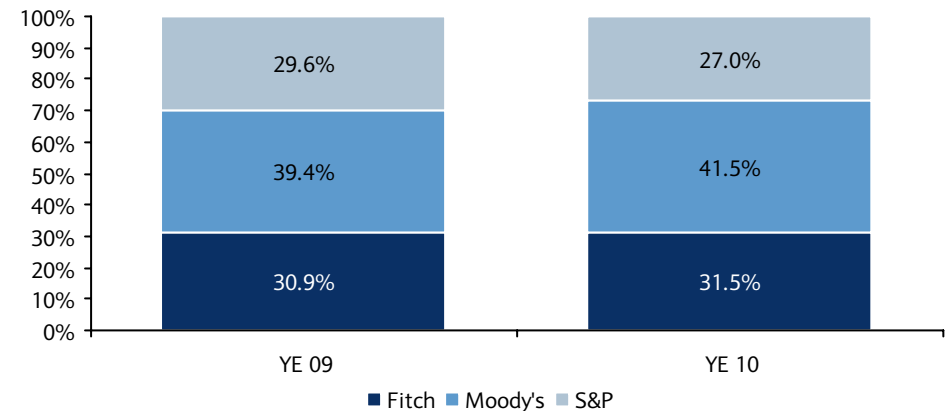
- (a) a more balanced asset-liability profile
- (b) more reliable capital market access
- (c) broader and more efficient access to central bank liquidity

Covered bond rating trends

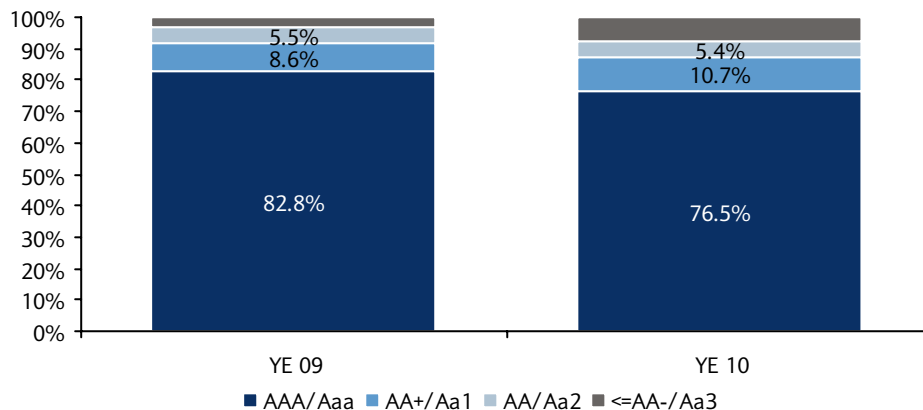
No. of ratings per benchmark covered bond programme



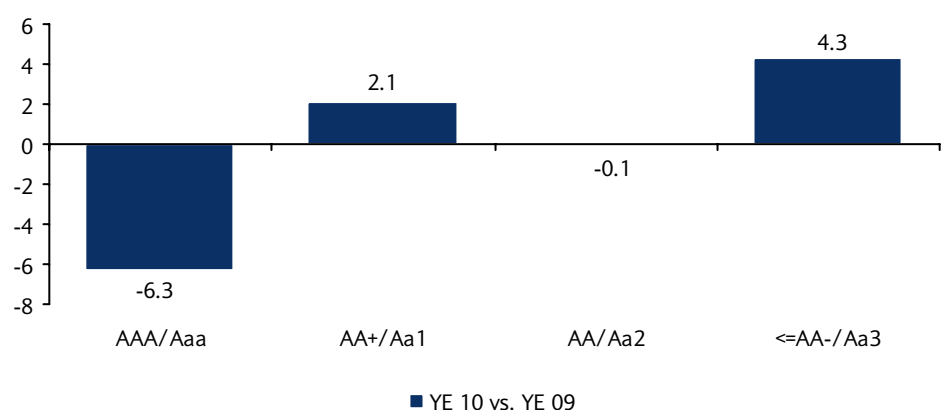
Market share by no. of benchmark covered bond ratings



Rating distribution (lowest rating)



Rating migration (YE 09 vs. YE 10 in % points)

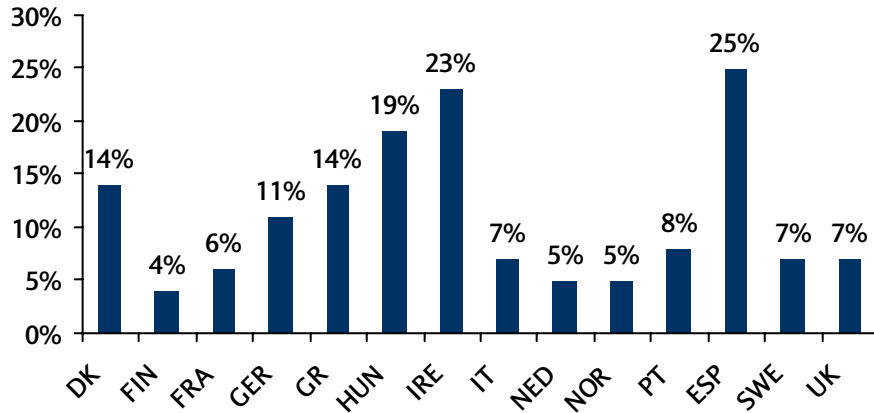


- The number of covered bonds rated by all three major rating agencies decreased from 35% at YE 09 to 24% at YE 10.
- The number covered bonds rated not worse than triple-A by any of the three major rating agencies decreased from 83% at YE 09 to 77% at YE 10.

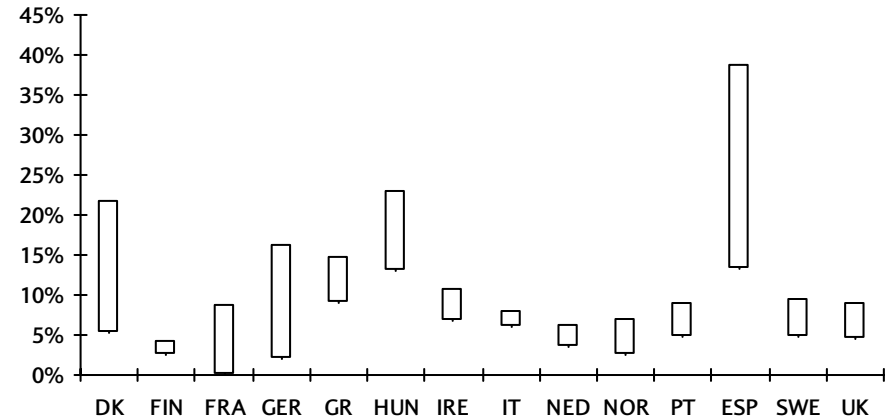
Source: Barclays Capital

Covered Bonds – Moody’s Collateral Score (Q3 10)

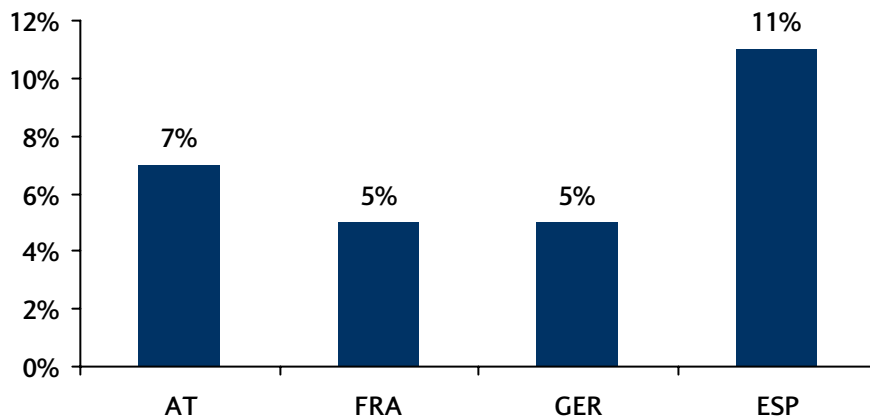
Average collateral score by country: mortgage CBs



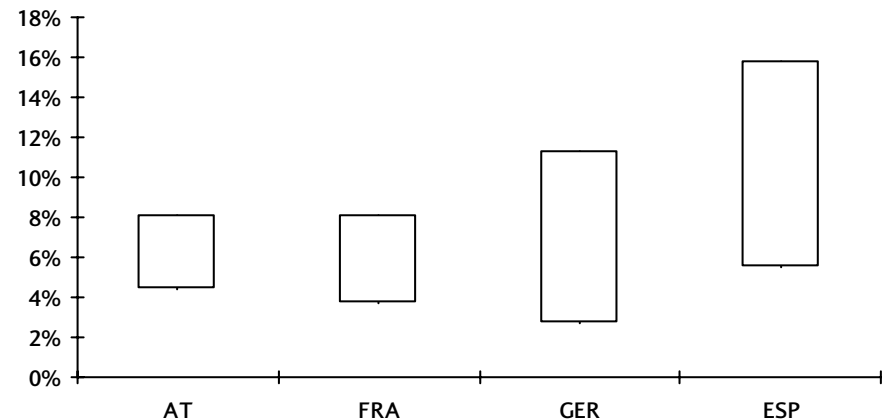
Max. and Min. collateral score by country: mortgage CBs



Average collateral score by country: pub.sect. CBs



Max. and Min. collateral score by country: pub.sect. CBs



- The quality of cover pools varies substantially from country to country. The distribution of mortgage collateral scores within the same jurisdiction is rather broad in Spain, Denmark, and Germany and particularly narrow in Finland, Italy, The Netherlands, Norway, Portugal, Sweden and the UK. On the public sector side, collateral scores vary the most in Germany and Spain.

Source: Moody's, Barclays Capital

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