1st Annual European Covered Bond Investors’ Survey

May, 2009

European Covered Bond Dealers Association
an Affiliate of SIFMA
ECBDA Investor Survey Overview

- European Covered Bond Dealers Association (ECBDA) compiled a survey with leading covered bond Investors across the European market
- Over 100 European covered bond Investors were contacted over the course of Q1 2009
- ECBDA reached out to a wide range of Investors across its SIFMA membership base, clients of the ECBDA members, as well as clients of Bloomberg and Tradeweb
- 65 Investors across a wide range of financial institutions and jurisdictions completed the survey
- The survey yielded a good representation of the wider European covered bond Investor market
European Covered Bond Investor Base

Respondents spanned a wide range of the Investor market from Investment Management Firms, Investment Banks, Central Banks through to Hedge Funds

- Majority of respondents (48%) represented Asset Management firms, followed by Broker-Dealers (17%)
- The survey also included responses from Central Banks or Treasury (8%) who play increasingly important roles as Investors of covered bonds under current market conditions
- Hedge Funds (2%) and Insurance Funds (2%) made up the smallest representation
Investor Demographic

Good split of Investors in terms of assets under management and positions

- 43% of respondents had over EUR 20bn equivalent of assets under management
- 63% of respondents were in a Fund/Portfolio Manager function, 25% in a Trading function, 8% in Sales whilst 5% represented Market Professionals in general
Investors spanned 18 different countries or regions

- Majority of the Investors were based in Europe but the survey also captured those who invested in European covered bonds but were based in North America (2%) or Middle East & Africa (2%)
- 17% of Investors surveyed were based in Italy, 15% in Germany whilst 9% were in Spain and the UK alike
- Investors in the ‘Other’ category were based in Eastern and Central European countries
The Secondary B2C market is still heavily dominated by voice (OTC) execution

- 42% of respondents chose voice as their preferred method of execution for jumbo covered bonds
- Multi-dealer request-for-quotes (RFQ) and multi-dealer inventory were seen as the next best methods as chosen by 28% and 25% of Investors respectively
- 6% preferred single-dealer streaming (including the dealer's own Bloomberg screens)
- No Investors selected a preference for an exchange
The survey showed key differences in strategies for the next six months compared to 2008

- In comparison the rest of their book, 34% of respondents said their covered bond portfolio remained largely the same in 2008

- Investors still saw buying opportunities in 2008 as 11% of Investors increased their holdings somewhat or significantly

- 37% deceased their covered bond holdings somewhat, whilst 18% decreased covered bonds significantly in 2008. When polled about the next six months, Investors looking to decrease their Jumbo holding was markedly lower at 28% somewhat and 8% significantly

- 48% of the respondents said their overall holdings of European Covered bonds over the next six months would remain more or less the same
With the market dislocation, Investors’ view of covered bonds has changed

- Majority of Investors surveyed 45% still consider covered bonds as a rate product, but with a significant credit element to it. Only 2% considered it to be a rate product outright.
- 32% of respondents saw covered bonds primarily as a credit product, but with some rate element to it.
- 22% of respondents saw covered bonds as an outright credit product.
Investor Views on Covered Bond Spreads

No clear consensus from Investors on their expectation of covered bond spreads this year

- 37% of respondents believed spreads will widen somewhat
- 34% of respondents expected spreads to remain more or less the same; 29% expected a small narrowing of spreads
- None of the Investors polled expected significant widening or contraction of spreads
Factors Responsible for Widening of Spreads to Swaps in Covered Bonds

- Lack of liquidity in the interdealer market: 4.11
- Concerns over the credit quality of covered bond issuers: 4.05
- Lack of liquidity in the B2C market: 3.95
- Concerns over the quality of the collateral: 3.87
- Widening of spreads to swaps of unsecured senior debt: 3.86
- Concerns over the quality of the structure of the covered bond: 3.51
- Competition from unsecured Government Guarantee Debt: 3.31
- Concerns over the timely payment of issuers in case of default: 3.13
- Competition from Government Bonds: 2.66
- Competition from Agencies: 2.59
- Index considerations: 1.90

Avg Weighted Responses
where 1 is unimportant and 5 is extremely important

- Investors expressed concerns over lack of liquidity in the interdealer market and concerns of Issuer credit quality as leading factors contributing to spread widening.
- Competition from Government Bonds, Agency Bonds or Index considerations were seen as the least contributing factors.
Lack of liquidity played a significant part of Investors covered bond investment choices

- The current reduced liquidity in the covered bond market deterred majority of investors away from covered bonds (53%)

- For the remaining respondents, a fairly even split of 22% and 25% respectively were taking a buy-and-hold approach, or a mixture depending on the bond’s jurisdiction
Covered Bonds are currently seen by covered bond Investors as presenting the lowest relative opportunities

- Government guaranteed bonds ranked the next highest in terms of relative value as government provide protection on otherwise unsecured debt

- Senior corporate debt presented the most relative value opportunities. Spreads in corporate debt have widened significantly and have represented cheap buying opportunities
Significant Factors To Address in 2009

Investors are most concerned with liquidity in 2009

- The top three issues to be addressed with almost equal weighting are increased B2C liquidity, improved secondary market transparency and increased interdealer liquidity.

- On Issuance standards, Investors showed a preference for improved disclosure on the collateral and harmonisation of legal frameworks. Issues such as lower LTV ratios, increased size of issues or Taps were less of a concern.

- Other factors given moderate weighting were outside of the control of the covered bond market such as, recovery in the underlying real estate market and reduced supply of government guaranteed debt.

### Most Significant Factors to Address for Jumbo Covered Bond Market to Recover in 2009

<table>
<thead>
<tr>
<th>Factor</th>
<th>Avg Weighted Responses</th>
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<tbody>
<tr>
<td>Increased B2C liquidity</td>
<td>4.22</td>
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<td>Improved secondary market price transparency for customers</td>
<td>4.20</td>
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<tr>
<td>Increased interdealer liquidity of covered bonds</td>
<td>4.14</td>
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<td>Greater disclosure of information concerning collateral pools</td>
<td>3.81</td>
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<td>Recovery in the European real estate market</td>
<td>3.71</td>
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<tr>
<td>Improved credit quality of covered bond issuers</td>
<td>3.67</td>
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<td>More harmonised legal framework for issuance across Europe</td>
<td>3.48</td>
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<tr>
<td>Reduced supply of government guarantee debt</td>
<td>3.48</td>
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<tr>
<td>Greater disclosure of information concerning the structure of covered bonds</td>
<td>3.45</td>
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<td>Greater standardisation of issuance practices across Europe</td>
<td>3.23</td>
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<td>Greater coordination amongst Rating Agencies on approach to rating covered bonds</td>
<td>3.02</td>
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<tr>
<td>Decreased covered bond spreads to sw aps</td>
<td>2.92</td>
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<tr>
<td>Lower LTV ratios for covered bonds</td>
<td>2.85</td>
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<tr>
<td>Increased covered bond spreads to sw aps</td>
<td>2.54</td>
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<tr>
<td>Increased size of issues</td>
<td>2.44</td>
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<tr>
<td>Increase use of taps by issuers</td>
<td>2.41</td>
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Where 1 is unimportant and 5 is extremely important.
1. Overall holdings in European covered bonds is expected to remain more-or-less the same over the next six months for majority of Investors.

2. The percentage of Investors looking to decrease holdings in 2009 is significantly lower than those who actually decreased in 2008 indicating that the distressed selling may have subsided this year.

3. Vast majority of Investors view covered bonds as a hybrid rate-credit product although still primarily a rate product.

4. Whist volatility in covered bonds spreads is expected to continue, no extreme widening or contraction of spreads is expected amongst Investors.

5. Majority of Investors see lack of liquidity as a major reason for spread widening in covered bonds and are deterred from investing in this product for this reason primarily.

6. Spread pick-up in the unsecured market has meant that senior corporate debt now presents the greatest relative value trades for Investors whilst covered bonds presents the least.

7. Finally, Investors would mostly like to see issues surrounding B2C and interdealer liquidity and transparency addressed in 2009.
The **European Covered Bond Dealers Association** (ECBDA) is a new initiative designed to bring the Securities Industry and Financial Markets Association’s (SIFMA) regulatory expertise and business-focused model to bear on Europe’s covered bond market dealers. Its objectives and purposes are:

- To represent the interests of covered bond dealers in European covered bond markets by creating a united voice in discussions with issuers and investors;
- To promote an efficient pan-European covered bonds market;
- To address primary and secondary issues in European covered bonds markets by facilitating consultation with key market participants;
- To complement and cooperate with other membership-based trade organisations in the covered bonds arena, on issues of mutual concern and in order to promote common interests;
- To be globally connected to covered bonds activities coordinated by SIFMA US and Asia.

Board Membership on the ECBDA is open to European covered bond dealers that make markets in at least 50 covered bonds or which rank among the top 20 underwriters in Europe of covered bonds. Associate Membership is open to all European covered bond dealers.

ECBDA members currently are: Barclays Capital, BNP Paribas, Commerzbank, Danske Bank, Deutsche Bank, Dresdner Bank, Morgan Stanley, Natixis, Royal Bank of Scotland, Société Générale and UBS
Contact the ECBDA

Mark Austen, Managing Director
mausten@sifma.org
Tel: +44 (0) 20 743 9343

Folake Shasanya, Director
fshasanya@sifma.org
Tel: +44 (0) 20 743 9318

Emmanuelle Roux, Associate Director
eroux@sifma.org
Tel: +44 (0) 20 743 9316

London | New-York | Washington D.C. | Hong-Kong
St Michael’s House
1 George Yard, London, EC3V 9DH, United Kingdom
Tel: +44 (0) 20 743 9300
Fax: +44 (0) 20 743 9301