Deutsche Bank

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Overview Covered Bonds

Adjusting to the new market

Asset Allocation

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2008 was the most challenging year for the Jumbo covered bond market since its inception in 1995. The general increase in risk premia, sharp declines in global real estate markets, significant restructuring of financial institutions and a considerable widening of non-core sovereign spreads have markedly impacted the Jumbo covered bond market.

Spread differentiation across different sectors, structures and issuers started in H2 2007 and accelerated in 2008. New issues of state guaranteed bonds are typically priced with high spreads over swaps and therefore put pressure on covered bonds. A negative covered bond - senior CDS basis in some names like e.g. BBVA, BNP and JP Morgan suggests that many covered bonds offer fundamental value. Covered bonds of sounder banks of stronger European countries seem attractive versus some peripheral sovereigns like Ireland and Greece.

Besides numerous taps and issuers making significant use of retained issues used for central bank funding, the inaugural issue of structured covered bonds by Crédit Agricole in the third week of January (7Y, EUR 1.5 bn, at ms + 135 bp) was the second EUR Jumbo covered bond issue in 2009 after BNP Paribas (5Y, EUR 1.5 bn, at ms + 110 bp), which is now trading at ms + 90 bp. LBBW followed with a 5Y Jumbo public Pfandbrief at ms + 75 bp, also suggesting that stronger banks (willing to pay a significant premium to secondary market spread indications) have access to Jumbo covered bonds. However, given ongoing deleveraging of bank balance sheets and massive primary market competition from state guaranteed bonds, agencies, supra-nationals, sub-sovereigns and non-core sovereigns, the primary market for EUR Jumbo covered bonds is likely to remain challenging.

AAA ratings of public Pfandbriefe of Depfa were put on negative watch by Fitch. Moody's put three Spanish Multi-Cédulas and structured covered bonds of Dutch Achmea on review for downgrade and mentioned downside rating pressure for covered bonds in its 2009 outlook due to higher refinancing risk and pressure on senior bank ratings. S&P put numerous AAA's of covered bonds on review for downgrade due to their amended rating criteria for swap counterparties in AAA cover pools. Given the significant changes in the market environment such as massive spread widening in non-core sovereigns and sub-sovereigns assets and generally lower liquidity of cover pool assets compared to pre-crisis levels, further adjustments of rating methodologies seem likely. Covered bond ratings are likely to remain under pressure, leading to increasing costs for issuers through stricter rating agency requirements to maintain triple A ratings.

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Overview of Legal Frameworks

		Germany	Denmark (SDO)	Spain	France (OF)	Ireland	Italy	Lux	Dutch	NOR	PT	Sweden	UK	Finland	US (contract)	Canada (contract)	Austria FSV	Austria Pfandbrief	Hungary
Specific legal framework		✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✕	✕	✔	✔	✔
Specialist banks		✕	✕	✕	✔	✔	✕	✔	✕	✔	✕	✕	✕	✔	✕	✕	✕	✔/✕	✔
Specific supervision		✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✕	✕	✔	✔	✔
Cover pool	Mortgage	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔
	Public	✔	✔	✔	✔	✔	✔	✔		✔	✔	✔	✕	✔	✕	✕	✔	✔	✕
	Other	✔	✔	✕	✔	✕	✔	✔		✔	✕	✔	✔	✔	✕	✕	✔	✕	✕
UCITS 22 (4)/CRD		✔	✔	✔	✔	✔	✔	✔/✕	✔/✕	✔	✔	✔	✔	✔	✕	✕	✔	✔	✔
Segregated asset pools		✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔
Lending area	Mortgages	EEA,CH*	OECD	EU	EEA,CH*	EEA,CH*	EEA,CH	OECD	EU[7]	OECD[6]	EU	EEA		EEA	US	CA	AT	EEA, CH	EEA
	Public	EEA,CH*	OECD[6]	EU	EEA,CH*	EEA,CH*	EEA,CH	OECD	EU[7]	OECD[6]	EU	OECD[1]		EEA		✔	EEA, CH	EEA, CH	
LTV	Residential	60%	80%[4]	80%	80%[2]	75%	80%	60%	EU[7]	75%	80%	75%		60%	80%/75%			60%	60%
	Commercial	60%	60%[5]	60%	60%	60%	60%	80%		60%	60%	60%		60%				60%	60%
	Other: Agricultural	60%	70%					80%				70%							60%
	Ships	60%	70%					60%											
Cover pool monitor		✔	✔	✕	✔	✔	✔	✔	✔	✔	✔	✔	✔	✕	✔	✔	✔	✔	✔
Substitute collateral		✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔
Limit on substitute assets		10/20%	15%	5%	15%	15%	15%	20%	✕/10%	20%	20%	20%	✕/10/15/20%	20%	10%	10%	15%	15%	20%
Derivatives in pool		✔	✔	✔/✕	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔
Limit on derivatives		12%	✔	✕	✕	✕	✕	✕	✕	✕	✕	✕	✕	✕	✕	✕	✕	✕	12%
Nominal coverage		✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔
NPV test		✔	✔	✕	✕	✔	✔	✔	ACT	✔	✔	✔	ACT	✔	ACT	ACT	✕	✕	✔
OC required		2% NPV	✕/✔	25/43%	✕/✔	3/10%	✕	2% NPV	✕/✔	✕	✔	✕/✔	✔	✕/✔	✔	✔	✕/2%	2%	✔
Continuity at default		✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✕/✔	✔	✔	✔	✔
Priority claim		✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔
OC protected		✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔
Cover pool administrator		✔	✔	✕	✔	✔	✔	✔	✔	✔	✔	✕	✔	✔	✔	✔	✔	✔	✔

*Source: Respective legal frameworks, Rating Agencies, Deutsche Bank, * plus USA, Canada, Japan; in case of Irish public sector ACS also plus New Zealand and Australia; in case of Irish mortgage ACS plus category A countries; 1- 0% risk-weighted only; 2 If the pool consists exclusively of residential mortgages; 3 maximum, 4 70%-75%, if the loans does not fulfill existing conditions on maturity and IO-period 5 70% if there is a guarantee for the loan between 60%-70%, 6 in line with CRD, 6 Outside EU if the risk weighting is 0%, 7 Cover assets have to be subject to the jurisdiction of an EU-member state, USA, Canada, Japan, South Korea, Hong Kong, Singapore, Australia, New Zealand or Switzerland*

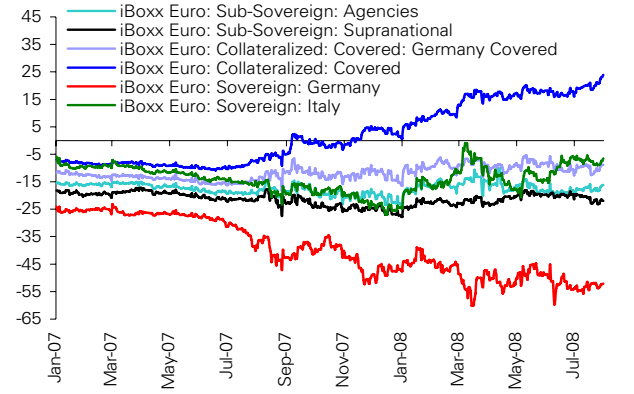
Source: Deutsche Bank

Market Snapshot

Covered bond spreads widened – increasing heterogeneity

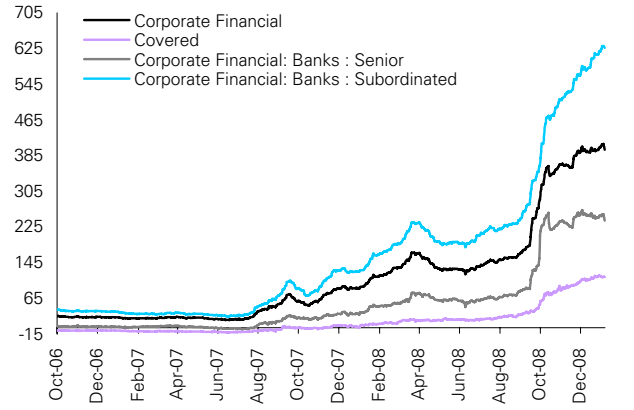
Average Jumbo covered bonds widened significantly versus swaps and other government, agency and supranational bonds in 2008. This confirms that covered bonds are not a pure rates product but have a significant credit component. The supras and agencies have fared comparatively well through the tough times as they benefit from quasi government status. On the other hand, covered bonds showed relative stability compared to senior and subordinated bank debt.

Covered bonds widened versus fixed income rates products



Source: iBoxx, Deutsche Bank

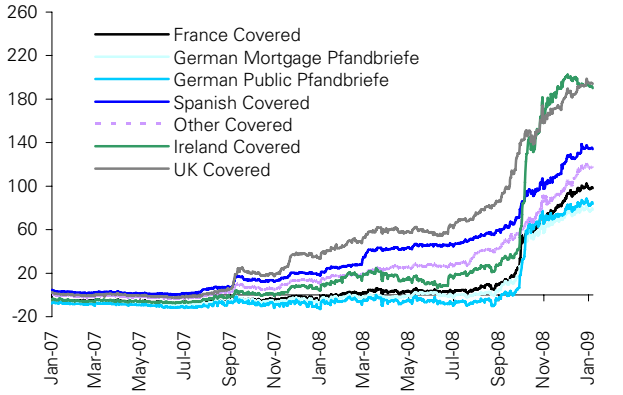
Spreads of covered bonds steady compared with senior and subordinated bank debt



Source: iBoxx, Deutsche Bank

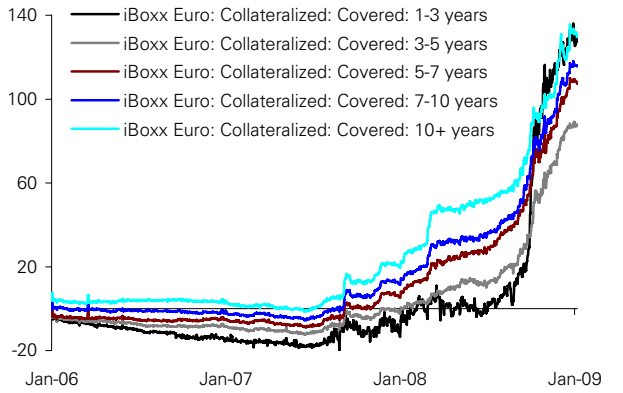
Spreads between different covered bond sectors also diverged significantly. US, Irish, UK and Spanish covered bonds showed the greatest widening.

2008 was the year of risk premia and spread divergence



Source: Deutsche Bank

iboxx Euro: Collateralized covered indices show the spread widening of covered bonds in 2008



Source: iBoxx, Deutsche Bank

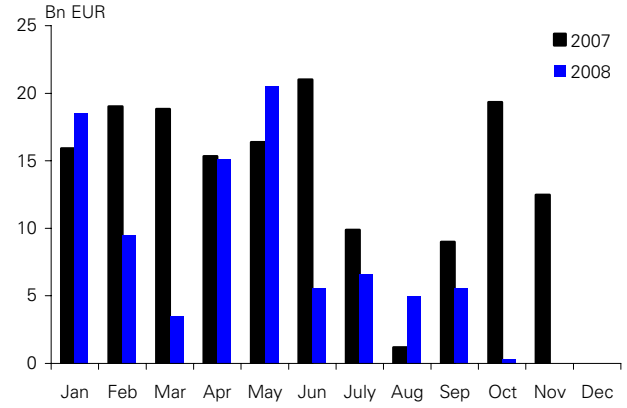
In line with the increasing spread differentiation of the various covered bond markets, spreads between public sector and mortgage covered bonds also widened strongly since pre-crisis.

Whereas the European mortgage covered bond market is very heterogeneous (consisting of very different products like German mortgage Pfandbriefe, Norwegian mortgage covered bonds, French Obligations Fonciéres, Swedish mortgage covered bonds, Danish mortgage covered bonds, Spanish Cédulas Hipotecarias, UK mortgage covered bonds, etc), the European public sector covered bond market is quite homogenous, consisting mainly of German public Pfandbriefe, French public Obligations Fonciéres and Irish mortgage ACS.

Besides rising risk premia for mortgage collateral versus public sector collateral, the spread of structured covered bonds versus legal framework based covered bonds widened also significantly since pre-crisis.

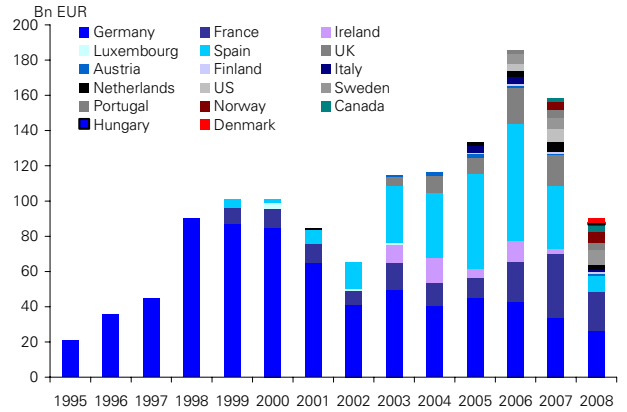
The growth of EUR Jumbo covered bonds came to a halt in 2008

Primary market for Jumbo covered bonds was shut in H2 2008



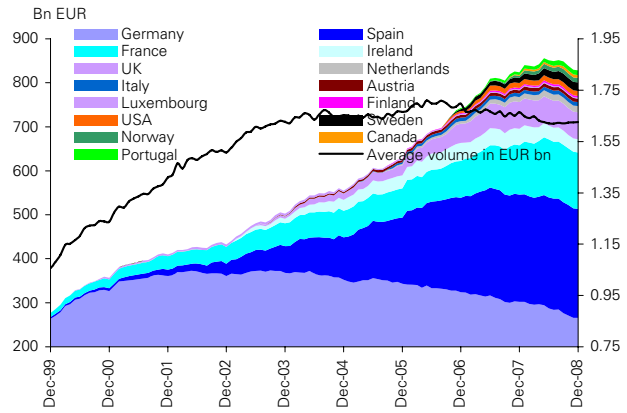
Source: Deutsche Bank

EUR Jumbo covered bond issuance volume significantly down in 2008



Source. Deutsche Bank

Outstanding volume of EUR Jumbo covered bonds decreased in 2008 for the first time



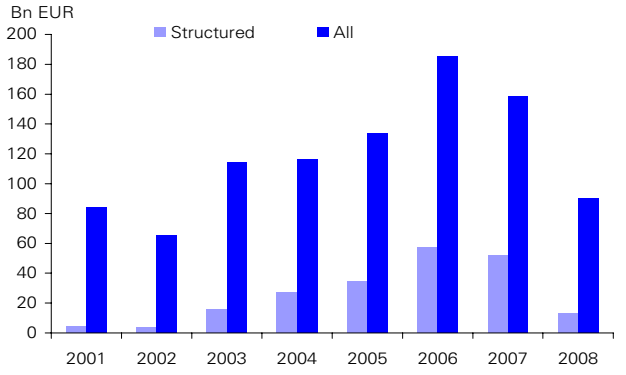
Source: Deutsche Bank

Inaugural Jumbo covered bond issuers 2008

Month	Issuer	Name	Country
January	SEB	Swedish Covered Bond	Sweden
January	HSHN	Ship Pfandbriefe	Germany
January	DPB	Hypotheken Pfandbrief	Germany
January	BESPL	Obrigacoes Hipotecarias	Portugal
January	BMO	Canadian Covered Bond	Canada
January	BPCOV	French Commonlaw Covered Bonds	France
February	OTP	Hungarian Covered Bonds	Hungary
March	INTNED	Dutch Covered Bonds	Netherlands
April	DANBNK	Danish Covered Bonds	Denmark
April	DEXGRP	Oeffentliche Pfandbriefe	Germany
May	BKTSM	Cedulas Hipotecarias	Spain
May	CAVALE	Cedulas Hipotecarias	Spain
May	SPNTAB	Swdeish Covered Bonds	Sweden
May	SANTAN	Obrigacoes Hipotecarias	Portugal
May	SOCGEN	Obligation Fonciere	France
June	CAJAME	Cedulas Hipotecarias	Spain
July	PMIIM	Obbligazione Bancaria Garantite	Italy
July	BPIPL	Obrigacoes Hipotecarias	Portugal
September	CM	Canadian Covered Bonds	Canada
September	CDEE	French Commonlaw Covered Bonds	France

Source: Deutsche Bank

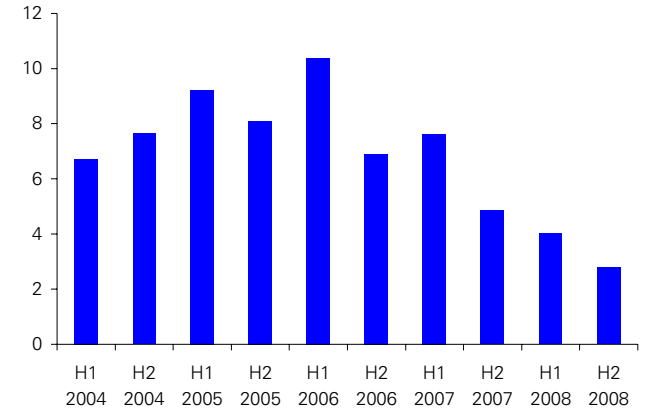
Issuance volume of structured covered bonds collapsed



Source: Deutsche Bank

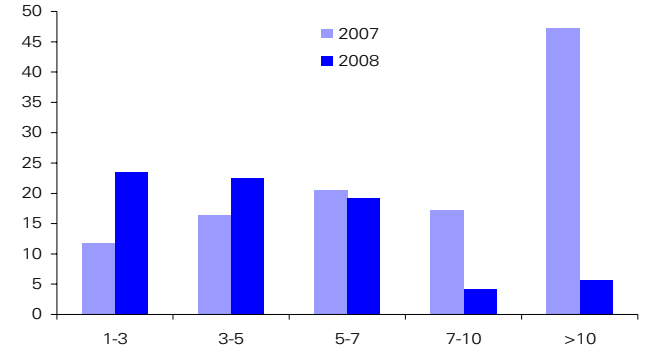
Like in other fixed income markets such as sub-sovereigns and senior unsecured bonds, EUR Jumbo covered bond issuance was focused on short-dated issues in 2008. Looking at the individual countries, the average maturity at issuance has fallen dramatically, for example for Spain to 2.15 years in 2008 from 11 years in 2007. For France there is also a fall from 6.25 years to 4.25 years with Germany sitting pretty steady at 4.5 years for both time periods.

Average maturity of newly issued EUR Jumbo covered bonds declined significantly in 2008



Source: Deutsche Bank

2008 supply of EUR Jumbo covered bonds focussed in short and medium dated issues



Source: Deutsche Bank

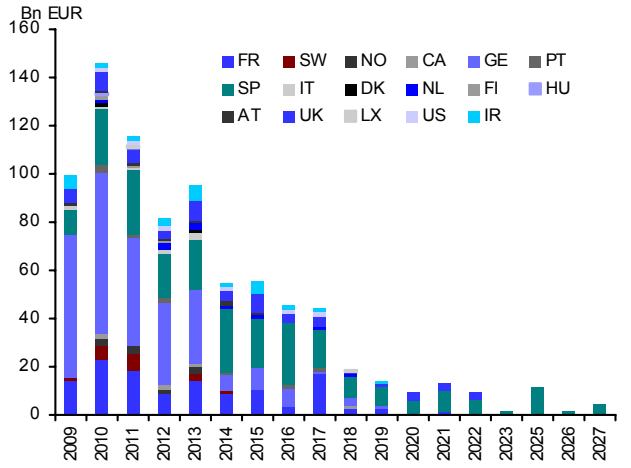
Regarding the outlook for the primary market of EUR Jumbo covered bonds in 2009, we need to analyse both the demand and the supply side. On the supply side, even though less attractive than before the credit crisis due to increasing rating agency requirements, it still seems attractive for banks to issue covered bonds. Breakeven spreads versus state guaranteed bonds suggest banks should still consider issuing covered bonds, particularly if they have unpledged collateral on their balance sheet.

On the other hand, the demand side looks far less positive for a potential recovery of EUR Jumbo covered bond issuance. With systemic risk moving from banks to governments (best seen in the US with USD 4 tn of assets having moved from the private sector to the public sector), investors are not incentivised to pay up for the preferential claim on a cover pool of collateral on top of the senior claim against deposit taking banks which are protected by states anyway. Moreover, with an expected volume of more than EUR 150 bn of EUR benchmark state guaranteed bonds hitting the market with a pick-up to swaps in 2009 and peripheral bonds which are likely to continue to trade wide, competition for rates investors' money is ample. Moreover, unsecured unguaranteed bank bonds (benefiting strongly from implicit state support) are also likely to hit the market at extremely wide spreads. This reduces the likelihood of credit investors being the new investor base for covered bonds on a broad scale.

Jumbo covered bond market set to decline further

The EUR Jumbo covered bond market amounted to around EUR 829 bn as of 1 Jan 2009. Redemptions of EUR Jumbo covered bonds will amount to EUR 100 bn in 2009, EUR 146 bn in 2010 and EUR 116 bn in 2011. New issuance in 2008 amounted to EUR 90 bn. Hence, given that the primary market is likely to remain challenging in 2009, the outstanding volume of EUR Jumbo covered bonds is set to shrink significantly going forward. In H1 2009 only, assuming zero new issuance of EUR Jumbo covered bonds, the total outstanding volume would decline to around EUR 785 bn. With some new issues and numerous taps are likely to hit the market, the decline in outstanding volume is likely to be smaller but still significant.

High redemptions of EUR Jumbo covered bonds in 2009 and 2010



Source: Deutsche Bank

This is not only indicated by the overall supply expectations and redemptions, but also by looking at the top issuers of EUR Jumbo covered bonds individually. With Eurohypo (EUR 66 bn), AyT (EUR 49 bn), La Caixa (EUR 26 bn), HBOS (EUR 25 bn) and Depfa (EUR 25 bn), the list of the top 15 issuers of EUR Jumbo covered bonds in terms of outstanding volume is full of banks which are either aiming to reduce their cover pool volume significantly and/or are finding it dfficult to access the Jumbo market. As new issuers are unlikely to make up for the volume in the current market environment, particularly given the spread widening of non-core sovereign spreads, the EUR Jumbo covered bond market will likely shrink significantly going forward.

Definition of Covered bonds

The growth of the covered bond market in recent years and the dramatic reassessment of the asset class in 2008 raises the question of what precisely is meant by the term 'covered bond'.

Definition of covered bonds in UCITS 22 (4)/CRD

The European Capital Requirement Directive (CRD) in conjunction with article 22 (4) of the United Investments in Transferrable Securities (UCITS) Directive provides the first definition of the term 'covered bond'. According to UCITS 22 (4), a covered bond is a bond issued by a credit institution that has its registered office in a EU Member State and is subject by law to special public supervision designed to protect bondholders. In particular, sums stemming from the issue of these bonds must be invested in conformity with the law in assets that, during the whole period of validity of the bonds, are capable of covering the claims attached to the bonds. In the event of failure of the issuer, the assets would be used on a priority basis for reimbursement of the principal and payment of the accrued interest.

On top of this, CRD regulates which assets are eligible for covering claims arising from covered bonds, hence, eligible to benefit from privileged equity capital backing (if included in covered bond cover pools). However, these regulations do not provide grounds for name protection. This means that any type of collateralized bond can continue to be marketed as a 'covered bond' in the future, as well. Here, the market, rather than EU law, decides which securities are regarded as covered bonds and which are not included in this category.

Recourse to the issuer necessary

The article 22 (4) of the UCITS Directive should clarify the principle of direct liability on the part of the issuing credit institution. After all, the currently valid criterion that the bond must be issued by a credit institution does not necessarily result in the latter's liability with respect to the issue. When a covered bond issued by a broadly diversified universal bank and offering recourse to the issuer in the event of the latter's insolvency is compared to a similar issue by the same bank but lacking such recourse, the difference becomes visible.

Specific legal frameworks advantageous

Besides the fact that UCITS 22 (4)/CRD requires a specific legal framework to grant a privileged risk weighting, there are further advantages, in our view. Typical covered bond investors seem to prefer having a specific legal framework and specific supervision. In addition there are also factual advantages.

Advantages of having a specific legal framework can be e.g. in the treatment of set-off risk. In the event of an issuer's insolvency or administration, borrowers may have the right to set off certain claims against their mortgage loan liabilities. This is called set-off risk. In most structured covered bonds, this risk is accounted for in the calculation of the asset coverage test.

For example, in case of HSBC's covered bonds, the asset coverage test calculation includes an amount intended to cover set-off from general deposit accounts. This will be calculated as the ratio between the balance of accounts held by the mortgagors with HSBC and the principal amount of mortgages backing the covered bonds (i.e. all mortgages in the additional covered bond collateral portfolio plus the covered bond entitlement percentage of the loans in the mortgage portfolio). In the case of German Pfandbriefe, such a complicated calculation is not necessary. According to article 29 of the German Pfandbrief Law, borrowers have no right to set off other claims against their liabilities from mortgage loans in the cover pool. In our view, this shows the advantage of having a specific legal framework, simply because the specific legal framework ranks higher than private contracts. Moreover, it makes no sense to dispute the exclusion of set-off before court. Hence, investor protection regarding set-off risk is easier in the case of German Pfandbriefe compared to UK structured covered bonds. Generally, insolvency remoteness is the key topic of covered bonds. If insolvency remoteness of the collateral backing the covered bonds is decided by a legislative act one could even call it insolvency proof instead of insolvency remote.

Conclusion

The diversity of structures launched in the covered bond market shows that opinions vary as to how the issuer's interest in favourable funding conditions can be combined with investors' interest in the highest possible level of security. Irrespective of the way in which the prerequisites for privileged risk weighting of covered bonds are determined at the EU level, innovative and market-driven development should not be impeded by the typical maze of legal regulations. Investors always have the possibility of demanding a spread premium for specific covered bonds like structured covered bonds that are more complex or deviate from the standard, particularly in the current market in which investors are price-makers instead of price-takers.

Covered bonds and MBS

COVERED BONDS AND MBS: DIFFERENT HISTORICAL ROOTS

Covered bonds and Mortgage Backed Securities (MBS) have different historical roots. Whereas MBS emerged in US financial markets, within the legal system of common law, covered bonds first emerged in Denmark with the Realkreditobligationer and in Germany with the Pfandbrief. Covered bonds are often enhanced beyond the structures stipulated by the legal framework (e.g. AYTCED, CEDTDA, IMCEDI). In some jurisdictions, RMBS notes are eligible as collateral for covered bonds (e.g. France, Italy, Luxembourg and Ireland).

Covered bonds have specific characteristics

The most crucial difference is that covered bonds are typically issued by credit institutions, not by a SPV like RMBS. So far, there is only one exception to this rule: US covered bonds issued by Washington Mutual and Bank of America are not issued by a bank, but by an SPV. Nevertheless, US covered bonds are obviously not true securitizations because the assets remain on the balance sheet of the US bank issuing the mortgage bond sold to the SPV. This gives the company the flexibility it needs in dealing with its customers, including being able to change the terms of the mortgages.

No specific cover pool for each covered bond issue

A cover pool of mortgage or public sector loans typically backs all outstanding covered bonds. However, there are some Eastern European countries like Russia, Bulgaria, Ukraine and Romania where there is a specific cover pool for each covered bond issue. In all Jumbo covered bond markets, there is no connection between a specific cover pool or single loans and outstanding covered bonds. In Germany, there are three cover pool categories allowed: a mortgage cover pool, a public sector cover pool and a ship cover pool. It is not allowed to establish further cover pools. In the past there have been discussions in the German Pfandbrief issuer community about introducing specific cover pools for specific countries or for residential and commercial loans. The Federal Financial Supervisory Authority (BaFin) rebuked such suggestions. With the introduction of the German Pfandbrief Act on 19 July 2005, it is even a clear consequence of the wording of the law, that such manifold cover pools are not allowed. This is true for most legal frameworks of covered bonds. Hence, in contrast to RMBS, outstanding covered bonds of a particular issuer are usually backed by one mortgage cover pool or one public sector cover pool.

Covered bonds have a dynamic cover pool

Another important point is the dynamic nature of the cover assets. A covered bond has a dynamic cover pool, offering the possibility of removing and adding cover assets at any time. In some countries like Germany, the approval of the cover pool monitor is necessary. The cover pool is used as collateral for all outstanding covered bonds. Where each outstanding covered bond has its own separate cover pool, the cover pools are dynamic only to a limited extent, i.e. only cover assets that have become ineligible over time may be removed and replaced by eligible cover assets. Only loans that are no longer eligible can be substituted. The issuers are not allowed to substitute performing assets by other performing assets.

Obviously, Eastern European countries have used securitization strategies as their role model when introducing their covered bond models or have been advised by consultants assuming that covered bonds and MBS will increasingly converge - or trying to orchestrate such convergence themselves. Cover pool assets have to be replaced if they no longer meet the eligibility criteria defined by the relevant legal framework. Generally, cover pools remain dynamic until insolvency of the issuer. Thereafter, no further assets will be added to the cover pool and no further covered bonds will be issued. As long as the issuer is solvent, the issuer or the originator actively manages the cover pool. If the cover pool no longer adequately backs the outstanding covered bonds and the issuer is not able to fix this by substituting or adding assets or buying back covered bonds, the cover pool usually accelerates.

Covered bonds rank pari passu with unsecured creditors

If the collateral is insufficient to repay all covered bond claims, covered bond creditors rank pari passu with senior unsecured creditors, except in France, where covered bond investors keep their privilege on all the assets of the Société de Crédit Foncier (SCF) against unsecured bond holders. The same holds true for Hungary, where investors keep their privilege on all assets of the issuing bank, and to a limited extent also Spain, where covered bond creditors have a priority claim not only against the eligible assets but against the whole mortgage loan or public sector loan book. Covered bond creditors have full recourse to the issuer as opposed to only the underlying assets transferred to the SPV in case of MBS. Consequently, in the case of covered bonds, investors have a dual claim – one against the issuer and one against the assets in the cover pool. Again, there are some exceptions to this rule. However, in our view, this is one

of if not the most important characteristic of a covered bond being different from MBS and providing distinctive investor protection. Hence, investors should always check the prospectus to determine if the respective covered bond really provides full recourse to the issuing bank.

Covered bonds backed by RMBS

There is an ongoing debate about whether MBS should be eligible as collateral for covered bonds. Currently, MBS are only eligible as collateral in France, Ireland, Luxembourg and Italy. In practice, France is the most important market in this regard. RMBS are eligible cover assets for French covered bonds (Obligations Foncières, OF). The securitization tools 'Fonds Communs de Créances' (FCC) are French RMBS that are regulated by law. Only senior tranches of FCC are eligible, if at least 90% of the assets consist of assets that would be directly eligible for OF. RMBS themselves as cover pool assets make diversification of the cover pool easier. Nevertheless, in Germany there is strong resistance regarding the eligibility of RMBS as cover pool assets and hence the eligibility of RMBS will not be introduced in the upcoming amendment. As the cover pool monitor may have difficulties in identifying the ultimate mortgage assets backing the Pfandbrief, it is argued that this would make the collateral of Pfandbriefe intransparent. Moreover, the underlying loans of the RMBS may not be valued according to the mortgage lending value. The cover pool monitor would have to rely on the rating agencies, something that is not considered to be in line with the structure of the Pfandbrief.

Eligible assets: limited convergence

Eligible assets of covered bonds are defined by the respective legal frameworks, which have to be in line with the CRD. According to the CRD, eligible assets are restricted to residential and commercial mortgage loans, public sector claims and ship mortgage loans. The issuers of structured covered bonds so far have restricted their issue documentations to these kinds of assets. Pre-crisis were tendencies to include other assets in structured covered bonds in the future, e.g. car loans. However, given the new capital market environment, the success of such transactions is difficult. Generally, the notion 'covered bonds' is not legally protected. Hence, bonds backed by any types of assets or claims and based on any structure can be called covered bond.

As mentioned above, in France, Italy and Ireland (and shortly also in Luxembourg), MBS are permitted in covered bond pools. Ireland has just recently modified its legal framework to include MBS. The CRD had limited their share to a maximum of 20% of the pool. However, CRD allows 100% when the MBS are rated AAA.

Covered bonds with longer maturity due to dynamic pool

Whereas in the case of covered bonds the economic and legal maturity is typically the same, it is different in case of RMBS. Due to the dynamic asset pool, covered bonds have on average a longer maturity compared to the weighted average life of RMBS, which may be very long dated.

MBS have a static pool and credit enhancement by tranching

Generally, covered bond holders bear the risk resulting from the system of a dynamic pool i.e. the cover pool administrator loses the capability to bring in sufficient new assets in order comply with the coverage regulations. As covered bonds typically have a fixed rate bullet structure, the cover pool must be constantly 'refilled', i.e. mortgage loans coming due must be reinvested. This can lead to higher credit and market risk in the cover pool compared to AAA-rated tranches of MBS transactions. Generally, a dynamic cover pool creates the need of an accurate asset liability management including stress test scenarios.

Apart from the credit risk of the cover pool assets, the main risks are the potential lower yield of newly added assets (negative carry risk as a result of differing amortisation profiles of covered bonds and cover assets) and the management of the interest rates risks between the fixed rate covered bonds and variable rates mortgage loans. As a result of the dynamic pool, covered bonds typically have a longer maturity than MBS.

In MBS, the highest credit risk is concentrated in the subordinated tranches following the 'tranching' of the mortgage portfolio where losses hit first. Investors have no recourse against the originator of the assets, and the risk is limited to the pool of assets, which has been securitised. MBS cover pools are, in most cases, static in the sense that even if assets can be substituted after a deal's launch (for instance in UK MBS Master Trusts), these additional assets do not benefit the investors as such in an 'old' issue.

Bankruptcy remoteness of covered bonds

In the case of covered bonds, the segregation of the asset pool and its bankruptcy remoteness can usually be considered strong, thanks to specific regulation establishing asset segregation outside the normal insolvency proceedings. In the case of structured covered bonds, based on contractual agreements and not on a specific law, the bankruptcy remoteness depends on the general law and jurisprudence regarding the bankruptcy process. Legal opinions are needed to prove the insolvency remoteness of structured covered bonds.

Transparency
In the case of both MBS and covered bonds, the information concerning the underlying cover assets is regularly monitored by the rating agencies and usually also published to investors. Frequency and content depend on the national regulations and voluntary behaviour of the issuers. In case of German Pfandbriefe at least some quarterly transparency requirements are stipulated according to the German Pfandbrief Act.

Covered bonds usually backed by prime mortgages
Residential mortgage backed covered bonds are usually backed by prime residential mortgage loans. As covered bonds are typically AAA/AA instruments, which are mainly bought by conservative investors, sub-prime mortgage loans are not an adequate asset class for the collateral pool of covered bonds. For RMBS issues, both prime and sub-prime mortgages have been used.

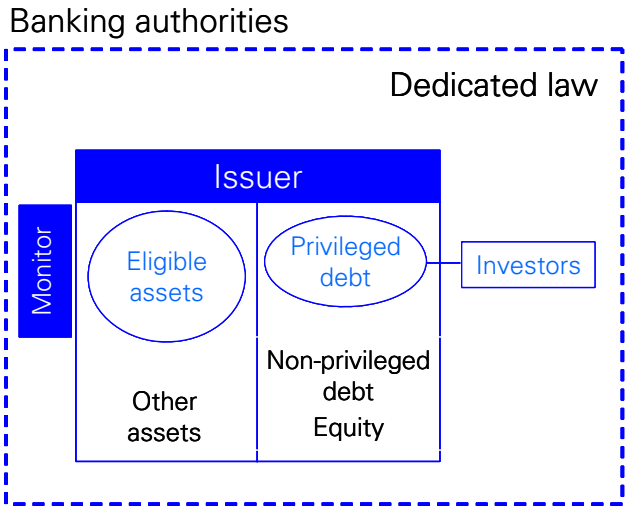
Under the Basel II/Capital Requirement Directive (CRD), for mortgage loans to be eligible as collateral for covered bonds, they must have a loan-to-value (LTV) ratio of less than 80% in the case of residential mortgage loans, and 60% in case of commercial mortgage loans. RMBS transactions are not restricted to LTV limits like covered bonds. Hence, RMBS transactions can typically be used to fund higher LTV loans.

Evaluation Criteria

ISSUE STRUCTURE

The first step in the covered bond analysis is to distinguish between those markets where there is a specific legal framework for covered bonds and those where there is not.

Covered bonds based on a specific legal framework



Source: Fitch, Deutsche Bank

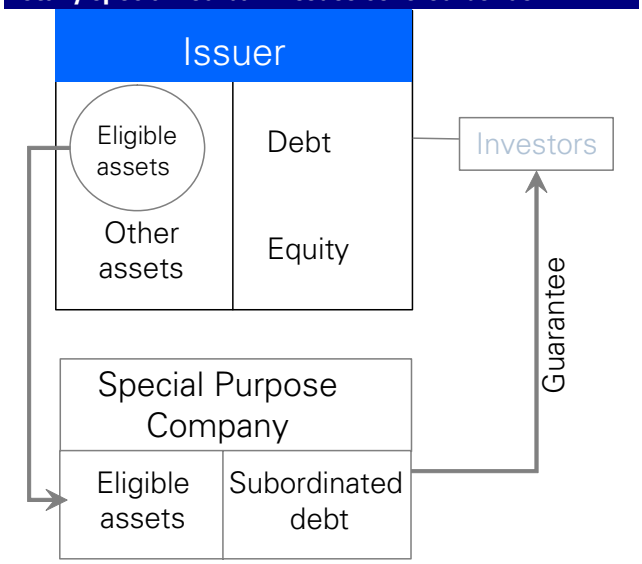
Having a specific legal framework governing the issuance of covered bonds does not automatically imply a safer product. However, having a special legal framework typically leads to a lower risk weighting and higher investment limits due to the UCITS directive, article 22 (4) and the Capital Requirement Directive (CRD).

Specialized versus universal banks
The second step is to distinguish between specialist and universal credit institutions as issuers of covered bonds. Until 19 July 2005 it was still true that most of covered bonds in Europe were issued by specialised credit institutions, with a narrowly defined scope of business activities, and subject to special banking supervision. With Germany, as the biggest market of (Jumbo and non-Jumbo) covered bonds, abandoning the specialist bank principle, this is no longer the case. Currently, e.g. France, Norway and Ireland use a specialist bank principle.

The specialist bank principle is accompanied by tight restrictions on the freedom of business for issuers of covered bonds. Generally, credit institutions in the EU enjoy the freedom to determine themselves the business activities in which they want to engage and the supervisory authority concentrates on monitoring the

'regularity' of the business. In contrast, under the specialist bank principle legislators impose particularly tight provisions on the issuers of covered bonds in order to reduce the risk of any such institution becoming insolvent. In this sense, the specialist bank principle can be viewed as the 'outer protective wall' for the covered bond creditor. By focusing on a restricted number of business activities, which are considered fundamentally safe, the specialist bank principle offers protection against insolvency of the issuers of covered bonds.

Totally specialized bank issues covered bonds



Source: Fitch, Deutsche Bank

A good illustration of the specialist bank principle is the limitation of non-eligible mortgage lending business. Under the German Mortgage Bank Act that was in force before 19 July 2005, German mortgage banks used to be restricted in their non-eligible business (i.e., LTV of more than 60%) to 20% of overall mortgage lending. In Hungary, absolute lending is limited to 70% LTV, whereas the eligibility criterion for the cover pool is set at 60%.

Another typical restriction on specialist banks is to limit the type of assets into which the bank's own funds or any surplus liquidity can be invested. In the case of Luxembourg for example, surplus liquidity can only be invested in high quality assets such as deposits with appropriate credit institutions, securities and claims on public authorities or debt instruments guaranteed by a public authority.

Finally, where public sector lending is concerned, the regulators may limit the size of the balance sheet. In theory, with zero-risk-weighted public lending, the balance sheet can grow indefinitely (under Basel I). Luxembourg imposes such a limit for the public sector lending business (like Germany did in the past under the German Pfandbrief Act). The volume of outstanding covered bonds to regulatory capital was restricted to 60 times in Luxembourg. The restriction was abandoned with the latest amendment. The volume of outstanding covered bonds to regulatory capital is restricted to 50 times for public ACS in Ireland.

Covered bonds issued by a SPV

Issuance via a SPV is untypical for covered bonds. Until 2008, only US covered bonds issued by Washington Mutual (now JP Morgan) and Bank of America were issued by a SPV. In July 2008 Fitch published a AAA rating for the first Greek covered bonds. The bonds were issued (for ECB repo) under the Greek Covered Bond Law via Alpha CB, a UK special purpose vehicle. Alpha Bank AE transferred a pool of Greek mortgage loans to Alpha CB and guaranteed the issuance directly and unconditionally.

COVERPOOL CREDIT QUALITY

The next step in the evaluation process focuses on the credit quality and bankruptcy remoteness of the cover pool. The combination of credit quality and bankruptcy remoteness provides optimal protection. As a first step, the assets securing covered bonds are restricted to mortgage and public sector loans. Different jurisdictions differ with respect to which geographic area is deemed to be cover pool eligible.

Mortgage lending eligible as collateral

Limits on the loan-to-value (LTV) ratio exist in all countries and are designed to protect the covered bond creditor against the potential erosion of the value of the underlying mortgage asset. Maximum LTVs range from 60-80% in Europe and are usually differentiated between commercial and residential real estate.

Besides the setting of conservative LTV ratios, careful valuation of property is a critical safety element for the covered bond holder. The issuing bank has to assess the value of the mortgage asset. The rules that regulate the valuation of real estate are usually laid down in legal provisions by regulatory authorities (e.g.: Germany, Denmark, France, Spain and Portugal) but may also be found in self-commitments of the respective mortgage bank (e.g.: Sweden and Finland).

Public Sector lending eligible as collateral

In some jurisdictions, there are issuers of public-sector backed covered bonds (E.g. Germany, Luxembourg, Austria and France). Public sector lending or 'communal credit' typically refers to loans granted to central, regional and local government authorities and other public bodies and institutions guaranteed by one of the mentioned public authorities. Public sector lending may be done in

the form of direct loans, loans secured by a public authority or in the form of direct purchases of public sector bonds. In some legal frameworks, e.g. in France, Ireland and Italy, covered bond issuers cannot only include mortgage or public sector assets in the cover pool, but also RMBS. Furthermore, the quality of otherwise non-eligible assets may be improved via a guarantee provided by a financial institution or an insurance company.

Geographical diversification versus deteriorating average credit quality

The choice of geographical area from which loans can be originated as collateral for covered bonds requires a compromise between obvious diversification benefits and a potential deterioration in the average credit quality and increased legal uncertainty. The geographic scope regarding the eligibility for covered bond pools varies widely.

The motivation behind the extension of the asset-side business towards the OECD area was the increasing competition in public sector lending within the EU, which eroded margins in this business. The limitation of asset-side business in most other European covered bond laws to the EU or to the EEA has increasingly been perceived as a brake on business activities. The amendments to the German and French legal frameworks for covered bonds, extending the geographical limit for public sector lending activities to Switzerland, the US, Canada and Japan (in Germany this holds true also for mortgage lending) have reduced the competitive advantage that Luxembourg covered bond issuers had enjoyed. German Pfandbrief banks have expanded the international business aggressively in the face of a low margin domestic real estate and public sector environment.

Limiting foreign lending where priority claim is threatened in case of bankruptcy

The various European covered bond laws initially only apply within their respective national frontiers. This aspect is particularly relevant in the event of bankruptcy of a covered bond issuer. As issuers become more active in cross border lending, other legislative environments need to be taken into account. If an insolvent cover pool has to be liquidated, the priority claim of covered bond creditors on cover pool assets would need to be enforced. If these assets are located in another country with different bankruptcy laws, a situation of competing claims over cover pool assets may arise. Different national legislations may not recognise the priority claim of covered bond creditors. This raises the risk of creditors entering into difficult, lengthy legal disputes that endanger the timeliness of payments on covered bonds. One way of limiting the amount of legal risk arising from cross-border lending is to impose a limit on foreign mortgage and public sector lending activities as is done for example in Germany and Ireland.

Within Europe, the legal risks involved in cross-border lending have been alleviated through the EU directive on the reorganization and winding-up of credit institutions (European Parliament and Council Directive 2001/24/CE). This directive, which was implemented by 2004, ensures that the winding-up of credit institutions with branches in other member states will be subject to a single bankruptcy proceeding, initiated in the member state where the credit institution has its registered office, and will thus be governed by a single bankruptcy law. However, a small risk remains that some unsecured creditor may try to secure a claim on an asset before official bankruptcy proceedings have been initiated. There is also the risk that not all EU countries have implemented the respective EU directive into national law. As insolvency regulation may be stipulated in different laws, it is not easy to verify if the respective country has indeed implemented the EU directive. Hence, the German Association of Pfandbriefbanks (vdp) recommends its member banks (in some cases) to continue using contractually enhanced solutions to secure the preferential claim of the Pfandbrief holder in countries where no legal opinion is available regarding the implementation.

Cross border lending risks higher for mortgage lending

Generally, the legal risks in cross-border lending are more important in mortgage than in public sector lending. There should be no risk in legally enforcing the asset in case of default of a bank if the bank provided a loan to a non-European public sector entity via a bond purchase, holding the respective bond with a European settlement house such as Euroclear or Cedel. Providing a direct loan to the same institution would complicate the situation since the claim on the loan could be more difficult to enforce than a straight bond.

Enforcement of foreign mortgage assets may be difficult

If the legal claim on a mortgage asset has to be enforced, the situation may easily become even more difficult. Consider the example of a German Pfandbrief bank providing a mortgage loan in USD to a US borrower. Assume that the funds for the loan up to the 60% LTV had been raised via a Pfandbrief and swapped into USD. Simultaneously, the future cash flows out of the USD loan up to the 60% LTV had also been swapped back into EUR. Assume that another 20% was funded in USD as an unsecured loan held by US investors. In the event of bankruptcy, the unsecured US creditors of the unsecured USD loan may demand to be satisfied out of the USD estate serving as collateral for the mortgage backing the

EUR Pfandbrief. As US legislation does not recognise the priority claim for the Pfandbrief holder, this could potentially lead to a loss to the Pfandbrief creditor. Under these circumstances, the 10% limit imposed in Germany on foreign lending where the priority claim of covered bond holders is not assured is an important additional security element for the buyers of Pfandbriefe.

Eligible and non-eligible asset side business

The discussion about the permitted geographical lending area is part of the more general discussion over what should be considered a cover pool eligible asset. The question of eligibility may be approached in different ways however. At one extreme would be the currently dominant approach of establishing an exclusive list of eligible cover assets. At the other extreme one could define a broad category of assets and allow covered bond issuers to select assets subject to certain rating constraints.

The French legal framework for covered bonds opened the discussion by making cover pool eligibility partially rating dependent. Structurally enhanced covered bonds, e.g. from Cassa Depositi e Prestiti also employ rating matrices to achieve a higher level of security. Germany employs a link between risk weightings and cover pool eligibility, which means a rating dependency under Basel II/Capital Requirement Directive (CRD). Düsseldorfer Hypothekenbank (DUSHYP), together with S&P, also devised a self-commitment based on a rating matrix to achieve a AAA rating. The two methods are therefore becoming increasingly mixed and the question of whether cover pool eligibility should be determined by law or by rating is becoming increasingly obsolete in practice. Even if it is not obvious which approach (legislation vs. rating constraints) is better suited to ensure the ongoing high quality of covered bonds, current trends (rating agencies, Basel II/CRD) give an increasing weight to ratings (assuming that ratings relate to probabilities of default).

There is a link between the quality of the cover pool assets and the implied margins: the better the credit, generally the lower the margin earned on the underlying asset. An issuer might therefore be tempted to include lower quality assets within the asset pool to improve margins. However, as the asset quality of the cover pool deteriorates it will become increasingly difficult to sell the covered bonds. Since covered bond banks compete on both the asset and the liability side, they will always have to strike a balance between the quality of the assets and the quality of the covered bonds. If banks cannot include any type of credit risk within their asset pools, they will be induced to generate extra revenue from market risk, e.g., interest rate mismatches.

COVER POOL RISK MANAGEMENT

A high credit quality of assets in the cover pool is a necessary condition for a high quality covered bond. However, the quality pool may be threatened by a large mismatch of interest rate or currency risk.

Prepayment risk may threaten security of covered bonds

The right of a borrower to prepay a loan, if present, may threaten the security of a covered bond if the covered bonds are not callable. The proceeds from an early prepayment may potentially only be reinvested at a yield inferior to that paid on the liabilities (negative carry), which would erode the margin embedded in the underlying cover pool. The ability of borrowers to prepay their mortgage loans varies significantly between countries. While German Pfandbrief banks are protected against prepayments through substantial prepayment penalties, Danish borrowers may prepay after a formal two-month notification to the covered bond issuer without a prepayment penalty (at market price, i.e. even below par). If the borrower is able to prepay but the bonds issued are (usually) non-callable, as is the case in most countries (e.g. Germany, France, Spain, Austria, France, etc.), the right to prepay is a potential risk for the covered bond issuer. In Denmark, so far, covered bonds are mostly callable so the prepayment risk is borne by investors, not the issuer.

Interest rate and currency risks

More important than prepayment risk are interest rate and currency risks. Currency risks currently need to be hedged in most covered bond laws (or limited via currency change scenarios like in the German Pfandbrief Act), while the scope to assume interest rate risk varies significantly between different jurisdictions. Even if the matching principle that is stipulated in UCITS 22 (4) requires the covered bonds to be secured by assets of at least equal interest and nominal, interest rate risk within the cover pool introduces substantial mark-to-market and liquidity risk.

Significant duration gaps may result in losses for the investor if the cover pool has to be unwound before maturity. The larger the duration gap the more important is the reliance on market liquidity to fund any duration gap between assets and liabilities. Duration mismatches between cover assets and liabilities (outstanding covered bonds) will drive a wedge between assets and liabilities as the market moves or the yield curve shifts. Accordingly, it is of utmost importance that interest rate risks are adequately managed and limited in size.

Interest rate risk can be a source of profit

The amount of interest rate risk that issuers of covered bonds may assume differs from country to country. Most European covered bond laws with the exception of Denmark, Switzerland and the special law for CDP in Italy allow for a limited amount of interest rate mismatching. Typically, covered bond laws now require that the cash flows from the assets (principal and coupon income) will at least match the cash flows due on the covered bonds over the lifetime of both the cover assets and the covered bonds. In the last two years this has moved from a nominal coverage to a net present value coverage. This can also be achieved via sufficient OC or via adequate substitute collateral and does not require the maturities to match exactly.

Interest rate risk is obviously one of the central risks a covered bond issuer assumes. Traditionally, universal banks fund themselves at the short-end through their deposit base to lend money at the long-end (mortgage loans, corporate loans, public sector loans, etc.). Interest rate risk is therefore also a source of profit.

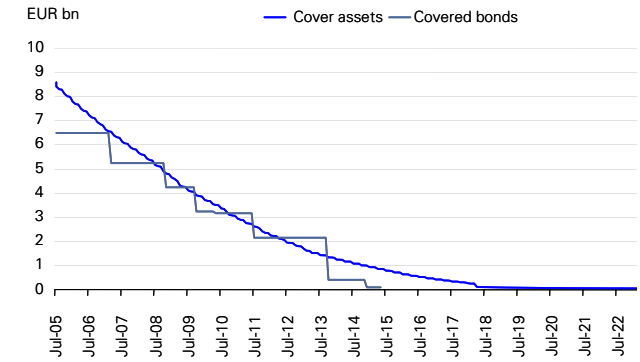
The rating agencies do not perceive a limited amount of duration mismatching as an obstacle to assigning a AAA rating. Rating agencies regularly receive extensive information on the issuing institutions' interest rate risk exposure. They use the cash flow information to stress test the risk-adjusted cash flows under different yield curve scenarios to see whether the collateral pools will suffice under any circumstance to satisfy the obligations on outstanding covered bonds. More precisely, rating agencies are prepared to accept a certain amount of maturity mismatching if the issuer of covered bonds provides sufficient OC to compensate for this risk. E.g. this is the case in the first Japanese covered bond by Shinsei Bank. The structure is similar to UK covered bonds, but no swaps are used. The resulting interest rate risk is compensated for by high OC. Alternatively, covered bond issuers' can make self-commitments to keep the duration mismatch below a certain limit to ensure a AAA rating.

Typically, the issuer will not assume excessive risk in the collateral pools since this would threaten the covered bond rating and erode the issuer's refinancing costs. In a sector with structurally low margins, any deterioration in funding conditions has severe repercussions. It is therefore more likely that issuers carry any potential 'excessive' interest rate risk in the non-eligible part of their businesses, i.e. outside the cover pools. While this is not an immediate risk to the covered bond creditor, it is of concern for the unsecured creditors, as it might threaten the covered bond issuer itself without necessarily endangering the cover pools.

Liquidity risk as a result of maturity mismatches

Liquidity risk received closer attention in 2002/2003 due to the downward adjustments in the ratings of a number of German Pfandbrief issuers. Particulary since H1 2007 and even more so after the Hypo Real Estate failure, liquidity risks inside and outside cover pools became a big topic. In a static pool where the maturities of cover assets and liabilities match exactly, and a margin has been locked in, a deterioration in funding conditions due to a reduced rating does not systematically threaten the liquidity of the cover pool. In dynamic cover pools, where maturities between cover assets and liabilities do not match, the solvency of the pool relies on continued access to market liquidity, at rates which are not prohibitively high so as to erode the margin inherent in the cover pool.

Maturity mismatches between covered bonds and cover pool



Source: Fitch, Deutsche Bank

In an extreme situation, where the covered bond issuer has become insolvent, access to market liquidity may not be possible at rates that will keep the cover pool solvent. Under these conditions, it may be crucial that the solvent cover pool can be transferred to a backup servicer in a timely manner to secure access to liquidity. While the legal frameworks which govern most covered bond laws leave little doubt about a timely transfer of a solvent cover pool to a backup servicer, a quick transfer becomes more necessary the higher the duration gap between cover pool assets and liabilities.

Higher liquidity risk in case of lower rated covered bond issuers

The lower the senior unsecured rating of the issuer the more important liquidity risk becomes to a covered bond investor. In other words, liquidity risk of the cover pool increases with the likelihood that credit lines to the issuer are cut. If the covered bond rating of an issuer has been lowered, the issuer could still take measures to reduce the exposure of the cover pool to liquidity risk. The issuer might, for example, actively shrink its balance sheet by

selling assets to reduce the need for capital market funding. Such a strategy is particularly important when the existing asset cover can only be refinanced at unprofitable conditions eventually leading to an erosion of the margin locked in the cover pool. The availability of OC or liquid assets in the cover pool represents a sufficient liquidity cushion to offset unforeseen short-term liquidity needs.

Treatment of derivatives in the case of bankruptcy of the issuer

The use of derivative instruments by European covered bond issuers has increased in recent years. This has enlarged the potential risks related to these instruments and raised the need for regulation in this area. If the purchase of an asset and the sale of a covered bond do not coincide in time, which is the general rule, then long positions in the asset or short positions in the covered bond will typically be hedged with swaps. There are two important aspects to note in the use of derivative instruments by a covered bond issuer:

- The increasing use of derivatives as a hedging tool has raised the counterparty risk exposure of the asset pools. CRD restricts the exposure to banks to 15% of the outstanding volume of covered bonds. The question remains if exposure to derivative counterparties falls under the 15% restriction
- The post bankruptcy treatment of claims resulting from a derivative hedge related to the asset pool needs to be clarified

France protects investors from risks emanating from derivatives in case of default. In case of insolvency of a covered bond issuer, the derivatives linked to the cover pool will not be unwound but will be continued until all creditors of OFs have been satisfied. The French law provides insufficient protection, however, against the risk that a swap counterparty goes bankrupt. In this case, the swap would have to be unwound and the cover pool could be exposed to a loss from the residual claims on the defaulted swap counterparty. This is even more important in France where the parent company of the bank issuing covered bonds is typically the swap counterparty. In order to limit the exposure of the covered bondholder to the default by a swap counterparty, additional measures are necessary, such as swap collateralisation. The 2002 amendment to the German Mortgage Bank Act, which was taken over by the Pfandbrief Act that came into force on 19 July 2005, has addressed this issue. The amendment fixes a limit of 12% on the net present value (NPV) of derivative instruments in relation to the cover pool. Thus, if the exposure limits are reached, the Pfandbrief issuer will be required to raise the amount of collateral or to reduce the claims or liabilities due under derivatives contracts. This should prevent the amounts due to the Pfandbrief issuer under these contracts from becoming too large in relation to other cover assets and thus leading to an excessively large counterparty exposure from these hedges. Limiting the amount of derivatives to 12% of the NPV cover pool assets requires the transition from a valuation principal based on nominal coverage to present value based coverage, which also serves to better control interest rate risk.

COVER POOL BANKRUPTCY REMOTENESS

Segregated assets or segregated cover pools

A fundamental concern is the separation of privileged and non-privileged assets. In order to separate cover pool assets from other assets in case of issuer insolvency, they must (at least) be subject to a privileged claim of the covered bond creditors. Typically, the preferential claim is implemented by holding the cover assets in specific cover pools segregated from other assets on the balance sheet and by entering these cover assets into a special cover register. Only the cover pools are continued in case of default of the issuer while other assets are liquidated. While holders of covered bonds have a priority claim on the cover assets under most national legislations, they also have a claim on the other assets on the balance sheet, where they rank pari passu with all other unsecured creditors of the bank. This is an important distinction to ABS transactions where the claims of the creditors are limited to the assets in the special purpose vehicle (SPV) rather than having full recourse on the assets of the originator. Another special case is Spain where covered bondholders have a preferential claim on the whole mortgage book instead of only the eligible mortgage loans that determine the maximum amount of covered bonds that can be sold.

'Super priority' in case of French and Hungarian covered bonds

In some cases the legislator has even provided the covered bonds creditors with some kind of 'super priority' on all assets on the balance sheet, as is the case in France and Hungary. Here, no other creditor can claim out of any asset on the balance sheet of the covered bond issuing bank until all privileged creditors have been satisfied. This is equivalent to subordination of all unsecured creditors of French and Hungarian covered bond banks. What this is actually worth in practice is a different matter since it makes little sense for these banks to carry any assets on their balance sheet other than those privileged assets securing the outstanding covered bonds.

Continuation of cover pools and bankruptcy remoteness

A preferential claim on the assets within the cover pool will not guarantee in itself a high level of bankruptcy remoteness. In the event of issuer insolvency the asset pools also need to be continued. If the covered bonds became due on default, the underlying assets in the cover pool would be liquidated which could expose the cash flow mismatch between cover assets and covered bonds. If the covered bonds become due, they would also become due at par, while the assets will not necessarily be sold at par. Thus, even an inherently solvent cover pool may not be sufficient to satisfy all claims if the covered bonds are paid back before maturity. While the continuation of the cover pools beyond the default of the issuer is an essential security mechanism, not all European covered bond laws do provide it. Most legal frameworks for covered bonds, e.g. Germany, France, Austria, Luxembourg, Ireland, Portugal, Sweden, Norway, Denmark and Finland have introduced the necessary legislation to make sure that the cover pools can be continued in case of issuer insolvency.

Still, one cannot automatically conclude from the legal possibility of a continuation of the asset pools that it is practical. Legislation also needs to clarify who will service the pools and the covered bonds once the issuing bank has ceased to exist. Recent legislative initiatives have made this much more explicit. The costs and the operational risk involved with finding a back-up servicer would justify that banks with a higher stand-alone rating (especially if these banks are considered 'too big to fail') should achieve more favourable funding conditions with their covered bonds.

Legal protection of OC after insolvency of the issuer

Rating agencies, notably S&P, typically improve the rating of a covered bond if a certain amount of OC exists. Moody's argues that it is not the existence of OC but the legal enforceability of OC after the insolvency of the issuer, which is the key for the rating. If OC remains within the pool, it will provide an important cushion to covered bond creditors. Since OC (above the mandatory legal minimum), however is not protected under most legal frameworks it is doubtful that it will be available to covered bond creditors beyond insolvency of the issuer. If the law protects only the nominal coverage (and mandatory OC) but not any additional OC, some of the OC may actually be released to unsecured creditors before all covered bond creditors have been satisfied. In the case of France, Hungary and Spain, the priority claim of covered bond creditors is formulated in a different way. Creditors of these covered bonds possess a 'super-priority' claim. No other creditor can satisfy his claim on the assets of the bank before the creditors of OFs have completely satisfied their claims. OC is therefore legally protected until all covered bond creditors have been satisfied.

Substitution risk as a result of dynamic cover pools

Another problem related to the enforceability of OC is substitution risk. Since the cover pools of the issuers are of dynamic nature, the issuers can remove certain assets from the pool and replace them with other, potentially weaker, eligible assets. Therefore, the investor has no guarantee that the issuer will continue to strive for the best possible rating by keeping the quality of the cover pool at the highest possible level. On the contrary, an issuer whose funding conditions have deteriorated has an incentive to include weaker rated but higher yielding assets in the cover pool to protect margin. Investors should therefore be aware that the covered bond rating is based on a given cover pool at a particular point in time, and that the quality of the cover pool and the rating can decline in the future. It is therefore important to judge the issuer's business model and the potential to profitably manage the asset pool in the future without deteriorating its quality.

EU Treatment of Covered bonds

COVERED BONDS AND BASEL II/CRD

As banks typically buy around 40% of Jumbo covered bonds, the risk weighting of covered bonds is important. On 30 Jun 2006, the Capital Requirements Directive (CRD) was published in the Official Journal of the European Commission. CRD is in force since 1 Jan 2007. Since 1 Jan 2008, the application of Basel II/CRD is compulsory for all financial institutions. (The application of the advanced internal rating based approach is permissible. Covered bonds issued before 1 Jan 2008 are grandfathered.)

CRD implements Basel II into European law which in turn has to be implemented into national law. CRD defines for the first time in more detail the term covered bond by stipulating assets that are collateral for covered bonds. Against the backdrop that there are countries like France and Sweden which have no separation of mortgage and public sector assets in specific cover pools, eligible assets are not split in asset classes (mortgage assets, public sector assets, ship assets, others). CRD simply spells out which assets are eligible and to what extent. Covered bonds are defined in article 22 (4) of Directive 85/611/EEC and collateralized by any of the following eligible assets mentioned in Annex VI, Part 1, Paragraph 68 (a) to (f) of the Capital Requirements Directive (CRD):

- Exposures to, or guaranteed by, central governments, central banks, public sector entities, regional governments and local authorities in the EU
- Exposures to, or guaranteed by, non-EU central governments, non-EU central banks, multilateral development banks, international organisations that benefit from at least a 20% risk weighting (minimum rating AA-, credit quality assessment step 1) under CRD standard approach
- Exposures to, or guaranteed by, non-EU public sector debtors that qualify for the credit quality assessment step 2 (rated between A+ and A-) are limited to 20% of the nominal amount of outstanding covered bonds. The risk weighting is not allowed to be higher than 20% for sovereign debt and 50% for sub-sovereign debt and other public sector entity debt. Hence, non-EU public sector assets with a risk weighting higher than 20% in case of sovereign debt and 50% in case of other public sector entity debt are not eligible as collateral
- Loans secured by residential real estate or shares in Finnish residential housing companies with a maximum loan-to-value (LTV) of 80 %
- Loans secured by commercial real estate or shares in Finnish housing companies with a maximum LTV of 60%. The competent authorities may recognise loans secured by commercial real estate as eligible where the LTV ratio of 60% is exceeded, up to a maximum level of 70 % if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10%
- RMBS that are secured by at least 90% with residential mortgage loans with a maximum LTV of 80%
- CMBS that are secured by at least 90% with commercial mortgage loans with a maximum LTV of 60%
- The RMBS/CMBS must be rated at least AA- and the total nominal amount of the securitization units is not allowed to exceed 20%. Until 2010 the 20% limit does not apply if the securitization units are rated AAA
- Loans secured by ships with a LTV ratio not over 60%
- Exposures to credit institutions that qualify for a 20% risk weighting (credit quality assessment step 1, minimum rating of AA-) under the CRD standard approach. The total exposure of this kind shall not exceed 15 % of the nominal amount of outstanding covered bonds. If the maturity does not exceed 100 days, bank debt exposure that qualifies for a risk weighting not higher than 50% under CRD standard approach, are also eligible. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by real estate to the holders of covered bonds shall not be comprised by the 15 % limit

Obviously, CRD contains some 'grandfathering clauses' like the eligibility of loans pledged by shares in Finnish housing associations and the eligibility of French securitization units FCC without the 20% limit if they are rated AAA.

German Banking Act does not include MBS as cover assets

Section 20a of the German Banking Act (KWG), the implementation of CRD into German law, is more stringent than CRD. In Germany for a covered bond to receive a privileged risk weighting, only cover assets from

the public sector, commercial and private mortgage loans and ship mortgage loans are allowed. MBS are not allowed in the cover pool. Finnish residential property companies are not allowed. Hence, some foreign covered bonds (issued after 1 Jan 2008) receive a 20% risk weighting under the Basel II/CRD standard approach in Germany.

CALCULATION OF CAPITAL REQUIREMENTS

There are three approaches to calculating capital requirements under Basel II. As CRD implements Basel II into EU law, the same holds true for CRD. Hence, we take a closer look at the new capital adequacy framework to discuss the changes relevant to covered bonds under two aspects: changes to the capital requirements for bank investments in covered bonds and changes in the relative economics of covered bonds and RMBS issuances.

Standardized Approach

Under the Basel II standard approach national supervisors have two options when assigning a risk weight to claims on banks. Under the first option, banks can be assigned a risk weighting based on the weighting of the sovereign of that country. Under the second option the risk weighting will be based on the external credit risk assessment of the bank itself. Under option 1 basically all Eurozone banks could be weighted at 20% with the exception of Greece, where the sovereign is rated below AA-. Higher risk weights are likely to result from the use of option 2.

Risk weight for claims on banks in the standardized approach (Option 1)

Credit assessment of Sovereign	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Bank senior unsecured risk weight	20%	50%	100%	100%	150%	100%
Covered bond risk weight	10%	20%	50%	50%	100%	50%

Source: BIS

If option 2 is applied, all issuers rated below AA will be impacted by an increase in risk weighting for their covered bonds. Under the second option the risk weighting will be based on the external credit risk assessment of the bank itself.

Risk weight for claims on banks in the standardized approach (Option 2)

Credit rating of bank	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Senior unsecured risk weight	20%	50%	50%	100%	150%	50%
Covered bond risk weight	10%	20%	20%	50%	100%	20%

Source: BIS

If the supervisor applied option 1 this would result in a uniform 10% risk weight for all European covered bonds except for Greek ones. If the supervisor opted, however, for option 2, then more covered bonds may be weighted above 10% depending on the external credit rating assessment of the bank. Covered bonds issued by banks rated AAA to AA- would in this case be weighted 10%, banks rated between A+ and A- and between BBB+ and BBB- would be weighted 20%. Thus under the standardized approach a large number of covered bond issuers face a 20% risk weighting if the national supervisor opted for option 2. In both options of the Basel II/CRD standardized approach the lowest risk weighting achievable for covered bonds outside the EU is 20%.

Internal Ratings-Based Approach (IRBA)

Upon approval from the national supervisor, banks may also follow the Internal Ratings-Based Approach to credit risk, if they meet certain minimum conditions and disclosure requirements. The banks may follow two different approaches within the Internal Ratings Based Approach: the Foundation Approach and the Advanced Approach. Those banks qualifying only for the foundation IRBA are allowed to provide their own estimates only of PD (probability of default); the other risk components are provided by the regulator. Banks qualifying for the advanced approach are allowed to provide their own estimates of all the risk components, subject to any constraints that may be specified by the regulator. According to Basel II/CRD the probability of default (PD) is not allowed to be lower than 0.03%. This ignores the fact that the PD of AAA and AA rated bonds is empirically lower than 0.03%. The goal of the internal ratings approach for covered bonds under CRD is to establish a homogeneous loss given default (LGD). The lack of distinction between mortgage and public sector collateral was driven by the intention to implement a level playing field. In reality, the LGD of these asset classes are very different. The internal ratings based approach accounts for the secured nature of covered bonds by a lower LGD. The rating of the covered bonds itself does not play a role in the calculation of the risk weighting.

Foundation Approach

Under the foundation approach, the banks themselves estimate the PDs of their risk assets while the supervisory authorities provide an estimate of the other risk components. The maturity M is fixed at 2.5 years. Under Basel II a 35% LGD is foreseen for bank claims secured on commercial (CRE) or residential real estate (RRE) with a minimum level of OC of 140% (71% LTV).

According to CRD a 12.5% LGD can be applied for (covered) bonds meeting UCITS 22 (4) and backed by assets eligible according to Annex VI, Part 1, Paragraph 65

(a) to (f) of the Capital Requirements Directive (CRD). Moreover a LGD of 11.25% can be applied if the respective covered bond is rated AAA or meets the following criteria regarding its collateral beside the general CRD criteria:

- Public sector assets have a risk weighting under the CRD standard approach of a maximum of 20%
- Securitization units do not account for more than 10% of the total volume of outstanding covered bonds
- There are no ship mortgage loans in the collateral pool

At least in the Jumbo covered bond market, almost all issues meet the above-mentioned criteria or are rated AAA. Hence, the Jumbo covered bond market will almost exclusively benefit from a LGD of 11.25% inside the EU. It is noteworthy that this is the only point where the covered bond rating is of relevance for the risk weighting for covered bonds. Outside the EU, under Basel II, covered bonds have a LGD of 45%, the same LGD as unsecured bank debt. By applying the look through principle, for residential mortgage backed covered bonds a LGD of 35% (even lower under the internal rating based approach), the same LGD as for residential mortgage loans, might be applicable.

Advanced Approach

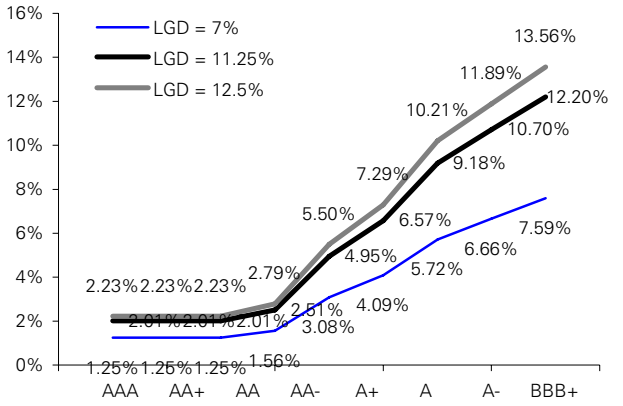
Under the advanced internal rating based approach (AIRB) approach, the real maturities (M) are used. Nevertheless, M can only lie between 1 and 5 years. Furthermore, the banks themselves are allowed to provide LGD estimates. In order to use their own LGD estimate the banks must be able to rely on at least five years of data. The German Association of Pfandbrief Banks (vdp) collected data on its mortgage bank institutions in order to develop the historical database necessary for LGD estimates. The analyzed 5-year data history points to an average LGD of 7%.

Unfortunately, under the AIRB, banks are required to estimate all risk components without relying on external data, hence, without data provided by covered bond issuers. Banks are lobbying to allow the use of data provided by third parties. In our view, even under AIRB, the regulators may allow the use of a common LGD of 12.5% (and 11.25%). Hence, banks in the EU may use the same LGD under the AIRB as under the FIRB. Banks outside the EU may find it difficult to estimate the LGD of a cover pool.

Risk weighting scenarios for different PDs and LGDs

Under the IRB approach, the risk weighting for covered bonds will differ, depending on different PD and LGD assumptions, given a prescribed maturity M of 1, 2.5 or 5 years. The PD will be different for different external ratings and internal rating assumptions. Taking into account historical default probabilities provided by rating agencies, our assumptions are conservative.

Risk weighting for covered bonds under different PD and LGD assumptions (M=1)



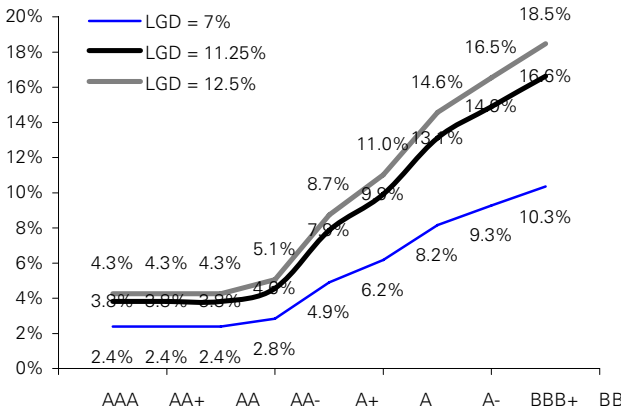
Source: Deutsche Bank

Underlying PD and LGD assumptions (M=1)

		Loss Given Default		
	PD	**7.00%**	**11.25%**	**12.50%**
AAA	0.03%	1.25%	2.01%	2.23%
AA+	0.03%	1.25%	2.01%	2.23%
AA	0.03%	1.25%	2.01%	2.23%
AA-	0.04%	1.56%	2.51%	2.79%
A+	0.10%	3.08%	4.95%	5.50%
A	0.15%	4.09%	6.57%	7.29%
A-	0.25%	5.72%	9.18%	10.21%
BBB+	0.32%	6.66%	10.70%	11.89%

Source: Deutsche Bank

Risk weighting for covered bonds under different PD and LGD assumptions (M=2.5)



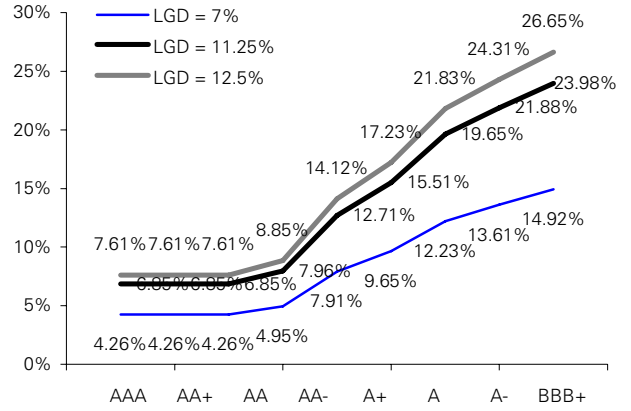
Source: Deutsche Bank

Underlying PD and LGD assumptions (M=2.5)

		Loss Given Default		
	PD	7.00%	11.25%	12.50%
AAA	0.03%	2.38%	3.83%	4.25%
AA+	0.03%	2.38%	3.83%	4.25%
AA	0.03%	2.38%	3.83%	4.25%
AA-	0.04%	2.83%	4.55%	5.06%
A+	0.10%	4.89%	7.86%	8.73%
A	0.15%	6.17%	9.92%	11.02%
A-	0.25%	8.16%	13.11%	14.57%
BBB+	0.32%	9.27%	14.89%	16.54%
BBB	0.40%	10.34%	16.62%	18.47%

Source: Deutsche Bank

Risk weightings for covered bonds under different PD and LGD assumptions (M=5)



Source: Deutsche Bank

Underlying PD and LGD assumptions (M=5)

		Loss Given Default		
	PD	7.00%	11.25%	12.50%
AAA	0.03%	4.26%	6.85%	7.61%
AA+	0.03%	4.26%	6.85%	7.61%
AA	0.03%	4.26%	6.85%	7.61%
AA-	0.04%	4.95%	7.96%	8.85%
A+	0.10%	7.91%	12.71%	14.12%
A	0.15%	9.65%	15.51%	17.23%
A-	0.25%	12.23%	19.65%	21.83%
BBB+	0.32%	13.61%	21.88%	24.31%
BBB	0.40%	14.92%	23.98%	26.65%

Source: Deutsche Bank

Property valuation under CRD

CRD also contains valuation requirements regarding the underlying real estate of mortgage loans collateralizing covered bonds. According to this, valuation has to be conducted by an independent valuer and is not allowed to exceed the market value. National regulation can stipulate the use of the 'mortgage lending value', which refers to the future selling price and is not time-point oriented (like the market value) but time-horizon oriented. Generally, the mortgage lending value is more conservative.

Commercial properties must be valued every year

CRD contains a definition of the market value, i.e. selling must be possible at the market value with adequate efforts. According to CRD, commercial properties must be evaluated every year. Residential properties must be evaluated every three years. For this general revaluation, statistical methods are applicable. In case of significant market value losses, the independent valuer must perform the revaluation. The independent valuer also must perform the revaluation at least every three years if the mortgage accounts for more than EUR3m or 5% of the equity of the credit institution extending the loan. In all other cases, statistical methods are applicable.

Conclusion

Since 1 Jan 2008, all European banks apply Basel II/CRD. Under the Basel II/CRD, standardised approach covered bond issuers rated below AA- are assigned a higher 20% risk weighting where the national supervisor opts for option 2. Hence, covered bonds became less attractive for banks using the standardized approach in countries prescribing option 2. But covered bonds will be more attractive for banks using the IRBA. Under the IRB approaches, the risk weighting of most covered bonds, particularly covered bonds of higher rated issuers, will fall below 10%. For AA rated issuers (minimum PD of 0.03%), a risk weighting of 4% seems achievable. Under the IRB, only BBB rated issuers will not benefit from a reduced risk weighting.

Privileged risk weightings for covered bonds which were issued before 31 Dec 2007 and which are UCITS 22 (4) compliant but not in line with the CRD eligibility criteria are grandfathered.

Upcoming amendment of CRD poses risk for covered bonds

There are proposals to restrict issuance of covered bonds to 50% of the balance sheet and to account covered bonds for 25% in large credit exposure limits (currenlty 0%). Both proposals would be negative for covered bonds. The first proposal would be negative for specialized banks where covered bonds typically account for more than 50% of the balance sheet. The second one would be negative as it would likely reduce demand for covered bonds. Given the political support for covered bonds in Europe, we expect both proposals are unlikely to be successful.

BASEL II/CRD AND SECURITISATION

The tables below summarize the risk weighting for securitisation exposures under Basel II. Under the standard approach, the AAA to AA- rated tranches are 20% risk weighted. Hence, most European covered bonds (issued in countries applying option 1) have a lower risk weighting than the most senior securitization exposures. Even under option 2, covered bonds issued by AA- or better-rated banks carry a lower risk weighting than securitization exposures. If the covered bond issuer is rated below AA-, the covered bond carries the same risk weighting as the most senior securitization tranches (20%).

Standard approach for securitisation exposures

Tranche	Risk weighting
AAA to AA-	20%
A+ to A-	50%
BBB+ to BBB-	100%
BB+ to BB-	350%
B+ and below	Full deduction

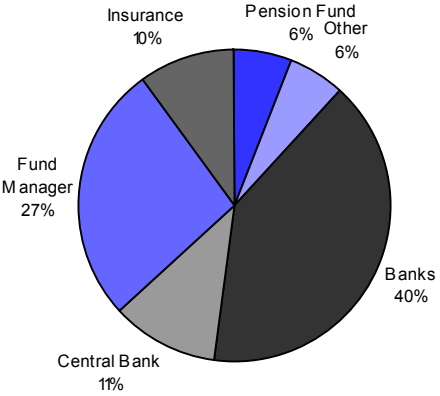
Source: BIS

Under the internal rating based approach, the relation is different. Particularly covered bonds of lower rated issuers (with higher PD) and with long maturities (M=5) will be at a disadvantage compared to highly granular AAA rated securitisation tranches (risk weighting 7%, under CRD even 6%).

Investor demand

European banks hold a significant amount of covered bonds as collateral for their liquidity transactions with the ECB. The combination of a low risk weighting, high security and ECB eligibility generates significant buying interest from banks.

Banks dominate as investors in Jumbo covered bonds



Source: Deutsche Bank, Estimate of typical covered bond distribution

Country wise, Germany typically accounted for around 40% of Jumbo covered bond buyers. However, investor distribution varied a lot in specific cases. E.g. in case of German Landesbank Pfandbriefe bank demand is typically over 70%, driven by demand from savings banks. In case of French issues, French investors typically take over 50% of the issue. Typcially, German investors and central banks accounted for over 70% of investors in Jumbo covered bonds. Compared to pre-crisis, investors increasingly prefer their domestic covered bond product leading to even higher shares of domestic investors in new issues of covered bonds.

Top 15 issuers of EUR Jumbo covered bonds in terms of outstanding volume

Issuer	Outstanding Volume (EUR bn)	Market Share
EURHYP	64.7	7.8%
AYTCED	46.7	5.6%
CFF	42.7	5.2%
DEPFA	40.6	4.9%
BBVSM	37.5	4.5%
DEXMA	29.4	3.5%
SANTAN	27.5	3.3%
CAIXAB	26.3	3.2%
HBOS	25.3	3.0%
CAJAMM	23.9	2.9%
CEDTDA	21.8	2.6%
DGHYP	19.4	2.3%
HVB	16.5	2.0%
BHH	16.1	1.9%
BANEST	15.0	1.8%

Source: Deutsche Bank

Outstanding volume of Pfandbriefe is declining due to structural reasons and the current market conditions

While the volume of public Pfandbriefe is constantly decreasing as a result of the grandfathered state guaranteed bonds maturing, we expect an even stronger decline in the next two years due to the sharply reduced new business of public sector lenders and the fact that most Pfandbrief issuers (like Eurohypo, Hypo Real Estate and Depfa) are in restructuring and hence should significantly reduce new business.

Redemptions of German Jumbo Pfandbriefe amount to EUR 59 bn in 2009 (2008: EUR 63 bn). As new issuance will most likely be significantly lower, we believe the outstanding volume of German Pfandbriefe is about to shrink much more than suggested by redemptions of grandfathered savings bank and Landesbank debt alone. As the business model for mortgage Pfandbriefe is likely to be less impacted by increasing funding cost, mortgage Pfandbriefe are likely to play a more important role going forward.

Cédulas market likely to remain extremely challenging

Given ongoing pressure on Spanish housing prices and Spanish sovereign spreads, the Cédulas market is likely to remain difficult in 2009. Jumbo issuance is likely to be zero or limited to a few attractively priced new issues or taps. More likely, Cédulas will be restricted to ECB funding and the government repo programme: Fund for Acquiring Financial Assets (FAAF).

UK covered bonds – no publicly issued covered bond in 2008 – unlikely to change in 2009

Although the last publicly placed EUR Jumbo UK covered bond was issued back in Oct 2007, overall issuance saw a new record in 2008. The total volume of UK covered bonds issued in 2008 was EUR 70 bn. The majority was done in GBP for the Special Liquidity Scheme (SLS) of the B0E. This trend continued in early 2009.

On 11 Nov 2008, the FSA announced the registration of covered bond programmes of ABBEY, ALLNCE, BACR, BOS, HSBC, NWIDE and YBS as 'Regulated Covered Bonds'. Under the UK Regulated Covered Bond Regulations, banks can apply with the FSA to have their outstanding programmes recognised as regulated programmes. The main consequence is a lower risk weighting and higher investment limits.

Irish ACS market – public sector side seems gone

EUR Jumbo ACS redemptions amount to EUR 5.5 bn in 2009. Hence, the market is likely to shrink by about 20%. Public sector ACS are likely to be in run-down mode. Depfa ACS bank and WestLB Covered Bond Bank will no longer issue and also the emergence of a new issuer is highly unlikely. Also in case of mortgage ACS, given the ongoing stress in the Irish housing market, Jumbo ACS issuance is unlikely in 2009.

Swedish issuers are able to issue state guaranteed covered bonds but are unlikely to do so

The Swedish bank rescue package allows banks to issue state guaranteed bonds with a maturity of up to 3Y in case of unsecured debt and 5Y in case of covered bonds. While Sweden (as Denmark and Ireland) is one of the few countries where issuance of state guaranteed covered bonds is possible, we do not expect significant issuance of Swedish EUR benchmark bonds in 2009. Issuers are unlikely to use their cover pool collateral for significant EUR Jumbo issuance to save a few basis points in issuance spreads and fees.

Netherlands, Austria, Portugal, Norway, Denmark, Italy and other countries are also stuck in the pipeline

As is the case in other countries, bank issuance backed by state guarantees is likely to be the preferred choice of banks. Some highly rated banks looking for longer term funding could use covered bonds even before the guarantee scheme has expired (31 Dec 2009). However, as in the case of other countries, we expect banks to mainly issue longer dated unguaranteed unsecured bonds.

As Kommunalkredit Austria (KA) was nationalized and the business model is likely to remain challenging, we do not expect any EUR benchmark covered bond issuance in 2009. Also BAWAG is unlikely to issue EUR Jumbo

covered bonds. For the time being, Austrian issuers are likely to focus on state guaranteed bonds for EUR benchmark issuance. Maturing Austrian Jumbo covered bonds amount to EUR 1 bn in 2009.

The Portuguese Jumbo covered bond market will see no redemption in 2009. Again, the new issue spreads of Portuguese state guaranteed bonds of 85 bp and 100 bp over swaps suggest that the market for EUR Jumbo covered bonds is likely to remain shut in 2009.

Norwegian banks cannot issue state guaranteed debt. As Norwegian covered bonds can be swapped by their issuers for government bonds with the Norwegian central bank Norwegian banks are unlikely to be in need to issue covered bonds. Although DnB Nor has been a prime issuer of EUR Jumbo covered bonds in the past, we see the primary market as difficult as in 2009.

The same is likely to hold true for Danish covered bonds. Danish banks can issue state guaranteed debt with a maximum maturity of 2Y. Hence, covered bonds seem the best choice for getting longer term funding. However, again, the EUR Jumbo covered bond market is likely to remain challenging in 2009. There will be no maturing Danish Jumbo covered bonds in 2009.

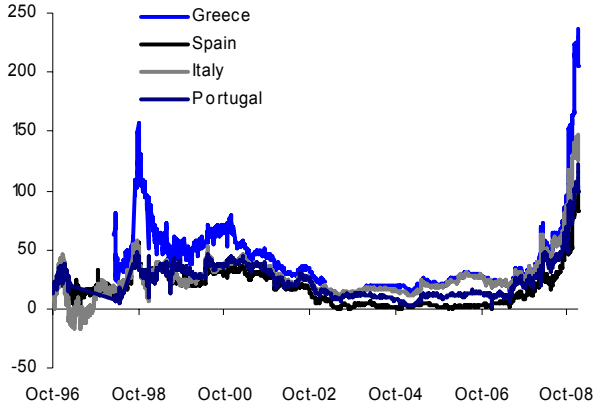
Jumbo covered bond issuance from Finnish banks in 2009 is also unlikely, independent from the current crisis. Italian Jumbo covered bonds are also likely to remain on the sidelines for 2009. After Banca Popolare di Milano issued the first Italian Jumbo covered bond last summer and also further issuers like UBI Banca and Unicredit waited in the pipeline, the EUR Jumbo covered bond market is likely to remain shut, particularly taking a look at Italian government spreads. Italy's bank guarantee scheme allows banks to issue state guaranteed debt with a maximum maturity of 5Y.

Regarding Canadian covered bonds, the picture also looks challenging. Given that Aa1/AA rated Province of Ontario had to pay ms + 100 bp for a 5Y issue recently, there seems to be little room for Canadian covered bonds at a reasonable spread from an issuers' perspective (even though the bond tightened massively in the secondary market).

NON-CORE SOVEREIGNS UNDER PRESSURE

As almost all European countries issued EUR Jumbo covered bonds in the past, the significant spread widening of non-core sovereign bonds is relevant for the European covered bond market, suggesting that significant spread convergence of covered bonds is unlikely in the short to medium term. Hence, the primary market regarding EUR Jumbo covered bonds for most European countries is likely to remain very challenging in 2009.

Despite recent tightening - 10Y Spreads to Germany close to highs



Source: Deutsche Bank

The spread widening has triggered further conjecture over the future of the EMU, and break-up scenarios continue to be discussed. In order to evaluate the impact of the spread widening we first analyse the evolution of interest costs (as a % of GDP) under different scenarios in order to assess the burden on sovereign finances, focusing our attention on Greece, Italy, Portugal, Spain, and Ireland. Our assumptions involve an unchanged debt stock, or growth in the next two years of 25% or 50%, both followed by steady stock. Additionally, we factor in spreads at current levels, as well as further increase of 50 bp, and 100 bp. This is of course a simple calculation which does not capture factors like countercyclical effects or a shift in the tern structure, for example.

In a scenario where spreads rise a further 100 bp from current levels and the debt stock grows 50% in the first and second years, Irish interest costs go to 6% of GDP. This compares to 0.9% recorded by Eurostat in 2007. Italy sees interest costs ranging from 4.5% to 9.6% which is still less than the 11.6% seen in 1995. The same applies to Greece, which had interest expenses beyond 10% of GDP in the mid 1990s. The estimated interest cost in Spain ranges between 2.2% to 5.8% of GDP under our assumptions, which exceeds the 1.4% in 2007, and the 4.4% in 1996.

Ireland interest expenditure

	New IR Cost	2009	2010	2011	2012	2013
Debt unch	Current Spread	1.3	1.3	1.6	1.6	1.9
	Spread +50bp	1.3	1.4	1.7	1.7	2.0
	Spread +100bp	1.4	1.5	1.8	1.8	2.2
Debt +25%	Spread unch	1.9	2.9	2.9	2.9	2.9
	Spread +50bp	2.0	3.2	3.2	3.2	3.2
	Spread +100bp	2.2	3.4	3.4	3.4	3.4
Debt +50%	Spread unch	2.9	5.0	5.0	5.0	5.0
	Spread +50bp	3.2	5.5	5.5	5.5	5.5
	Spread +100bp	3.4	6.0	6.0	6.0	6.0

Source: Deutsche Bank

Italy interest expenditure

	New IR Cost	2009	2010	2011	2012	2013
Debt unch	Current Spread	4.8	4.7	4.6	4.5	4.5
	Spread +50bp	4.9	4.8	4.7	4.7	4.6
	Spread +100bp	4.9	4.9	4.9	4.9	4.8
Debt +25%	Spread unch	5.9	6.8	6.8	6.8	6.8
	Spread +50bp	6.0	7.1	7.1	7.1	7.1
	Spread +100bp	6.2	7.3	7.3	7.3	7.3
Debt +50%	Spread unch	6.8	8.6	8.6	8.6	8.6
	Spread +50bp	7.1	9.1	9.1	9.1	9.1
	Spread +100bp	7.3	9.6	9.6	9.6	9.6

Source: Deutsche Bank

Greece interest expenditure

	New IR Cost	2009	2010	2011	2012	2013
Debt unch	Current Spread	4.5	4.5	4.6	4.6	4.6
	Spread +50bp	4.5	4.6	4.7	4.8	4.8
	Spread +100bp	4.6	4.7	4.8	4.9	5.0
Debt +25%	Spread unch	5.7	6.9	6.9	6.9	6.9
	Spread +50bp	5.8	7.2	7.2	7.2	7.2
	Spread +100bp	5.9	7.4	7.4	7.4	7.4
Debt +50%	Spread unch	6.9	9.5	9.5	9.5	9.5
	Spread +50bp	7.2	10.0	10.0	10.0	10.0
	Spread +100bp	7.4	10.5	10.5	10.5	10.5

Source: Deutsche Bank

Spain interest expenditure

	New IR Cost	2009	2010	2011	2012	2013
Debt unch	Current Spread	1.6	1.8	2.0	2.1	2.2
	Spread +50bp	1.6	1.9	2.1	2.3	2.5
	Spread +100bp	1.7	2.0	2.3	2.5	2.7
Debt +25%	Spread unch	2.2	3.1	3.1	3.1	3.1
	Spread +50bp	2.4	3.3	3.3	3.3	3.3
	Spread +100bp	2.5	3.6	3.6	3.6	3.6
Debt +50%	Spread unch	3.1	4.8	4.8	4.8	4.8
	Spread +50bp	3.3	5.3	5.3	5.3	5.3
	Spread +100bp	3.6	5.8	5.8	5.8	5.8

Source: Deutsche Bank

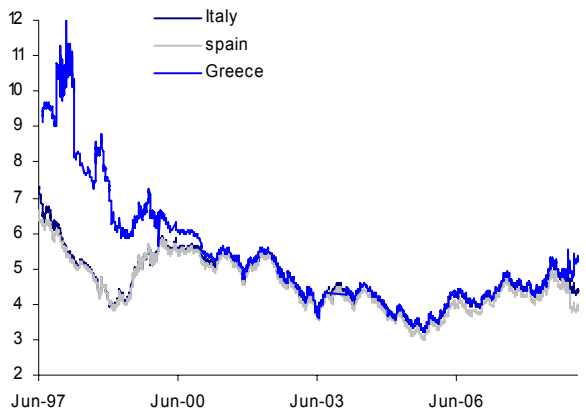
Portugal interest expenditure

	New IR Cost	2009	2010	2011	2012	2013
Debt unch	Current Spread	3.0	3.0	3.0	3.0	3.1
	Spread +50bp	3.0	3.0	3.1	3.1	3.2
	Spread +100bp	3.1	3.1	3.2	3.2	3.4
Debt +25%	Spread unch	3.8	4.6	4.6	4.6	4.6
	Spread +50bp	3.9	4.9	4.9	4.9	4.9
	Spread +100bp	4.0	5.1	5.1	5.1	5.1
Debt +50%	Spread unch	4.6	6.3	6.3	6.3	6.3
	Spread +50bp	4.9	6.8	6.8	6.8	6.8
	Spread +100bp	5.1	7.3	7.3	7.3	7.3

Source: Deutsche Bank

The simple calculations highlight that spreads are of less importance in an environment of declining rates. The chart below shows that current 10Y rates are still comparatively low for these countries. Additionally, these countries had historically sustained higher yield levels and interest costs (as a percentage of GDP) prior to joining the EMU.

Historical 10Y yields

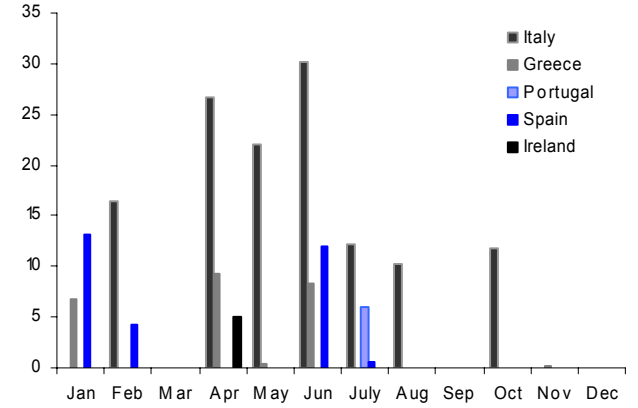


Source: Deutsche Bank

Wider spreads may become an issue if rates were to rise at the same time. However, this would entail an economic recovery and it is debatable whether current issues would remain as concerning in a growth environment.

In our view, the real risk is a buyer's strike, as opposed to the fundamental credit risk. This would have an impact if it were to prevent either interest payments or the refinancing of maturing debt. We therefore see redemptions as a more important risk factor in the near term.

Redemption Schedule (EUR bn)



Source: Deutsche Bank

So far, however, the EMU sovereigns have managed to complete all auctions to date. Greece had a TBill auction this week that was well covered; and while Spain's long end auction saw a large concession, it still managed to sell EUR 3-4 bn. At this point at least it appears to be more a matter of price than of demand.

Nonetheless, recent events increase the risks that a sovereign faces an immediate funding shock. For example, such a situation could be linked to the health of the banking sector. In an extreme scenario, there is the possibility of a bank failure that requires a large cash injection that is too large for the respective sovereign to shoulder. In such a scenario, the sovereign would have to either renege on its guarantee or go into default.

In our view, default is a last resort, and would create systemic risk that all parties would be keen to avoid. For the remaining members, providing help would avoid a domino effect that would likely affect the weaker sovereigns, and ultimately the EMU as a whole. For an individual country, letting individual banks fail is a preferable solution to letting the sovereign fail because a default of the sovereign would probably be catastrophic for domestic banks. Given the incentives, allowing a bank failure is the most palatable option, in our view, similar to the Icelandic experience.

So far in the EMU, there has already been experience in dealing with troubled local and cross-border banks, and funding needs that have occurred as a result were covered. If there was a bank failure too big for a sovereign to viably takeover, a likely solution would be for an orderly unwind of the institution, perhaps requiring the temporary aid of other EMU members.

There are several routes by which aid could be provided. In the Future of EMU article in the Fixed Income Outlook 2009, we discuss several of the options. Under the Maastrict Treaty, a bailout of member states by another member state or the EC is not allowed. However Article 122 provides a potential loophole for direct or indirect financial assistance.

When a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on the proposal from the commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken. (Article 122 (2) Consolidated Version of the Treaty on the Functioning of the European Union, May 2008)

This may well be a plausible solution, given EU already has experience in contributing to the Hungarian package alongside the IMF. Aside from direct government help, an increasingly viable option is to use state owned or part-owned banks to direct lending to troubled sovereigns or purchase assets from troubled banks. The ECB may also legally provide help via the purchase of government bonds in the secondary market; however, given institutional aversion to providing aid, and noting the tone of the recent press conference, such actions are likely to be the last resort for providing aid.

Our conclusion is that default (and break-up of the EMU as discussed in the Future of EMU article) is not an optimal solution, and that aid will be provided when necessary. Article 122 provides an option to legally extend help to a member state, and a sovereign default or even debt restructuring would likely be disastrous for the domestic banking system. However, it seems apparent that while the incentives to help are present, there is not enough incentive to act preemptively. Arguably the situation would have to escalate sufficiently to require a reaction, though we do think help will be forthcoming once deemed necessary.

Overview Ratings

As we expect further adjustments of rating methodologies for covered bonds, rating methodologies for covered bonds are unlikely to provide meaningful help in forecasting or interpreting rating changes. Hence, we have skipped detailed descriptions of rating methodologies for covered bonds. Despite a great deal of delinkage of the covered bond rating from the senior unsecured rating of the sponsor bank, pressure on senior bank ratings continues to be the main threat to covered bond ratings (in addition to cover pool asset quality deterioration, generally lower liquidity of cover pool assets and increased refinancing risk).

Ratings of German Pfandbrief issuers and their Pfandbriefe

	Senior Unsecured Debt			Public Pfandbrief			Mortgage Pfandbrief		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Aareal Bank	-	-	A-- n	-	-	AAA	-	-	AAA
Bayerische Landesbank (unguaranteed)	Aa2 wn	A n	A+ s	Aaa	AAA	AAA	Aaa	AAA	AAA
Bayerische Hypo- und Vereinsbank	A1 s	A+ n	A n	Aaa s		AAA	Aa1 wp	-	AAA
Berlin Hannoversche Hypothekenbank	-	-	A+s	Aaa	AAA	-	Aa1	AA+	-
Bremer Landesbank	Aa2 s	-	A s	Aaa	-	-	Aaa	-	-
Dekabank	Aa2 s	A s	A- s	Aaa	AAA	AAA	-	-	-
Depfa Deutsche Pfandbriefbank	A3 n	BBB develop	A- s	Aaa wn	AAA wn	AAA wn	Aaa	-	AAA
Deutsche Apotheker- und Aertzebank	A2 s	A+ s	A+ s	-	-	-	-	AAA	-
Deutsche Hypothekenbank Hannover	Aa3 s	-	-	Aaa	-	-	Aaa	Aaa	-
Deutsche Kreditbank	-	-	-	Aaa	-	-	-	-	-
Deutsche Postbank	Aa2s	A- p	A n	-	-	-	Aaa	AAA	AAA
Deutsche Schiffsbank	A2 s	-	-	-	-	-	-	-	-
Dexia Kommunalbank	-	-	-	-	AAA	AAA	-	-	-
Deutsche Genossenschafts-Hypothekenbank	-	A n	A+ s	-	AAA	AAA	-	AAA	AAA
Düsseldorfer Hypothekenbank	-	-	A- wn	-	AAA wn	AAA	-	-	-
Eurohypo	A1 s	A n	-	Aaa	AAA	AAA	Aaa	AAA	AAA
Hamburger Sparkasse	-	-	-	-	-	-	Aaa	-	-
Hypo Real Estate Bank	A3 n	BBB develop	A- s	Aaa wn		AAA wn	Aa3 wn	-	AA+ wn
HSH Nordbank	Aa3 s	A wn	A s	Aaa	-	-	Aaa	-	-
Kreissparkasse Köln	Aa2 s	-	-	-	-	-	Aaa	-	-
Landesbank Baden-Württemberg	Aa1 s	A+ n	A+ s	Aaa	AAA	AAA	Aaa	-	AAA
Landesbank Berlin	A1 s	-	AA- s	Aaa	-	AAA	Aaa	-	AAA
Landesbank Hessen-Thüringen	Aa2 s	A s	A+ s	Aaa	AAA	AAA	-	-	AAA
Landesbank Rheinland-Pfalz	Aa1 s	-	A+ s	Aaa	AAA	AAA	Aaa	-	AAA
Landesbank Saar	Aa2 wn	-	A+ s	-	-	-	-	-	-
Landesbank Sachsen	Aa1 s	A+ n	-	-	-	AAA	-	-	AAA
Münchener Hypothekenbank	Aa3 s	-	A +s	Aaa	-	-	Aaa	-	-
Norddeutsche Landesbank	Aa2 s	A n	A s	Aaa	-	AAA	Aaa	-	-
SEB AG	A1 n	-	A+ p	Aaa	-	-	Aaa	-	-
Sparkasse Aachen	Aa2 s	-	-	-	-	-	-	-	-
Stadtsparkasse Düsseldorf	Aa1 s	-	-	-	-	-	-	-	-
Sparkasse Köln Bonn	Aa2 s	-	-	Aaa	-	-	Aaa	-	-
Westdeutsche Immobilienbank	-	A- wn	-	-	AAA	-	-	AAA	-
WestLB	A2 n	A- wn	A- s	Aaa	AAA	-	-	-	-
Westfälische Landschaft Bodenkreditbank	-	A+ s	-	-	AAA	-	-	AAA	-
Wüstenrot Bank Pfandbriefbank	-	BBB+ s	BBB+	-	AAA	AAA	-	-	AAA

Source: Rating Agencies, Deutsche Bank

Ratings of Spanish Cédulas issuers and their Cédulas

	Senior unsecured rating			Cédulas Territoriales			Cédulas Hipotecarias		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch	Moody's	S&P	Fitch
AYT Cédulas Cajas	-	-	-	Aaa*	AAA	AAA	Aaa	AAA	AAA
Banco de Sabadell	Aa3 s	A+ n	A+ s	-	-	-	Aaa	-	-
Banco Pastor	A2 n	-		-	-	-	Aaa	-	-
Bancaja	A2 s	-	-	-	-	-	Aaa	-	-
Banco Popular Espanol	Aa2 n	AA- n	AA s	-	-	-	Aaa	AAA	AAA
Banco Espanol de Credito (Banesto)	Aa2 s	AA s	AA wn	-	-	-	Aaa	-	AAA
Banco Bilbao Vizcaya Argentaria	Aa1 s	AA s	AA- p	Aaa	-	AAA	Aaa	-	AAA
Banco de Credito Local	Aa1 s	AA s	AA- p	Aaa	-	-	-	-	-
Bankinter	Aa3 s	A s	A+ s	-	-	-	Aaa	-	AAA
Banco Santander Central Hispano	Aa1 s	AA s	AA wn	Aaa	-	AAA	Aaa	AAA	AAA
Caixa Galicia	A2 s	-	A n	Aaa	-	-	Aaa	-	-
Caja Madrid	Aa3 s	A+ n	AA- n	Aaa	-	-	Aaa	-	-
Caja Rural Intermediterranea SCC (CajaMar)	A2 s	-	A s	-	-	-	Aaal	-	-
Caja Mediterrianecrpro	A2 n	-	A- s	-	-	-	Aaa		
Caixa Catalunya	A2 n	-	A n	-	-	-	Aaa		AAA
Cédulas TDA	-	-	-	-	-	AAA	Aaa	AAA	AAA
IM Cédulas	-	-	-	-	-	-	Aaa	AAA	AAA
Caja de Ahorros y Pensiones de Barcelona (La Caixa)	Aa1 s	AA- n	AA- s	Aaa	-	-	Aaa	AAA	-
PITCH	-	-	-	-	-	-	Aaa	AAA	-
Santander Consumer Finance	A1 s	AA- s	AA- wn	-	-	-	Aaa	-	-

**AYT has a CT rated by S&P and one rated by Moody's and Fitch, Source: Rating Agencies, Deutsche Bank*

Ratings of French covered bond issuers and their covered bonds

	Parent company senior rating			Obligations Foncières/French covered bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
CIF Euromortgage	A1 s	A+ n	A+ s	Aaa	-	AAA
CFF	Aa3 s	A s	A+ wn	Aaa	AAA	AAA
DEXMA	A1 s	A s	AA- s	Aaa	AAA	AAA
Societe Generale	Aa2 s	AA - n	AA- s	Aaa	AAA	AAA
BNP Covered Bonds	Aa1 n	AA n	AA n	Aaa	AAA	AAA
CM-CIC Covered Bonds	Aa3 s	A+ s	AA- s	Aaa	AAA	AAA
Banque Populaire Covered Bonds	-	-	A+ wn	Aaa	AAA	-
GCE Covered Bonds	Aa3 s	A+ s	A+ wn	Aaa	AAA	
Credit Agricole Covered Bonds	Aa1 wn	AA- s	AA- s	Aaa	AAA	AAA
Societe Generale	Aa2 s	AA - n	AA- s	Aaa	AAA	AAA
CRH	-	-	-	Aaa	-	AAA

Source: Rating Agencies, Deutsche Bank

Ratings of UK covered bond issuers and their covered bonds

	Senior unsecured rating			UK mortgage covered bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Abbey National	Aa3 s	AA s	AA- s	Aaa	AAA	AAA
Alliance & Leicester	Aa3 s	AA s	AA- wn	Aaa	AAA	
Anglo Irish Bank	A2 n	A- wn	A- s	Aaa	-	-
Bank of Scotland	Aa1 wn	AA- n	AA- s	Aaa	AAA	AAA
Barclays	A1 s	A+ n	AA- s	AAA	AAA	AAA
HSBC Bank	Aa1 s	AA n	AA n	Aaa	AAA	AAA
Northern Rock	A2 wd	A s	A- wn	Aaa wn	AAA	AAA
Bradford & Bingley	Baa3 wn	-	A- s	A1 wp	AAA	AAA
Nationwide	Aa2 n	A+ s	AA- s	Aaa	AAA	AAA
Yorkshire BS	A2 s	A n	A n	Aaa	AAA	AAA

Source: Rating Agencies, Deutsche Bank

Ratings of US covered bond issuers and their covered bonds

	Senior unsecured rating			US Covered bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Bank of America NA	Aa2 n	AA- n	A+ s	Aaa	AAA	AAA
JP Morgan NA	Aa1 s	AA- n	AA- s	Aaa	AAA wn	AA+

Source: Rating Agencies, Deutsche Bank

Rating of Italian covered bonds and their issuers

	Senior unsecured rating			Italian Covered bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Cassa Depositi e Prestiti	Aa2 s	A+ s	AA- s	Aaa	AAA	AAA
Banca Populare di Milano	A1 s	A- s	A s	Aaa	AAA	-
UBI Banca	A1 s	A p	A+ s	Aaa	AAA	AAA

Source: Rating Agencies, Deutsche Bank

Rating of Danish covered bonds and their issuers

	Senior unsecured rating			Danish Mortgage Covered bond		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Danske Bank	Aa1 wn	AA- n	AA- s	Aaa	AAA	AAA
Nykredit	Aa3 s	-	-	Aaa	-	-

Source: Rating Agencies, Deutsche Bank

Ratings of Irish covered bond issuers and their covered bonds

	Issuer rating			Public ACS			Mortgage ACS		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Allied Irish Banks (the issuer Allied Irish Bank Mortgage Bank is not rated)	Aa2 wn	A+ n	A s	-	-	-	Aaa	AAA	AAA
Bank of Ireland (the issuer Bank of Ireland Mortgage Bank is not rated)	Aa2 wn	A+ wn	A s	-	-	-	Aaa	AAA	-
Depfa ACS Bank	A3 n	BBB n	A- s	Aa1 wn	AAA wn	AAA	-	-	-
WestLB Covered bond Bank	A2 n	A- wn	-	Aaa	AAA	AAA	-	-	-
Anglo Irish Bank	A2 n	A- wn	A- s	-			Aaa		AAA

Source: Rating Agencies, Deutsche Bank

Ratings of Norwegian covered bond issuers and their covered bonds

	Senior unsecured rating			Norwegian Covered Bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
DnB NOR Boligkreditt (unsecured rating of DnB NOR Bank ASA)	Aa1 n	AA- n	A+ s	Aaa	AAA	AAA
Sparebanken 1 Boligkreditt	-	-	A s	Aaa		AAA
Terra Boligkreditt				Aaa		
Storebrand Kredittforetak (senior rating of Storebrand ASA)	Baa2 n	BBB s		Aaa		

Source: Rating Agencies, Deutsche Bank

Ratings of Swedish covered bond issuers and their covered bonds

	Senior unsecured rating			Swedish Covered Bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
LF Hypotek	-	-	-	Aaa	AAA	
Nordea Hypotek	Aa3 s	-	-	Aaa	AAA	-
Stadshypotek	Aa1 s	AA- s	AA s	Aaa	-	-
Swedish Covered bond Corporation (senior rating of Swedish Housing Finance Corp)	A1 n	A+ n	-	Aaa	AAA	-
SEB	Aa2 n	A+ n	A+ s	Aaa	-	-
Swedbank Hypotek	Aa3 n	-	AA- s	Aaa	AAA	-

Source: Rating Agencies, Deutsche Bank

Ratings of Portuguese covered bonds issuers and their covered bonds

	Senior unsecured rating			Portuguese Covered Bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Caixa Geral Depositos	Aa1 s	A+ s	AA- s	Aaa	AAA	AAA
Millennium BCP	Aa3 s	A n	A+ s	Aaa	AAA	AAA
Banco Espirito Santo	Aa3 s	A n	A+ s	Aaa	AAA	AAA
Banco BPI	A1 s	A s	A+ s	Aaa	AAA	
Santander Totta	Aa3 s	AA- s	AA wn	Aaa	AAA	AAA

Source: Rating Agencies, Deutsche Bank

Ratings of Finnish covered bond issuers and their covered bonds

	Issuer rating			Finnish Covered Bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Sampo Bank Plc (the issuer Sampo Housing Loan Bank is not rated)	Aa1 wn	AA- n	-	Aaa	-	-
Pohjola Bank PLC (the issuer OP Mortgage Bank is not rated)	Aa1 s	AA- s	AA- s	Aaa	AAA	-
Aktia SavingsBank (the issuer Aktia Real Estate Mortgage Bank is not rated)	A1 s	-	-	Aaa	-	-

Source: Rating Agencies, Deutsche Bank

Ratings of Canadian covered bond issuers and their covered bonds

	Issuer rating			Canadian Covered Bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Royal Bank of Canada	Aaa n	AA - s	AA s	Aaa	AAA	AAA
Bank of Montreal	Aa1 s	A+ s	AA- s	Aaa	AAA	AAA
Bank of Nova Scotia	Aa1 s	AA- s	AA- s	Aaa	-	AAA
CIBC	Aa2 n	A+ n	AA- wn		AAA	AAA

Source: Rating Agencies, Deutsche Bank

Ratings of Hungarian covered bond issuers and their covered bonds

	Issuer rating			Hungarian Covered Bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
FHB Land Credit and Mortgage Bank	Baa3 s	-	-	Aa3s	-	-
Unicredit Jelzalogbank	-	-	-	Aa3 s	-	-
OTP Jelzalogbank	A3 s	BBB n	-	Aa1	-	-

Source: Rating Agencies, Deutsche Bank

Ratings of Austrian covered bond issuers and their covered bonds

	Senior unsecured rating			Austrian Covered Bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Kommunalkredit Austria (KA)	Aa3 wn	-	AA- s	Aaa	-	-
BAWAG	Baa1 s	-	-	Aaa wn	-	-
Erste Bank	Aa3 wn	A n	A s	Aaa		

Source: Rating Agencies, Deutsche Bank

Ratings of Dutch covered bond issuers and its covered bonds

	Senior unsecured rating			Dutch Covered Bonds		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
ABN Amro Bank	Aa2 wn	A+ wd	AA- s	Aaa	AAA	AAA
Achmea Hypotheekbank	-	A- s	-	Aaa wn	AAA	-
ING Bank	Aa3 s	AA n	AA- n	Aaa	AAA	AAA
SNS Bank	A2 s	A n	A+ n	Aaa	AAA	AAA
NIBC Bank NV	Baa2 n	BBB+ n	BBB+ s	-	AAA	AAA

Source: Rating Agencies, Deutsche Bank

Soft Bullet Structures

Soft bullet structures have become popular in the Jumbo market

Covered bonds with soft bullet maturities have become more popular in recent years. The share of soft bullet structures in yearly new issuance increased from below 10% in 2003 (mainly Spanish Multi-Cédulas) to around 30% in 2007. Due to the significant decrease in Spanish Multi-Cédulas issuance and UK covered bond issuance in 2008, the share of soft bullet structures in new issuance decreased to around 20%. The high share of soft bullet structures in the EUR Jumbo covered bond market is noteworthy as it is one of the very few structural arrangements allowed in the Jumbo market. By definition, Jumbo covered bonds cannot be issued in structured format like callable, inflation-linked, index-linked or putable covered bonds.

Such structures are only possible in non-Jumbo format, and in some case are not even allowed by law. For example, the German Pfandbrief Act does not allow the issuance of putable Pfandbriefe. So far, investors have not demanded any pick-up for soft-bullet versus hard bullet structures.

Soft bullet structures ease liquidity pressure – investor may be at a disadvantage

The increased use of soft bullet structures was primarily driven by rating agencies which view such structures positively. In case of soft bullet structures, the repayment of the covered bonds can be delayed by a certain time if there is not enough liquidity in the cover pool. The time of delay differs from issuer to issuer and ranges from 60 days (in case of JP Morgan covered bonds), 12 months (in case of UK, Irish, Portuguese, Dutch, Finnish and Norwegian covered bonds), 3 years (in case of TDA, Intermoney and old AYT issues) to an undefined number of years (maturity of the longest outstanding bond plus 3 years in case of AYT Global Cédulas programme). During the extension period, the issuer has to pay the same coupon as before. Hence, in times of crisis, liquidity pressures are eased by soft bullet structures but the investor may be at a disadvantage if the coupon is lower than it would be under market conditions at the time of extension. Cash flow stress tests of rating agencies can be met more easily with soft bullet structures. This may reduce the OC requirements and hence makes issuing covered bonds cheaper. Rating agencies like soft bullet structures regarding the timely and full payment of the coupon and full payment of the principal. With the use of soft bullet structures issuers may avoid a covered bond default due to operational delays in finding a cover pool administrator or in case of a transfer of the cover pool and the covered bonds to another bank.

Issuers with soft bullet term structures in the Jumbo covered bond market

Country	Max. extension	Issuer
Portugal	12 Months	Caixa Geral
	12 Months	Millennium BCP
	12 Months	Bano Espirito Santo
	12 Months	Banco BPI
	12 Months	Banco Santander Totta
USA	60/90 Days	JP Morgan
	60/90 Days	Bank of America
Canada	12 Months	Royal Bank of Canda
	12 Months	Bank of Montreal
	Hard Bullet or 12 Months	CIBC
Spain	Longest Maturity of all Outstanding bonds + 3 Years	AYT Global-Programme
	3 Years	AYT (stand alone issues)
	3 Years	TdA
	3 Years	InterMoney
UK	12 Months	Northern Rock
	12 Months	Bradford & Bingley
	12 Months	Nationwide BS
	12 Months	Abbey National
	12 Months	Yorkshire BS
	12 Months or Hard Bullet	HSBC
Ireland	12 Months	Bank of Ireland
	12 Months	Allied Irish Banks
Netherlands	12 Months	Achmea Hyp
	12 Months	SNS Bank
Norway	12 Months	DnB NOR
	12 Months	SpareBank1
Finland	12 Months	OP Mortgage Bank
	12 Months	Sampo Mortgage Bannk
Denmark	12 Months	Danske Bank

Source: Deutsche Bank, Transaction Documents

Most UK covered bonds with soft´bullet structure

Most UK covered bonds have a soft-bullet structure. Following the serving of a notice to pay, the covered bond LLP may not have sufficient proceeds for full and timely payment of covered bonds. In this case, the final maturity will be extended by 12 months in order to allow the issuer to sell cover assets. US covered bonds also have a soft-bullet maturity. However, the extension period is much shorter. The extension period in case of WM covered bonds is only 60 days, compared with 12 months in the

case of UK covered bonds. Following a mortgage bond issuer event of default, the covered bond issuer may not have sufficient cash for full and timely payment, as the enforcement of the security interest against the Mortgage Bond Issuer and its receiver or conservator may cause payment delays. In this case, the final maturity will be extended to allow for a realisation of cover assets.

Minimal pricing effect of soft bullet structures

To calculate the pricing effect of a hard bullet versus a soft bullet structure, the net present value difference of the alternative cash flow profiles has to be calculated. To do this, the forward rate at the maturity of the bond for the extension period is necessary. The situation becomes even more complex if one assumes partial payment and only partial extension. The pricing effect is bigger, the longer the extension period and the higher the difference between the coupon of the bond and the interest rate at the time of the extension. In case interest rates are lower than the coupon at the time of the extension, the investor may even benefit. However, in our view the typical Jumbo investor wants to have maximum security. Hence, from an investor perspective, a hard bullet structure (with strong pre-maturity tests or other liquidity requirements) safeguarding the bond payment seems preferable. Registered Covered bonds.

Registered Covered Bonds

Incentive to invest in registered covered bonds

Since 2005, publicly traded companies have to apply International Accounting Standards (IAS). This led to an increasing incentive for publicly traded investors in AAA securities to abandon investments in benchmark bonds and shift towards investments in registered (covered) bonds. Under IAS 39, financial assets are divided into four categories:

- Financial assets at fair value through profit or loss
- Available for sale
- Loans and receivables
- Held to maturity

There is an important difference between 'loans and receivables' and 'held to maturity' on the one hand and 'financial assets at fair value through profit or loss' and 'available for sale' on the other hand. Assets of the former may be accounted for at amortized costs. If the asset prices move below/above amortized costs, this represents unrealized losses/gains. The disclosure at amortized costs represents an opportunity for companies to reduce volatility of the income statements. Assets held as 'loans and receivables' have an advantage compared to those 'held to maturity' as they allow a more flexible sale prior to maturity. This possibility mainly applies in Austria, Germany, Ireland and Luxembourg.

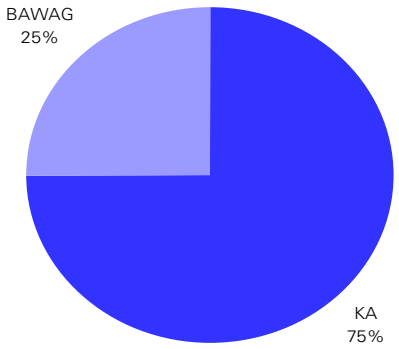
Registered covered bond issuance may increase

As a result, there will likely be more issues of registered covered bonds in the future and a lower market share of benchmark covered bonds. This development can be seen in the German market. The share of Jumbo Pfandbriefe declined over the last few years, whereas the share of registered Pfandbrief issuance has been on the rise; accounting for 34% of the Pfandbrief market as of 30 Oct 2008, up from about 25% in Q3 2002.

Austria

MARKET OVERVIEW

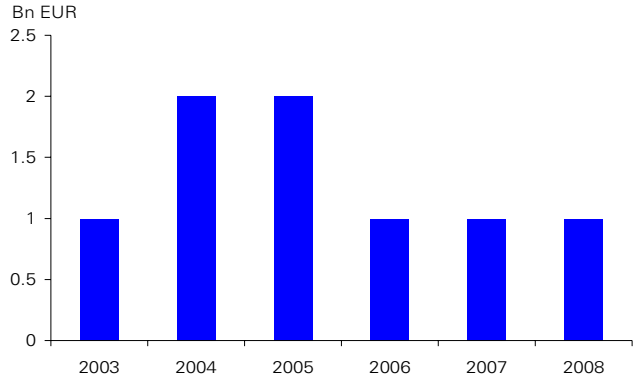
Austrian Jumbo covered bonds dominated by KA



Source: Deutsche Bank

All Austrian EUR Jumbo covered bonds are secured bank bonds (Fundierte Bankschuldverschreibungen). So far, the Pfandbrief market is purely domestic and there are no Austrian EUR Jumbo Pfandbriefe outstanding.

Yearly new issuance of Austrian EUR Jumbo Covered bonds in EUR bn



Source: Deutsche Bank

Little foreign participation in Austrian covered bonds

Despite the high ratings of Austrian Pfandbriefe, there is only little foreign participation. This is mainly due to the lack of liquidity and the fact that small to mid-sized issues dominate.

Both issuers of EUR Jumbo covered bonds (KA, BAWAG) have limited the eligible assets for the inclusion in the cover pool within their articles of association to Austrian public sector debt, i.e. bonds and loans from the Republic of Austria, its provinces and municipalities, or debts guaranteed by them.

FUNDIERTE BANKSCHULDVERSCHREIBUNGEN

Issue Structure

The Law on Secured Bank Bonds (Gesetz betreffend fundierte Bankschuldverschreibungen - FBSV) of 1905 (amended on 21 June 2005) has a broader scope than the Austrian Pfandbrief and the Austrian Mortgage Bank Act, which only refer to mortgage credit and to public sector loans. The Law on Secured Bank Bonds does not stipulate a specialist bank principle. The issuing banks' business scope is not restricted. Hence, all banks with an Austrian banking license and which allow for the issuance of Secured Bank Bonds (Fundierte Bankschuldverschreibungen, FBSV) in their articles of association are legally allowed to do so. Consequently, banks already issuing Pfandbriefe and meeting the statutory requirements of the Law on Secured Bank Bonds can also issue FBSV.

COVER POOL CREDIT QUALITY

For the cover pool of FBSV, only 'extremely safe' ('mündelsichere') bonds are eligible as collateral.

Mortgage lending

Mortgage assets are eligible as collateral if they are registered in a 'public book'. Land registers are considered public books. There are no further restrictions such as LTV limits or geographical restrictions, comparable to those of the Austrian Mortgage Bank Act. Mortgage loans are eligible without limit, meaning mortgage loans with an LTV higher than 60% are also eligible as collateral. Hence, mortgage loans that are noneligible as collateral for Pfandbriefe may be eligible as collateral for FBSV.

Property valuation

There are no specific rules stipulated in the Law on Secured Bank Bonds. Nevertheless, other applicable regulations of property valuation mean that only the durable, non-speculative aspects of the property and the yield which any tenant can ensure permanently by good management may be taken into account.

Public sector lending

Loans to EU, EEA and Swiss central and regional governments, regional authorities and bodies of these countries with a risk weighting of up to 20%, or loans guaranteed by such authorities are eligible as collateral for public sector backed FBSV.

MBS/covered bonds

MBS and covered bonds are not allowed as collateral.

Geographic scope
There are no geographic restrictions in case of mortgage backed FBSV. Public sector backed FBSV are only allowed to be covered by EU/EEA and Swiss public sector assets.

Substitute collateral
Cash and deposits held at an OECD bank or a central bank are eligible as substitute assets. The respective OECD country must not have rescheduled their external debt in the previous five years. Total substitute assets are not allowed to exceed 15% of the volume of outstanding FBSV.

Cover pool monitor
The Ministry of Finance assigns the cover pool monitor ('Regierungskomissionär'). He has to check that the legal requirements regarding the cover pool are met. The cover pool monitor supervises the stipulated cover register which was introduced in the Law on Secured Bank Bonds by the amendment on 1 June 2005. Cover pool assets can only be registered and de-registered with prior consent of the cover pool monitor.

COVER POOL RISK MANAGEMENT

Prepayment risk
Mortgage loan borrowers have the right to prepay subject to prepayment penalties. Only after a period of 10 years in case of fixed rate loans is there a prepayment right without penalty. In practice, prepayments are low. Moreover, as public sector assets so far dominate the collateral for FBSV in practice, prepayment risk is not considered material for Austrian FBSV. Floating rate and foreign currency loans play a far more important role in the Austrian mortgage loan market than in the German one.

Matching requirements
The Law on Secured Bank Bonds stipulates that the value of the cover pool assets has to match the total nominal volume of outstanding bonds at every point in time. There are no 2% nominal OC requirements as for Austrian Pfandbriefe. However, the articles of association of the issuer (Satzung) may require a given level of OC. KA and BAWAG committed themselves to a 2% OC on an NPV basis. The Law on Secured Bank Bonds does not stipulate a maturity-matching as is the case for Pfandbriefe and it does not exclude currency risk. Hence, without contractual self-restrictions, interest rate and currency risk could be higher in case of FBSV than in case of Austrian Pfandbriefe.

Liquidity risk
Regulations regarding liquidity risk are the above mentioned matching requirements which act to restrict liquidity risk at least somewhat.

Taking derivatives into cover
Derivatives designed to hedge the cover pool interest, currency and credit risks are permitted to be registered in the cover pool with prior consent of the cover pool monitor. Derivatives must not include a termination clause in case of issuer insolvency and derivative counterparties rank pari passu with holders of FBSV. There is no specific limit for derivatives as in the German Pfandbrief Act. It also seems that there is no legal requirement regarding the credit quality of the derivative counterparties. As mortgage and public sector loans tend to be comparably safe, the use of credit derivatives for hedging purposes should not be large.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
Cover assets are to be held in a cover register, and the registers have to be separate for different types of covered bonds. If the bank also issues Pfandbriefe, the cover pools for these are to be held separate from the cover pools for FBSV.

Preferential claim and bankruptcy remoteness
The creditors of covered bonds have a preferential claim on the cover assets. In addition, covered bond creditors rank pari-passu with all unsecured creditors with regards to assets outside the cover pool to the extent if the cover pool is insufficient to satisfy their claims. Assets registered in the cover register are not part of the insolvent estate in case of insolvency of the issuer. The Law on Secured Bank Bonds does not stipulate that FBSV become due in case of issuer insolvency.

In contrast to Austrian Pfandbriefe, the issuers' articles of association may provide for an acceleration of FBSV in case of issuer insolvency. If there are enough cover pool assets, repayment would have to be made at market value, if not repayment would have to be made at par. If there are not even enough cover assets so that the repayment at par is achievable, holders of FBSV would be paid pro rata.

In case of issuer insolvency the bankruptcy court will appoint a cover pool administrator who will manage and run down the cover pool assets and the outstanding FBSV. The cover pool administrator is allowed to take bridge financings to pay claims of FBSV holders as needed. Bridge finance creditors would rank pari passu with holders of FBSV and derivative counterparties.

Hence, bridge financing should be accessible for the cover pool administrator even in case of issuer insolvency.

Legal protection for OC
Unsecured creditors have no access to the voluntary OC before the FBSV creditors are fully satisfied. In case there is a voluntary OC, it is considered insolvency remote.

Risk Weighting
FBSV comply with UCITS 22 (4)/CRD. Hence, they benefit from a 10% risk weighting in Austria and all other European countries acknowledging a 10% risk weighting for covered bonds that are in line with UCITS 22 (4).

LEGAL FRAMEWORK OF AUSTRIAN PFANDBRIEFE

Issue Structure
Austria has two types of covered bonds and three different laws. The two types are Secured Bank Bonds (Fundierte Bankschuldverschreibungen, FBSV) discussed above and Pfandbriefe. Pfandbriefe are issued on the basis of two different laws, the Mortgage Bank Act ('Hypothekenbankgesetz') and the Public Pfandbrief Act ('Gesetz über Pfandbriefe und verwandte Schuldververschreibungen öffentlich-rechtlicher Kreditanstalten'). The Austrian Mortgage Bank Act was established in 1938 with the German Mortgage Bank Act as blueprint.

No specialist banks in Austria
Even though a specialist bank principle is stipulated in the Austrian Mortgage Bank Act, there is no such specialist bank in Austria. There are two issuers that issue Pfandbriefe on the basis of the Mortgage Bank Act, namely Erste Bank and Bank Austria Creditanstalt. Both are universal banks and not restricted in their business activities. When the Austrian Mortgage Bank Act came into effect in 1938, the legal antecedents of these two banks were universal banks and therefore were grandfathered with the introduction of the Mortgage Bank Act. Since then, no further Austrian mortgage bank was founded. A specific Pfandbrief law for Austrian public sector banks (Landeshypothekenbanken, LHB), the Public Pfandbrief Act, came into force in 1927. Hence, in this respect the situation is very similar to the situation in Germany before the introduction of the Pfandbrief Act on 18 July 2005. As a result of the state guarantee mechanisms for Austrian LHB, the details of the Public Pfandbrief Act have hardly played any role so far. The same was the case for Pfandbriefe issued by German Landesbanks under the Public Pfandbrief Act before 18 July 2005.

Pfandbriefstelle as joint issuing institution
Pfandbriefstelle was established 1939 as a funding vehicle for Austrian LHB. The Pfandbriefstelle plays a similar role as the Pfandbriefzentrale in Switzerland for the cantonal banks. As a public entity, the Austrian Pfandbriefstelle has no shareholders, but members (Austrian Landesbanks) which do not contribute any share capital.

Pfandbriefstelle is a public entity with nine member banks, which are:

- Hypo-Bank Burgenland AG
- Hypo Alpe-Adria-Bank AG
- Hypo Alpe-Adria-Bank International AG
- Niederösterreichische Landesbank-Hypothekenbank AG
- Oberösterreichische Landesbank AG
- Salzburger Landes-Hypothekenbank AG
- Landes-Hypothekenbank Steiermark AG
- Hypo Tirol Bank AG
- Vararlberger Landes- und Hypothekenbank AG

Member banks are jointly liable
In case of a default, all these institutions are jointly liable (Gesamtschuldner). Additionally, all member banks – except Salzburger Landes-Hypothekenbank – have a deficiency guarantee provided by their respective federal province.

Because of the EU induced changes in the Pfandbriefstelle Act, the respective liable public authorities are only liable for obligations that arose before 2 April 2003. Furthermore, the guarantors are liable for liabilities that arise between 2 April 2003 and 1 April 2007 only if the agreed terms do not mature after 30 September 2017. Hence, Austrian LHB had more time to prepare for the EU driven abolition of state guarantee mechanisms than their German peers, the Landesbanks, had.

COVER POOL CREDIT QUALITY

Mortgage lending
The value of the property on which the LTV is based must never exceed the resale value of the property. Like in Germany, The LTV is fixed at a maximum of 60% for both commercial and residential mortgage lending under the Mortgage Bank Act. The same LTV of 60% is regulated in the articles of association of the Landeshypothekenbanken, for which the Public Pfandbrief Act applies.

Property valuation
In the property valuation only the durable, non-speculative aspects of the property and the yield which any tenant can permanently ensure by good management may be taken into account. According to the Mortgage Bank Act the value of the property used as a basis for the loan (lending value), may not exceed the market value established by careful assessment.

Whereas the valuation of owner-occupied family houses is predominantly based on the real value, in case of the lending value for commercial premises, office buildings, shops, residential buildings and any other rented premises, the valuer will place more emphasis on the income value. In the event of a default of the mortgage borrower, the bank may take steps to repossess the property. At an enforced auction, the property is sold to the highest bidder. The minimum amount for which the property can be sold is set at 50% of the market value assessed by a valuer appointed by court.

Public sector lending
Public sector lending comprises debt to central governments and sub-sovereign in Austria, EEA countries and Switzerland, as long as debtors enjoy a maximum risk weighting of 20%.

Geographic scope
The geographic scope for mortgage and public sector lending comprises Austria, EEA countries and Switzerland. The volume of loans in countries where the preferential claim of the covered bondholders is not secured is limited to 10% of all mortgage loans.

Substitute collateral
Total exposure to substitute collateral must not exceed 15% of outstanding covered bonds. The allowed substitute assets comprise cash, bank deposits in bank accounts with a zone A central bank or credit institution, bank debentures issued by public-law corporations, and bonds from public issuers from Austria, EEA countries and Switzerland.

Transparency requirements
The Mortgage Bank Act stipulates that Pfandbrief issuers have to publish the outstanding volume of Pfandbriefe and the volume of collateral assets on a semi-annual basis. There are no further material transparency requirements. Nevertheless, in practice, issuers of Jumbo FBSV publish their cover pool data regularly without legal requirement to do so.

Cover pool monitor
The Ministry of Finance assigns the cover pool monitor. The Austrian Financial Market Authority (FMA) is responsible for banking supervision in Austria.

COVER POOL RISK MANAGEMENT

Prepayment risk
Mortgage loan borrowers have the right to prepay subject to prepayment penalties. Only after a period of 10 years in case of fixed rate loans is there a call right without prepayment penalty. In practice, prepayments are low. Floating rate and foreign currency loans play a far more important role in the Austrian mortgage loan market than in the German one.

Matching requirements
Under the Austrian legal framework for Pfandbriefe, the total volume of bonds in circulation must at all times be covered at their nominal value by mortgage loans (i.e. public sector loans in case of public sector covered bonds) of at least the same amount and with at least the same amount of interest payments. The amendment of 1 June 2005 stipulated a mandatory 2% nominal OC in highly liquid substitute cover assets. The articles of association of the respective issuer may provide for net present value cover in addition to cover at the nominal value. The Austrian Mortgage Bank Act and the Pfandbrief Law explicitly forbid the issuers of Pfandbrief to take currency risk.

Liquidity risk
Liquidity risk may be a concern, given the potentially high level of interest rate risk. The amendment of the legal framework on June 2005 introduced the exclusion of set-off for mortgage loans borrowers. The bank has to inform customers that their loans are to be introduced into the cover pool and state in writing that no loans in the cover pool are subject to compensation. Set-off statements of derivative counterparties are admissible when it is about claims and liabilities deriving from the same mater agreement.

Taking derivatives into cover
Interest rate derivatives, currency derivatives and credit derivatives are permitted as cover pool assets. But derivatives are only permitted for hedge purposes. There is no specific limit for derivatives like in the German Pfandbrief Act. Derivatives designated to hedge the cover pool interest, currency and credit risks are permitted to be registered in the cover pool with prior consent of the cover pool monitor. Derivatives must not have an allowance to be terminated in case of issuer insolvency and derivative counterparties rank pari passu with holders of Pfandbriefe.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
Covered bond issuers, i.e. issuers of Pfandbriefe are required to maintain separate cover pools for mortgage and public-sector covered bonds with different cover registers.

Preferential claim and bankruptcy remoteness
The cover bondholders enjoy a preferential claim on the cover assets. Covered bond creditors rank pari-passu with all unsecured creditors with regards to assets outside the cover pool. In case of insolvency, the assets recorded in the stipulated cover register form a special estate for claims of secured creditors. All assets registered in the respective cover pool. The preferential claim is on those parts of the bank's assets that have been declared to serve as cover. In case of insolvency of the issuer, a special administrator nominated by the insolvency court administers the cover assets. This special cover pool administrator is different from the insolvency administrator.

The special cover pool administrator has legal rights stipulated in the legal framework for covered bonds but not in the general bankruptcy regulation. The special cover pool administrator is mandated to manage the cover pool upon insolvency of the Pfandbrief issuer and to organize liquidity management, e.g. bridge financings. These loans would rank pari passu with the claims of the bondholders and the claims under derivatives transactions in the cover register. The special cover pool administrator has the right to sell individual cover assets or make interim financings. Usually claims of the covered bondholders will not become due ahead of schedule.

Under the Austrian legal framework, the special cover pool administrator has the right to transfer the cover pool to another bank. As the cover pool is continued, the covered bondholders receive timely payment of interest and principal. As an alternative to a transfer of the cover pool to another issuer, redemption of covered bonds at the discounted present value is possible. This is allowed if the net present value of the cover pool suffices for complete redemption and if this option is part of the issuer's articles of association. A moratorium scenario is unlikely, as the special cover pool administrator has to use the cash flows from the cover assets for the claims of the covered bond holders (principal and interest). Only if the assets in the cover register are insufficient to satisfy the claims of the bondholders, will the claims of the bondholders be accelerated.

Legal protection for OC
Any OC is insolvency remote, as only those assets in the special estate that are obviously not needed to cover the claims of the covered bond holders (and other respective costs) are passed on the insolvent bank's insolvency estate. As the insolvency administrator has to prove that part of the OC is obviously not needed, which is nearly impossible, any OC, can be regarded as insolvency remote.

Risk Weighting
Austrian Pfandbriefe comply with CRD/UCITS 22 (4). Hence, they benefit from a 10% risk weighting in Austria and all other European countries acknowledging a 10% risk weighting for covered bonds that are in line with CRD/UCITS 22 (4).

Canada

MARKET OVERVIEW

Unlike many European countries, there is no specific legal framework for covered bonds in Canada. In Oct 2007, Royal Bank of Canada (RBC, Aaan/AA-s/AAs) became the first Canadian issuer to tap the EUR Jumbo covered bond market. Bank of Montreal (BMO) followed suit with its covered bond programme and tapped the market in early 2008. Also Canadian Imperial Bank of Commerce (CIBC) tapped the EUR Jumbo market in 2008. Bank of Nova Scotia planned to issue but has not done so due to adverse market conditions. So far, the total volume of EUR Jumbo covered bonds amounts to EUR 8 bn as of 31 Jan 2009.

EUR 6.25 bn of outstanding Canadian EUR Jumbo covered bonds

Ticker	ISIN	Maturity	Coup	Issue date	Volume (bn EUR)	Issue spread
CM	XS0386792286	16-Sep-10	5.25	02-Sep-08	2	+52 bp
BMO	XS0341749116	23-Jan-13	4.25	16-Jan-08	1	+24 bü
RY	XS0340256147	22-Jan-18	4.625	09-Jan-08	1.25	+20 bü
RY	XS0328142715	05-Nov-12	4.5	23-Oct-07	2	+10 bp

Source: Deutsche Bank

Similar to the UK FSA, the Office of the Superintendent of Financial Institutions (OSFI) set issuance limits for covered bonds to protect depositors. In a letter dated 27 June 2007, the OSFI in Canada allowed financial institutions to issue covered bonds up to 4% of their total assets. If at any time after issuance the 4% limit is exceeded, the covered bond issuers must immediately notify OSFI. OSFI further stated that the pledging policies of the issuing entity need to be amended prior to the issuance of covered bonds and that it expects board or committee approval of these specific changes. The detailed rules stipulated by the OSFI were the following:

- Covered bonds must not, at the time of issuance, make up more than 4% of the total assets of the Deposit Taking Institution (DTI). If at any time after issuance the 4% limit is exceeded, the DTI must immediately notify OSFI. Excesses due to factors not under the control of the issuing institution, such as foreign exchange fluctuations, will not require the DTI to take action to reduce the amount outstanding. For other excesses, the DTI must provide a plan showing how the DTI proposes to eliminate the excess quickly.
- Total assets for the purpose of the limit will be equal to the numerator of the asset-to-capital multiple.
- OSFI expects DTIs' current pledging policies to be amended to specifically take into account the issuance of these instruments, consistent with the limits and conditions contained in this letter. OSFI also expects board committee approval of these specific changes prior to the issuance of covered bonds.

CHARACTERISTICS OF CANADIAN COVERED BONDS

The following description is based on the covered bond programmes of RBC and BMO.

Issue structure

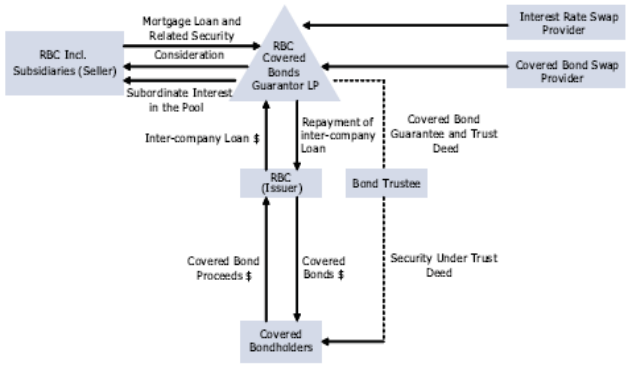
Unlike many European countries, there is no specific legal framework for covered bonds in Canada that prescribes asset segregation upon an issuer's insolvency without having to transfer assets off balance sheet. RBC used a structure similar to the structure of UK covered bonds.

The covered bonds issued by both RBC and BMO are senior unsecured debt of the issuer that have recourse to a portfolio of specific assets through a guarantee in the event of the issuer's default. The issuer is obligated to pay the interest and principal on the bonds. Upon default, the assets specifically pledged are available to repay the covered bonds.

On the closing date, the guarantor i.e. a special purpose entity (Guarantor LP in case of RBC and BMO Covered bond Trust in case of BMO) will use the proceeds from an inter-company loan granted by RBC and BMO respectively to acquire all rights, title, interests in and certain records related to a specified pool of mortgage loans originated by the issuer. The intercompany loan, an interest-bearing facility, is composed of a multi-currency term loan and a demand loan denominated in CAD. The Guarantee Loan balance is equal to the outstanding covered bond balance plus over-collateralisation (as determined by the ACT). The demand loan amount will be a revolving credit facility equal to the difference between the intercompany loan and the term loan at any time.

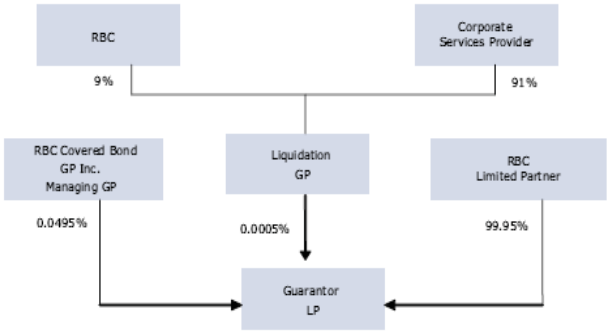
In the case of RBC, the guarantor (Guarantor LP) is a special purpose entity with 99.95% interest held by RBC as limited partner, 0.0495% interest held by RBC Covered bond GP Inc. as managing general partner and 0.0005% interest held by Liquidation GP as liquidation general partner. BMO Covered bond Trust is a special purpose entity established under the laws of the Province of Ontario.

RBC covered bond structure



Source: DBRS

Guarantor LP structure



Source: DBRS

COVER POOL CREDIT QUALITY

On the sale of the mortgages, the issuer represents and warrants that the mortgages comply with its underwriting guidelines, and makes other statements defining the mortgage characteristics. To the extent that these representations and warranties are untrue or incorrect, the issuer will be required to cure the breach, repurchase the relevant mortgages or provide indemnities.

The eligibility criteria are:

- each loan was originated by the issuer in Canadian dollars
- all of the properties are located in Canada
- each loan has a current balance of less than CAD 3,000,000
- each loan has a remaining amortisation term of less than 50 years
- the borrower is an individual and the whole of the outstanding principal balance, interest arrears and accrued interest is secured by a mortgage over a residential property
- each loan is secured by a first mortgage lien
- at least one loan payment has been made
- a valuation report was obtained prior to origination or a valuation was received from an independently maintained valuation model in both cases not older than 12 months
- the property is required to be covered by a buildings insurance policy
- the seller has full unencumbered legal and beneficial title to the loans
- In the event of a breach of the representations and warranties, the seller will be required to repurchase the relevant loan(s)

Substitute collateral

The program also has a provision for substitute collateral i.e if there is no asset coverage test breach notice outstanding, the Trust/Guarantor LP will be permitted to invest in substitution assets, which are subject to certain rating and concentration restrictions and a 10% limit of the portfolio.

Cover pool monitor

The program incorporates an Asset Coverage Test that is calculated monthly by the Cash Manager and monitored by a third-party Asset Monitor. The test is designed to ensure that a minimum level of credit enhancement is available, in the form of overcollateralization. On an ongoing basis the issuer has to ensure that the Asset Coverage Test is met on each calculation date.

If the Asset Coverage Test has been breached, then an Issuer Event of Default will be triggered and the Bond Trustee will be required to serve an Issuer Acceleration Notice on the Issuer, following which the Bond Trustee must serve a Notice to pay on the guarantor, which is a Covered Bond Guarantee Activation Event.

The program also has an amortization test which is calculated to verify whether the amortization test aggregate loan amount of the covered bond portfolio is at least equal to the notional amount of outstanding covered bonds.

Derivatives in cover: Interest rate swap

The Guarantor LP has entered into an interest rate swap agreement with the issuer to swap, on a monthly basis, interest paid on the loans into CAD BA plus a margin. The actual margin will be adjusted depending on the product mix within the cover portfolio, but will have to be sufficient to cover the payments on the covered bonds, the Guarantor LP's senior expenses (conservatively assumed to be at 30 bp per annum) and an additional 2 bp per annum. The swap notional will be the average principal amount of the performing loans in the cover pool

during each preceding monthly calculation period, while the maturity will always be at least the same as that of the longest-maturing asset in the pool.

Derivatives in cover: Cross-currency swap
For each series of covered bonds, the Guarantor LP will enter into a covered bond swap to hedge for currency exchange risk between the Canadian dollar CAD BA flows received from the interest rate swap and the EUR-denominated fixed-rate covered bond. The swap notional will equal the amount of each relevant series of covered bonds. If at any time a swap counterparty is downgraded below A/F1, language is in place whereby the relevant obligations will either be guaranteed by a third party with the requisite rating, transferred to a counterparty with a rating commensurate with Fitch's rating agency criteria or collateralised to prevent a downgrade. If the swap provider is downgraded below F2, a guarantor or suitably rated replacement counterparty would have to be found. As long as the issuer acts as swap counterparty to the Guarantor LP, and for so long as no issuer event of default has occurred, there will be no exchange of cash flows under the covered bond swaps. However, if swap counterparty is required to post collateral to the Guarantor LP, this will be posted in the Guarantor LP's account. The value of the collateral will not be taken into account in the ACT, as it does not secure the payments of the covered bonds, but is a guarantee against a default of the swap counterparty.

The swap counterparties rank senior to the covered bondholders in the order of priority of payments.

Matching requirements
The aggregate principal balance of the mortgage loans acquired by the guarantor, as well as cash and substitution assets, will be at least equal to the covered bonds outstanding subject to the asset coverage test (matching requirement). A dynamic asset coverage test (ACT) is calculated to ensure that sufficient OC is available to provide full repayment of the covered bonds in a AAA stress scenario. Under the ACT of RBC, the ratio of covered bonds to mortgage assets (the asset percentage) can never exceed 97%. The asset percentage as of Oct 2007 was 94.5%, which provides a minimum 5.5% credit enhancement and is sufficient to withstand the agency's AAA stresses. Although the LTV is not capped in the eligibility criteria, the ACT only gives credit to a maximum of 80% of the latest valuation of the properties for uninsured mortgages. The test also accounts for negative carry, and adjusts for delinquent loans.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
The sale of the mortgages to the special purpose entity is on a fully-serviced basis and the issuer is initially the servicer. Prior to the occurrence of a servicer termination event and subject to certain conditions, the issuer is allowed to commingle the collections from the mortgages with its general funds and remit the collections monthly. BMO will remit the collections daily.

Preferential claim and bankruptcy remoteness
Under the Trust Deed, the Trust/Guarantor LP (guarantors), as principal obligors, guarantee the prompt performance by the issuer with respect to the covered bonds (Guarantee). This guarantee is first demand, continuing, absolute, unconditional and irrevocable and secured by the assets of the guarantor (including the portfolio). The occurrence of a default by the issuer is not deemed a default on the covered bonds as long as the Trust/Guarantor LP are able to make timely payment of interest and principal from the proceeds of the portfolio subject to the 12-month extension period for principal.

The guarantor will be entitled to set off amounts paid under the Guarantee against any amounts outstanding under the intercompany loan, first against interest, and then against principal owing on or in respect of the intercompany loan. Upon the occurrence of a trust event of default, the bond trustee is entitled to serve a trust acceleration notice. If such notice is served, all covered bonds outstanding become immediately due and payable.

If the withholding or deduction of taxes, duties, assessments or governmental charges is required by law, the issuer will pay such additional amounts. Under the Guarantee, the guarantor will have no obligation to gross up the payment or pay any such additional amounts. However, interest paid or credited (or deemed to be) on the covered bonds by the guarantor pursuant to the Guarantee will be exempt from Canadian withholding tax to the extent interest paid or credited by the Issuer on such covered bonds would have been exempt.

Risk Weighting
Canadian covered bonds can not meet UCITS 22 (4)/CRD. Hence, the risk weighting under the Basel II/CRD standard approach is in line with the risk weighting of senior bank bonds. However, due to the protection provided by the cover pool, the LGD used in the internal rating based approach (particularly in the advanced internal rating based approach) might be significantly lower than in case of senior unsecured debt.

Denmark

While the Danish domestic covered bond market is one of the biggest in Europe, so far only Danske Bank tapped the EUR Jumbo covered bond market. The total outstanding volume amounts to EUR 2.5 bn as of 31 Jan 2009.

Outstanding issues of Danish EUR Jumbo covered bonds – both issued by Danske Bank

Maturity	Coupon	Supply Date	Outstanding Volume (EUR bn)	Spread at issue versus swaps (bp)
11-Jun-13	4.875	03-Jun-08	1.25	20
14-Apr-10	4.375	07-Apr-08	1.25	10

Source: Deutsche Bank

THE DANISH COVERED BOND LEGISLATION

There were mainly two main reasons for the new Danish covered bond legislation to be introduced in July 2007:

- Commercial banks were not allowed to issue mortgage bonds before. Under the former special banking principle, mortgage banks had an exclusive right to issue Realkreditobligationer (RO) or mortgage bonds.
- Realkreditobligationer are not in line with the Capital Requirement Directive (CRD). Danish Realkreditobligationer meet UCITS 22 (4), but are not in line with CRD. Hence, under Basel I/UCITS 22 (4), Realkreditobligationer (RO) benefited from a 10% risk weighting under Basel I whereas this is not the case under Basel II/CRD.

Universal banks can issue covered bonds

In July 2007, Denmark introduced the new Mortgage Act (also known as the Danish covered bond legislation), thus enabling banks as well as traditional mortgage institutions to issue newly introduced pan-European style covered bonds called Særligt Dækkede Obligationer (SDO), covered bonds which are in line with CRD, in addition to 'old-style' pass-through mortgage bonds .

The general provisions in the new law on covered bonds are also applicable to the covered bonds collateralised by ship mortgage loans. Nevertheless, given the differences between ship covered bonds and mortgage or public covered bonds, ship covered bonds are regulated by a special law (lov om et skibsfinansieringsinstitut). In the following we focus on mortgage and public sector covered bonds.

Issue structure

As in other covered bond legislations, banks and mortgage institutions need a license from the Danish financial supervisory body for the issuance of the new SDOs. This license can be withdrawn if its terms are breached.

The mortgage institutions are able to issue three types of mortgage backed covered bonds – the old RO, Særligt Dækkede Realkreditobligationer (SDRO) and SDO. SDRO satisfy the requirements applying to traditional Realkreditobligationer (RO), but also the requirements that apply to covered bonds under the CRD. One argument for continuing to issue Realkreditobligationer is the eligibility of agricultural sector assets up to a LTV of 70% (that are, however, not CRD-compliant).

RO issued before 1 Jan 2008 are grandfathered and hence UCITS and CRD-compliant if the series were closed for new issuance. RO issued after 1 Jan 2008 are not CRD compliant as they do not fulfil the requirements with regard to the monitoring of LTV and hence do not benefit from a privileged risk weighting.

Universal banks are only allowed to issue SDO. As mortgage institutions also can issue SDO, there is no longer a specialist bank principle in Denmark.

Prepayment risk was passed on to investor

In Denmark, early repayment of the mortgage loan is possible at any time. Under the old Mortgage Act, pre-payment risk of callable mortgage loans was fully passed on to investors through callable mortgage bonds and bond rollovers. The borrower has the right to repay (early) mortgage loans. The borrower can buy back the bonds funding the mortgage directly at the market price and deliver the bonds to the mortgage bank. As the call option is priced in, the risk of early repayment is reflected in the market price of callable bonds.

Under the SDO legislation, long-term callable mortgage loans will still be pass-through products, even under the new General Balance Principle. According to Nykredit, embedding the optionality in the bonds funding the callable loans is still the best way to handle and price the market risks. The borrower's repayment and early redemption rights are unchanged under the SDO framework. The long-term callable mortgage products will most likely not be part of an international funding programme but will continue to be funded in the domestic market in the 'old fasnioned' way.

Two different balance principles coexist

This new Danish balance principle consists of two balance principles – a modified version of the old balance principle ('Specific Balance Principle') and a balance principle similar to other legal frameworks for covered bonds ('General Balance Principle').

Issuers of Danish covered bonds can (in theory) use both balance principles. For example, a mortgage institution can issue 30Y fixed rate callables under the modified version of the existing balance principle and issue noncallable bonds under the EUR covered bond market-style balance principle. For this, the issuer has to set up different capital centres or cover registers. The covered bonds issued under the two balance principles cannot be mixed within one capital centre or cover register. The EUR covered bond market style balance principle can contain existing loan types.

Pass-through products (i.e. 30Y fixed rate callables) can be handled under the general balance principle and can coexist with new products without links between loans and bonds within the same capital centre. High volume within a capital centre is necessary in order to keep the guarantees on new lending within the 15% limit for exposures on other banks.

COVER POOL CREDIT QUALITY

Assets eligible for backing the SDO are similar to those in the guidelines for eligible assets in CRD. Eligibility criteria differentiate the SDO and SDRO, where the assets backing the SRDO are a subset of the eligible assets backing the SDO.

Mortgage lending

There are no geographic restrictions regarding residential and commercial mortgage lending for Realkreditobligationer. Nevertheless, domestic mortgage lending dominates the activities of Danish mortgage banks. The eligibility criteria for SDRO and SDO do not significantly deviate from the criteria for RO. In case of SDO, eligible lending is restricted to the OECD.

A SDO cover pool can include residential, commercial, agricultural and ship mortgage loans. The loans have to be secured by a registered mortgage (or by a registered lien in case of ship loan). Mortgage banks must not issue SDO backed by ship loans). The mortgage has to serves as security for a loan funded by covered bonds. The regulator can give exemptions for loans secured by real estate located outside Denmark. The maximum LTV ratios are 80% for residential mortgages, 60% for commercial mortgages, and 70% for agricultural mortgages.

Maximum loan to-value ratio:

- Residential mortgage loans: 80%
- Agricultural mortgage loans: 60% (can be raised to 70% against additional collateral)
- Ship mortgage loans: 70%
- Commercial mortgage loans: 60% (can be raised to 70% against additional collateral)
- Other mortgage loans: 40%

The 70% LTV limit for agricultural loans can be used only if additional collateral of at least 10% is provided for the part of the loan that exceeds 60% of the value of the property. The 60 % LTV limit of commercial loans may be raised to 70% if additional collateral of at least 10% is provided for the part of the loan that exceeds 60% of the value of the property. Residential mortgage loans with maturity longer than 30 years or interest-only period longer than 10 years have a LTV limit of 70% which is due to be raised to 75% in 2009.

As universal banks (in contrast to mortgage banks) are deposit taking institutions, the covered bonds it issues could potentially be subject to setoff risk. In the first covered bond programme by a universal bank, Danske Bank has initiated measures to reduce setoff risk to a large extent by way of existing Danish borrowers explicitly waiving their right to setoff. In addition, new loans originated after 1 April 2008, will for all relevant jurisdictions (already at inception) include such waiver of set off (However, certain consumer protection and other country specific regulations e.g. applicable for Irish collateral might not allow to fully mitigate the total risk of setoff.

Property valuation

The Danish law specifies property valuation rules that broadly represent a prudent market value approach. In Denmark, the term 'real estate' goes very far. Also fixtures and fittings can (to a certain extent) be included in the valuation of a property.

The value of commercial property has to be reassessed each year. The value of a residential property has to be assessed every third year. In case market conditions change significantly, reassessments must be carried out more frequently and reviewed by a qualified expert. The qualified expert conducting the valuation needs to be independent of the credit granting process of the bank.

Public sector lending

Under the old Danish Mortgage Act, mortgage banks only lend to public sector borrowers in the normal course of mortgage lending, e.g., for social housing projects. Hence, there are no public sector covered bonds in Denmark. Under the new law, SDRO and SDO can be backed by public sector loans.

Public sector credit assets granted to or guaranteed by a public body (central governments, central banks, public, regional or local authority) within the EU.

Bonds or debt instruments (issued or guaranteed) by central governments, central banks, a public, regional or local authority in a country outside the EU, multilateral development banks or international organisations provided their risk-weighting is 0%.

Substitute assets

There are no substitute assets in case of (old) RO. In case of SDRO and SDO substitution assets are limited to a maximum of 15% of the value of the issued covered bonds. Eligible substitute cover assets have to be safe and liquid securities, including government bonds, deposits with central banks or bonds or instruments of debt issued by financial institutions that qualify for up to 20% risk-weightings, and bonds and debt instruments with an original term of 100 days or less, issued by EU-domiciled financial institutions that qualify for up to 50% risk-weightings. Mortgage banks are likely to buy Danish governments bonds as substitute assets.

Substitute cover assets are funded through the issuance of senior debt (also called junior covered bonds, to be discussed later). Excess funds from an issue of covered bonds or via the bank's capital base (at least 8% of the bank's risk-weighted assets and off-balance sheet items). Lenders of senior debt rank below covered bond investors and counterparties of derivatives entered to hedge mismatches between the cover assets and the outstanding covered bonds. Senior debt can only be applied if maximum LTV ratios are breached. The senior debt agreement must state the register, series with a series reserve fund or capital centre for the funds that are to be applied as substitute collateral. These funds must be kept in a separate account, a separate custody account or be marked otherwise from the time the debt is raised; but the funds are not yet used to acquire substitute cover assets. The reason for this requirement is to earmark such assets and funds as collateral for the relevant covered bonds.

Taking derivatives into cover

Danish issuers can make use of derivatives to manage market risks. Derivative contracts can be concluded with suitable counterparties qualifying for a 20% risk weighting under the Revised Standardised Approach. The requirement with reference to the counterparty's risk weighting needs to be fulfilled on an ongoing basis. If the rating of a derivative counterparty affiliated to the issuer falls below a single-A, the regulator may ask for additional substitute cover assets to be provided or for all contracts with that counterparty to be transferred and set up with another counterparty. Claims of derivative counterparties rank pari passu with those of covered bond investors. All derivatives used for hedging mismatches need to be registered in the cover pool.

Cover register

In Denmark, the cover register is not maintained by an independent trustee, but the issuer has the obligation to maintain that register based on requirements set forth by the covered bond legislation and by the DFSA. In Denmark, a register must not include both loans secured by mortgages on real estate and by liens on ships. If an issuer has more than one register, the assets registered in one cover register must not be used to meet the claims secured by assets recorded in another register. Mortgage institutions do not need to have a specific cover register. Mortgage institutions are required to assign cover assets for RO, SDO or SDRO to a series with a series reserve fund or capital centre.

COVER POOL RISK MANAGEMENT

Matching requirements

The nominal and net present value of the cover pool must always exceed the value of the covered bonds.

Commercial banks are not required to maintain minimum capital ratios on a cover pool basis but are required to set internal minimum voluntary overcollateralization limits based on their view of the expected fluctuations in the value of the cover assets and the covered bond prices. E.g., in agreement with the DFSA, Danske intends to maintain a minimum 2% NPV OC for each category of covered bonds. The total capital base of a mortgage bank has to account for at least 8% of its risk-weighted assets and off-balance sheet items (not less than 5m). Every series with a series reserve fund or capital centre has to comply with the 8% capital requirement.

Commercial banks can chose between the general and the specific balance principle. Both balance principles take into account interest rate, currency, and liquidity risks related to mismatches between future cash flows. E.g Danske Bank has chosen to comply with the general balancing principle. The balancing principle can be changed but this must be communicated to investors.

Risk management under the two different balance principles

	General Balance Principle	Specific Balance Principle
Interest rate risk	Risk limit 1% 100 bp shift/twist.50% offset of euro interest rate	Risk limit 1% 100 bp shift/twist. No off set of euro risk.
Exchange rate risk	Risk limit 10% of overcollateralization 10% shift in EU currency/50% in other	Risk limit 0.1% of overcollateralization. Currency risk indicator 2
Option risk	Risk limit 0.5%. 100 bps shift in volatility.	Perfect hedge required
Liquidity risk	Deficits in interest payments may not exceed OC within 12 months plus net present value surplus of all payments.	Deficit limited to 25% of overcollateralization in years 0-3, 50% of overcollateralization in years 4-10, and 100% of OC from year 10 onward

Source: Danske Bank, Deutsche Bank

Liquidity risk

On top of the liquidity requirements mentioned in the balance principle, there are general liquidity requirements. 'Liquidity' is defined as operating cash, deposits with credit institutions and insurance companies, safe and liquid securities (safe and liquid securities are detailed as bank debt, claims on central banks and governments in OECD countries, and claims on multinational development banks) and debt instruments. Liquidity must not be less than 10% of a bank's given undrawn credit lines on call loans granted on overdraft terms that have not been funded by a bond issue. If a bank does not meet this requirement and does not remedy it within eight days from failure, it must inform the regulator DFSA promptly. The regulator will stipulate a new deadline for meeting the requirement. Should this not be met the regulator has the right to revoke the bank's banking licence.

Moreover, on top of the general liquidity requirements and in the balance principle, issuers can include additional measures in their documentation like soft bullet structures (as done by Danske Bank) to reduce liquidity risk.

COVER POOL BANKTUPTCY RISK

Bankruptcy remoteness and preferential claim

If an issuer becomes insolvent, the holders of the covered bonds have a preferential claim on the proceeds arising from the cover assets. Danish covered bonds do not automatically accelerate if the issuer becomes insolvent. Potential costs have to be born by the cover pool and are senior to the holders of the covered bonds. Senior debt holders have a secondary preferential treatment on cover assets, ranking junior to covered bond holders and derivative counterparties but senior to holders of subordinated debt or hybrid core capital. Potential excess after the respective category wind-down will therefore become available for unsecured creditors.

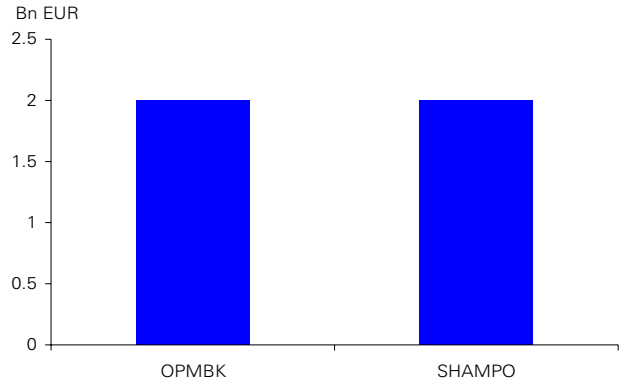
Despite the fact that holders of covered bonds have a preferential claim on cover assets and covered bonds do not accelerate in case of issuer insolvency, there are some differences in the insolvency procedure between banks and mortgage institutions. E.g. in case of a commercial banks, the claims of the covered bond holders not satisfied by the cover assets rank pari passu with those of unsecured creditors. In contrast to this, covered bonds holders of a mortgage institution have a preferential claim versus other creditors.

Finland

MARKET OVERVIEW

After Sampo Bank in 2005, OP Bank Group tapped the EUR Jumbo market in 2007. Aktia regularly issued EUR non-Jumbo issues.

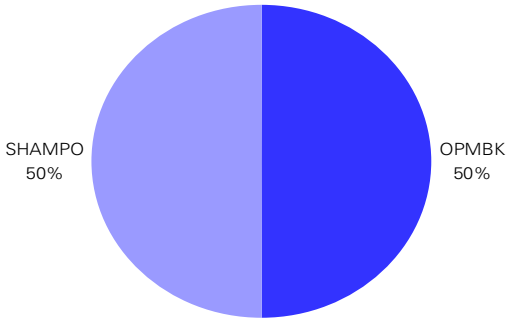
Outstanding volume of Finnish EUR Jumbo covered bonds



Source: Deutsche Bank

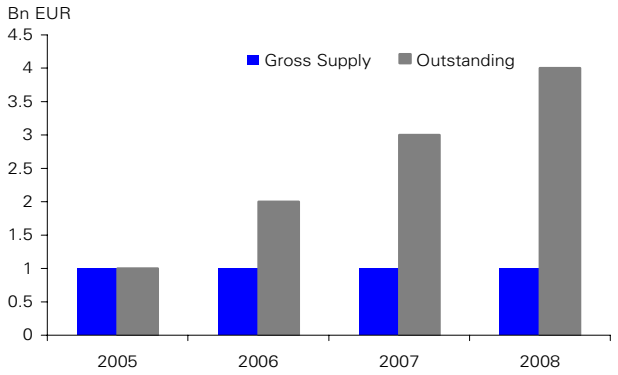
So far there are only four Finnish EUR Jumbo covered bonds outstanding amounting to EUR 4 bn. Given that Sampo will most likely no longer issue Finnish covered bonds (due to their takeover by Danske Bank), its market share is set to decline.

Sampo's market share in the Finnish EUR Jumbo covered bond market will most likely decline



Source: Deutsche Bank

Yearly issuance and outstanding volumes (EUR bn)



Source: Deutsche Bank

LEGAL FRAMEWORK OF FINNISH COVERED BONDS

Issue structure

The Finnish Mortgage Bank Act was amended in 2003 following the disappointing rating agency reactions to the 2001 Mortgage Bank Act. Finnish mortgage banks are specialist banks in the form of limited companies and restricted to a defined number of business activities. Finnish mortgage banks are prohibited from owing other real estate, share and participations beside those necessary for their restricted business. Finnish mortgage banks need a license from the Finnish FSA. They are allowed to issue bonds covered by mortgages, kiinteistövakuudellinen joukkovelkakirjalaina (KJ), or by public sector loans, julkisyhteisövakuudellinen joukkovelkakirjalaina (JJ). The issuing banks hold the cover assets on the balance sheet. Despite strong implicit support, holders of covered bonds do not have recourse to the parent bank of the covered bond issuing specialized bank. In case of OP Mortgage Bank, recourse to assets of all 231 cooperative banks and OKO Bank is stipulated in the Finnish cooperative banking act.

There is no limit on the amount of outstanding covered bonds. Mortgage banks will also be subject to special supervision to ensure they comply with the Mortgage Bank Act.

COVER POOL CREDIT QUALITY

Mortgage lending

A LTV of 60% is applied to all different types of mortgage collateral. If a mortgage loan has a LTV greater than 60%, in contrast to Germany, no part of the loan can be used as collateral for covered bonds. If the house price declines and as a result the LTV ends up above 60%, the loan has to be taken out of the cover pool. However, a loan with a LTV of greater 60% (e.g. 70%) can be used as OC by being registered but not accounted for in the matching

calculations. The total amount of mortgage loans with a LTV of between 60% and 100% is restricted to one-sixth of the total mortgage portfolio. Non-eligible business is restricted to 16.7% of total mortgage loans.

Commercial real estate lending is limited to 10% of the pool. A common feature of the Finnish Mortgage Bank Act and the Swedish legal framework for covered bonds is the possibility to pledge shares in housing corporations as collateral. The shares are quite liquid and provide the holder with a claim on the real estate serving as collateral.

Property valuation
The market value is the basis for property valuation. The Ministry of Finance is responsible for the valuation regulation. Valuations need to be undertaken at least every three years. Moreover, in case of significantly declining property values, new valuations have to be done.

Public sector lending
Loans to public sector entities are eligible as collateral for Finnish covered bonds. Also claims against public law companies can be used as collateral for Finnish covered bonds.

MBS/covered bonds
MBS and covered bonds are not eligible as collateral.

Geographic scope
Finnish covered bonds are secured on real property and public sector loans from within the EU and the EEA.

Substitute collateral
Substitute collateral is limited to (temporarily) 20% of the cover pool. This may only be invested in low risk assets as defined by the law on credit institutions. These are government bonds of the EEA, Finnish public sector organization debt, social insurance institution debt, Finnish municipal bonds and municipal debt of other EEA states that are comparable to Finnish ones. The same holds true for debt issued by credit institutions that are not in the same group as the mortgage bank.

Transparency requirements
The issuer is responsible for the cover pool monitoring and reports this monthly to the FFSA. There are no specific transparency requirements to investors.

COVER POOL RISK MANAGEMENT

Matching requirements
The nominal and the net present value of the cover pool must exceed the nominal value of outstanding covered bonds at all times. Sampo Mortgage Bank and OP Mortgage Bank committed themselves to hold a minimum nominal 5% OC. Aktia has committed itself to hold a nominal OC of at least 4%. The average duration of covered bonds should always be shorter than the average duration of the cover pool. The pool of cover assets and covered bonds should always have positive net interest income in any given 12-month's period, after taking into account any derivative transactions hedging assets or bonds. Cash-flows with floating rate of interest must be stress-tested with a 100 bp parallel shift of interest rate curve up and down. Currency risk has to be hedged. According to the Finnish Mortgage Bank Act, risk reporting procedures must be in place to check the stipulated matching requirements.

Prepayment risk
The conditions for early prepayment are settled between borrower and creditor.

Liquidity risk
Given the restriction on positive net interest income mentioned above liquidity risk is less of a concern in case of Finnish covered bonds. In addition, e.g. Sampo and Aktia have committed themselves contractually to a cash test. At any time there is cash deposited at an eligible bank to cover interest payments under the covered bonds for the immediately following three months (Sampo) or six months (Aktia). Moreover, Sampo Mortgage Bank and OP Mortgage Bank have a soft bullet structure. If the issuers cannot pay the claims of the covered bondholders in full at maturity, the remaining outstanding covered bonds can be extended by 12 months.

Taking derivatives into cover
Finnish issuers enter into swap agreements to mitigate the interest-rate risk stemming from notes paying mainly fixed coupons and the assets yielding variable-rate interest. Derivatives that hedge cover assets will be registered in the cover pool and will be continued in the case of default of the mortgage bank. Beside the fact that derivatives are permitted only for hedge purposes, there are no further restrictions. The counterparty, usually the parent company, is required to put up collateral. In case of insolvency, the swap counterparty ranks subordinated to covered bondholders.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
Finnish mortgage banks are required to keep two separate cover pools and two separate cover registers for public sector and mortgage assets. The segregation of the cover assets from the insolvency estate is a consequence of law, no other steps are necessary.

Preferential claim and bankruptcy remoteness
The creditors of covered bonds have a preferential claim on the cover pools that will be continued in the case of bankruptcy of the mortgage bank. Covered bond creditors rank pari-passu with all unsecured creditors with regards to assets outside the cover pool. In case of bankruptcy of the mortgage bank a special attorney (cover pool administrator) is appointed by the FFSA to represent the interests of the covered bondholders. Covered bonds do not accelerate automatically in case of issuer insolvency.

The bankruptcy administrator may not sell or transfer any cover pool assets without the prior permission of the special attorney and the FFSA. The administrator may, with the permission of the special attorney transfer the cover pool and any connected liabilities to another domestic or foreign mortgage bank subject to supervision comparable to that under the Finnish Mortgage Bank Act.

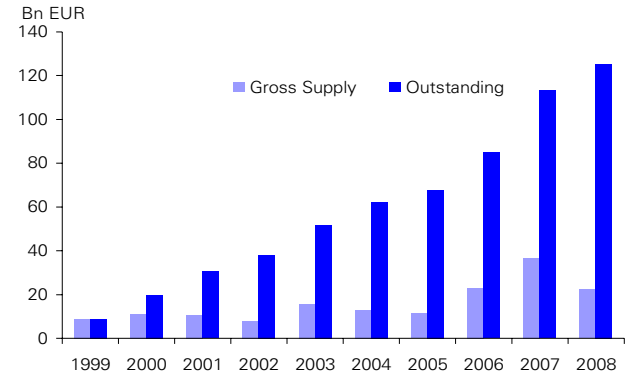
Legal protection for overcollateralization
In case of Finnish covered bonds, OC is legally protected.

Risk Weighting
Finnish covered bonds comply with UCITS 22 (4)/CRD. Hence, Finnish covered bonds benefit from a privileged risk weighting in Finland and in other European countries that acknowledge a 10% risk weighting for UCITS 22 (4) compliant covered bonds.

France

MARKET OVERVIEW

Gross issuance and outstanding of French EUR Jumbo covered bonds



Source: Deutsche Bank

Besides public Jumbo issuance, French issuers (as issuers in other countries) made considerable use of ECB refunding. E.g. Caisse d'Epargne (GCE Covered Bonds) has already 'issued' EUR 21 bn of covered bonds. However, so far, only EUR 1 bn was issued in public Jumbo format. Hence, like in other countries, e.g. particularly the UK, the outstanding volume of French covered bonds grew much more than suggested by publicly issued EUR Jumbo covered bonds only. The total volume of the French covered bond market amounts to EUR 255 bn as of 31 Jan 2009.

Three types of covered bonds in France
Besides Obligations Foncières and structured covered bonds, some French banks can fund mortgage loans via CRH under a special legal framework. Mortgage loans remain on the balance sheet of the participating banks. Whereas Obligations Foncières and CRH's covered bonds are risk weighted with 10%, French structured covered bonds are 20% risk weighted.

Currently, there are four issuers of Obligations Foncières:

- Compagnie de Financement Foncier (CFF)
- CIF Euromortgage (CIFEUR)
- Dexia Municipal Agency (DEXMA)
- Société Generale (SOCGEN)

BNP tapped the market at the end of 2006 with structured French covered bonds outside the legal framework for

Obligations Foncières. Banque Fédérative du Crédit Mutuel (BFCM) did so in 2007 and Group Banque Populaire and GCE Covered bonds (a subsidiary of Caisses d'Epargne et de Prevoyance) issued in early 2008. Credit Agricole Covered Bonds (a subsidiary of Credit Agricole) issued its inaugural issue in January 2009. HSCB France announced a covered bond program in 2008, but has not issued public Jumbos so far. In December 2008 Crédit Mutuel federations, which form the Arkéa Group, announced a structured covered bond program. The issuing bank is Crédit Mutuel Arkéa Covered Bonds, but no public benchmark bonds have been issued so far.

LEGAL FRAMEWORK FOR OBLIGATIONS FONCIERES

Issue structure

The French Mortgage Bank Act of June 1999 grants specialist credit institutions, Sociétés de Crédit Foncier (SCF) the right to issue French covered bonds, Obligations Foncières. SCFs are allowed to engage only in a restricted number of business activities. The law does not set a limit on the issuance of non-privileged debt. The loans are not directly granted by the SCF, but by the respective parent company. The loans are transferred to the SCF from the holding bank with all guarantees attached by a statement established in accordance with Decree No 99-655 dated 29 July 1999. The SCF holds the cover assets on its balance sheet. The legal construction separates the SCF from the holding bank without recourse on the holding bank in case of default. As the SCF has in practice only cover assets on its balance sheet, holders of French OF have limited recourse.

The SCF is not allowed to hold equity interests and has no employees of its own. In compliance with Article L.512-22 of the Code, the administration or recovery of the mortgage loans, similar debts, securities and instruments, the issuance of Obligations Foncières or other facilities must be carried out by a credit institution bound to the issuer by a contract. Generally, these activities are operated by the parent company of the SCF. The issuance structure is somewhat similar to a securitization transaction. However, the SCF has bank status and there is no further transfer of the cover assets to a special purpose vehicle. Like the legal framework for covered bonds in Sweden, the French law makes no distinction between bonds secured by mortgage loans or public sector loans.

Under the French law the transfer of mortgage loans is effective between parties and becomes binding to third parties on the date indicated on the statement as the date of service. This is regardless of the origination date, maturity date or due date of the debts, of the law applicable to debts and the law of the country of domicile of the debtors. These provisions are subject to foreign law applicable to the originator of the mortgage loans or to the loans acquired by a SCF in a foreign country. On April 20, 2007, France published a decree (Ordonnance 2007-571 du 19 avril 2007) to align certain elements of the law on Obligations Foncières with CRD.

COVER POOL CREDIT QUALITY

Mortgage lending

The LTV limit is 60% if the SCF uses residential and commercial mortgage loans as cover pool assets. This limit can be increased up to 80% if all loans of the cover pool are composed of loans granted to private individuals for the construction or the acquisition of housing.

Moreover, the LTV is 80% when the part of the mortgage loan that exceeds the required limit, benefits from the guarantee of a credit institution or an insurance company, and 100% when the mortgage loan benefits from a guarantee of the Fonds de Garantie à L´Accession Sociale à la Propriété (FGAS). The LTV can also be 100% if the part exceeding the prescribed minimum is guaranteed by a public sector entity. The LTV is measured when the mortgage loan is granted by the SCF or at its acquisition by the SCF when another company grants it. The LTV requirements are not applicable when the SCF acquires senior units of securitisation funds.

As indicated above, SCF can also have guaranteed loans on the balance sheet. A financial institution or insurance company providing the guarantee must hold capital of at least EUR 12 m. With the amendment of the legal framework in April 2007, the potential utilization of such loans was increased from 20% (and hence within the limits of substitute collateral), to 35%, increasing the potential use of home loans in cover pools of OF.

Property valuation

The properties financed by eligible mortgage loans in guarantee must be subject to prudent valuation rules. The valuation has to be done by surveyors who are independent of the entity that granted the mortgage loan and applies rules using evaluation principles laid down in legislation (L.515-30 and Réglement n 99-10). The valuation should be based on the properties' long-term characteristics, normal and local market conditions, current and possible use of the properties. The value should not be higher than the current market value. The Specific Controller reviews the property valuations.

Commercial properties have to be evaluated once a year in case the purchase price or the last estimated price is above EUR 450,000 and every three years if the price is below this level or in case of home loans.

The property value of these properties between two valuations and the value of residential properties are calculated annually using statistical methods.

Public sector lending
With the alignment of the legal framework in April 2007, the definition of public assets was changed in a way that public sector exposure ('expositions sur les personnes Publiques') has been replaced by loans ('créances'). However, what will be less restrictive is the broader utilization of other public sector debt and debt stemming from regional authorities ('collectivités territoriales'). Securities have to be bought and held to maturity. SCF are not allowed to actively trade debt securities. Leasing contracts with French public entities may also be regarded as public sector collateral.

MBS/Covered bonds
Senior securitisation units comprising of at least 90% of eligible loans, are eligible as collateral for Obligations Foncières. However, the LTV requirements are not applied. In France, Fonds Communs de Créances (FCC) are the dominant securitization vehicles. The assets are sold to the FCC who finances the purchase by selling shares (units) to investors. But also senior securitization units issued by similar entities in other countries of the EEA, the US, Canada, Switzerland or Japan are eligible as collateral if they consist at least 90% of eligible loans.

Geographical scope
Mortgage loans from France, French Overseas Territories, EEA, Switzerland, the US, Japan or Canada are eligible as collateral for Obligations Foncières. The properties financed by loans benefiting from the guarantee of a credit institution or an insurance company must also be located in these geographical areas. The same geographic scope applies to public sector lending. Also, the securitization units eligible as collateral must be subject to the law of a state belonging to the EEA, Switzerland, the US, Canada or Japan. The legal framework for covered bonds in France is unique as it attaches a weighting to various assets depending either on law or rating, as such an asset can be partially eligible regarding the matching requirement calculation.

Substitute collateral
The SCF is allowed to include substitute collateral in the cover pools. Liquid assets eligible for repo transactions with the ECB, short term claims on banks with a remaining maturity of less than one year and covered bonds issued by other SCFs are allowed as substitute collateral. The replacement values are not allowed to exceed 15% of the total assets of the SCF. Substitute collateral is weighted at only 95% in such a way that the use of substitute collateral introduces OC in the matching requirement calculation.

Transparency requirements
Once a year, 45 days after its annual general meeting at the latest, the SCF must publish a report in the 'Bulletin des announces légales obligatoires' on the nature and quality of its assets and on the level and sensibility of its interest rate exposure. Additionally, the report has to be sent to the French banking regulator. The cover pool composition is also mentioned in the annual and semi-annual report of the SCF. There are no other specific transparency requirements for investors.

COVER POOL RISK MANAGEMENT

Prepayment risk
SCFs are exposed to the risk of prepayment since the French Consumer Code introduced a maximum prepayment penalty of six months interest or 3% of the loan.

Matching requirements
The French law stipulates that the nominal volume of cover assets has to be higher than the nominal volume of outstanding Obligations Foncières at all times. Under French regulation, SCF must manage and cover the risk on its assets, liabilities and off-balance-sheet items (interest rate risk, currency risk, cash flow mismatch between liabilities and assets). SCF must have a system to assess overall interest rate risk under the conditions provided for in article 28 of regulation No 97-02. The documentation and reports must be made accessible to the Specific Controller, to the banking authorities and the auditors.

Taking derivatives into cover
SCF is allowed to use derivatives in order to cover the risk on their assets, liabilities and off-balance-sheet items. The sums due under these derivatives contracts have privileged status. The privileged status does not apply if the derivatives hedge non-privileged claims.

All types of derivatives are allowed, however only if they are used for hedging purposes. Cash or liquid investment-grade securities deposited by the counterparties for the benefit of the SCF can secure derivatives. There is no specific limit for using derivatives in the cover pool like in Germany, where derivatives are restricted to 12% of the cover pool on a net present value basis. The legal framework does not address counterparty risk resulting from derivative exposure.

Liquidity risk
Liquidity risk is not explicitly addressed by the matching requirements that cover cash-flow mismatches. But liquidity risk is of less concern, as beside the matching requirements the SCFs are not allowed to actively trade debt securities.

Cover pool monitor
The Specific Controller (Controlleur Spécifique) is approved by the supervisory authority and chosen from the list of auditors appointed by the company. He is appointed for a term of four years by the company's management, subject to a positive opinion from the banking authorities. The tasks of the Specific Controller are to ensure that the SCF complies with the provisions of the legal framework for Obligations Foncères, e.g. he ensures that the investments of the SCF are in eligible assets only. The Specific Controller checks the conformity of the asset-liability indicators.

The Specific Controller signs off on the reporting schedules submitted to the banking authorities and particularly the semi-annual report of the SCF relating to the coverage ratio. He makes sure that the quarterly issuing programme of the management board does not lower the coverage ratio below the minimum requirement and verifies this for every new issue of Obligations Foncières which amounts to EUR 500 m or above. In accordance with the management of the SCF, he might decide to verify the coverage ratio for issues amounting to less than EUR 500 m. He issues an annual report on his work. The Specific Controller attends shareholders meetings and also reports to the Management Board at the latter's request. He is required to notify the banking authorities of any facts or decisions that make him believe that the SCF may not be able to continue operating as a going concern. Under French law, the specific controller is liable towards both the company and third parties for the prejudicial consequences of any breach or negligence.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
The French legal framework does not foresee separate cover pools for mortgage assets and public sector assets. The assignment of mortgage loans to a SCF is made via notification of the assignee. With the notification, the assignment becomes binding for third parties. A change of the mortgagee in the land register is not required. This regulation overrules only French but not foreign law. Consequently, French cover pools only include domestic mortgage loans (besides foreign mortgage loans which are in RMBS).

Preferential claim and bankruptcy remoteness
The holders of Obligations Foncières have a preferential claim on cover assets. Under the French legal framework the privilege of the holders of Obligations Foncières supersedes all other creditors of the issuer regardless of whether the latter have preferred status or sureties. In particular, the privilege even supersedes that of the public tax administration.

Bankruptcy proceedings or liquidation of a company that holds equity shares in a SCF cannot be extended to the SCF. This is an exception to the general French insolvency law. In case of default of the SCF cover assets and residual sums from derivative hedges taken into cover will be continued and do not become due. No other creditor may satisfy their claims before the creditors of Obligations Foncières have completely satisfied their own claims. The fact that holders of Obligations Foncières have recourse on both privileged and non-privileged assets represent a de facto subordination of all the assets on the balance sheet. As such it is doubtful that the SCF would hold a significant amount of non-cover pool assets on the balance sheet.

Under French insolvency law, payments made by a company on matured debts after the date of suspension of payments and instruments for money consideration concluded after this date may be cancelled if the parties knew about the suspension of payments. These provisions are not applicable to the SCF, or to legal transactions carried out by it or on its behalf, given that such contracts or such transactions are directly related to the object of the SCF. Liquidity can be committed specifically to the cover pool.

The insolvency administrator appointed by the banking authorities, reporting to the specific controller, manages the cover pool. In case of insolvency, the banking authorities appoint the insolvency administrator. There are no specific regulations relating to the sale or the transfer by the SCF of its assets, but the sale of senior units of securitisation funds is easier than the sale of other assets, e.g. mortgage loans.

Legal protection for OC
Since Obligations Foncières holders have a priority claim over all unsecured creditors, French law provides legal protection for any existing OC.

Risk Weighting
Obligations Foncières meet the requirements of UCITS 22 (4) and Basel II/CRD and therefore benefit from a 10% risk weighting in most European countries (under Basel II/CRD standard approach). In Germany, the definition of covered bonds in the German Banking Act (article 20a), does not

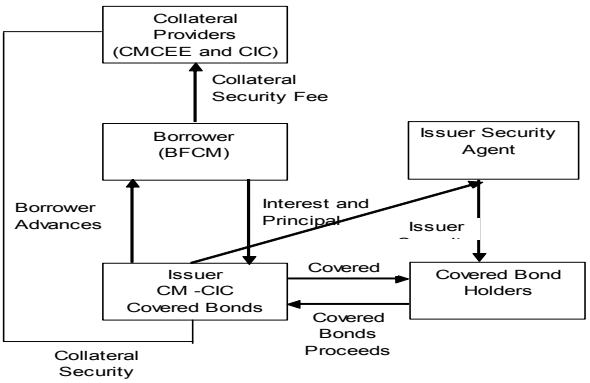
include securitizations as eligible collateral. Hence, French covered bonds with ABS in the cover pool do not qualify for a privileged risk weighting for German risk weighting sensitive investors. In case the ABS are only used to transfer loans inside one banking group, the German regulator may allow these as cover pool eligible.

FRENCH STRUCTURED COVERED BONDS

Issue structure

The issuers of French structured covered bonds are specialized banks solely serving the purpose of issuing covered bonds. Their activities are restricted to the holding of the collateral assets and issuing the covered bonds, and do not have any employees. As there are differences between the structures of French structured covered bonds, a closer look at the respective prospectus seems necessary.

CM-CIC – covered bond structure



Source: Fitch

The covered bonds are direct, unsecured and unsubordinated obligations of the issuer. There is a two-step structure, in which the issuers issue covered bonds whose proceeds are used to fund advances to the borrower. The covered bonds are secured by a pledge over the issuer's assets governed by French law, while the advances are secured by a pledge over cover assets remaining on the borrowers' balance sheet. The security will be created under the provisions of articles L. 431-7 of the French Monetary Code, which were passed in 2005 and which implement the stipulations of EU Collateral Directive 2002/47. The purpose of the Directive is to protect the validity and enforceability of financial collateral arrangements (including the substitution of assets), from the adverse effects of bankruptcy. The issuers are supervised by Banque de France but are not within the scope of the regulations applicable to the issuers of Obligations Foncieres.

Under the borrower facility agreement, the issuer grants advances to the borrower, typically the parent bank, whose terms and conditions exactly match those of the covered bonds, which are, in turn, issued to finance these advances.

COVER POOL CREDIT QUALITY

Mortgage loans and guaranteed loans as collateral

Eligible loans are mortgage loans and loans guaranteed by e.g. Crédit Logement in the case of BNP, Crédit Logement and CMH (member of CMCEE) in case of CM-CICB and Sociétés de Cautions Mutuelles Immobilières (SOCAMI) or CASDEN and Crédit Logement in the case of BPCB.

In addition, the contractually based criteria are e.g.:

- Loans have to be located in the jurisdiction of the originator of the loans
- The loan amount has to be less than EUR 1 m and the LTV ratio may not exceed 100%, whereas only 80% are taken into account in the asset coverage test
- The loan must be denominated in EUR or another specified currency
- The time to maturity must be less than 30 years
- The borrowers may not be employees of the originator
- The loans may currently not be in default
- The loans have to amortize monthly or quarterly
- No amount drawn under the loan is capable of being redrawn by the borrower, except if there is a prior rating agency affirmation
- The borrower under the loan does not benefit from a contractual right of set-off
- CMCICB only allows French collateral and the currency of the loans granted is limited to EUR and CHF.

Substitute collateral

Substitute collateral is typically limited to 20% of the cover pool. There are significant differences in the different covered bond programmes regarding substitute collateral. Hence, investors need to take a closer look at the respective prospectus. Typical substitute assets are e.g.:

- Time deposits, certificates of deposits, long-term and short-term debt obligations (including commercial paper) with a maturity of not more than one year and

a rating of at least Aa3/AA-/--- or P-1/A-1/F1+, respectively.

- Government and public securities with a rating of Aaa/AAA/AAA
- Residential mortgage backed securities (RMBS) with a maturity of not more than one year, which are adequately liquid, and have a rating of at least Aa3/AA-/--- or P-1/A-1/F1+, respectively.

COVER POOL RISK MANAGEMENT

Matching requirements

The portfolio is serviced by the borrower, the parent bank of the issuing specialized subsidiary. Assets that are included in the portfolio backing the covered bonds are provided to a security agent. The programmes incorporate an asset coverage test (ACT) that is calculated monthly for as long as no borrower event of default has occurred. Under this test, the ratio of covered bonds to cover assets may not exceed 92.5%, leading to a minimum mandatory OC of 8.1%. Within the complex calculation of the asset amount only 80% of each mortgage loan or 80% of guaranteed loans are eligible. If the ACT is breached, the issuer is not allowed to issue more covered bonds as long as the ACT is not remedied. If compliance with the ACT is not re-established on the next calculation date, a borrower event of default occurs. Thereafter, no more advances can be made to the borrower and the existing borrower advances become immediately due and payable.

Liquidity risk

A pre-maturity test typically ensures that the issuing entity has sufficient liquidity to settle principal payments and mitigates the risk of a default by the borrower shortly before a hard bullet payment on a covered bond is due. Whenever the borrower's short-term rating falls below P-1/A-1+/F1+ in the nine-month rolling basis before a hard bullet covered bond matures, it will have to post an amount of cash sufficient to cover the relevant covered bond principal payment as well as the related expenses scheduled to be paid by the issuer. Failure to comply with the pre-maturity test results in a borrower event of default.

COVER POOL BANKRUPTCY RISK

Bankruptcy remoteness and preferential claim

According to the documentation of French structured covered bonds, insolvency remoteness is at risk in very few cases:

The issuer is a special purpose entity, with exclusive and limited purpose and a financial institution license and is intended to be a ring-fenced entity that will be unaffected by the insolvency of the Group, in particular by including limited recourse and nonpetition wording in the relevant programme documents'.

The issuer is intended to be a ring-fenced, bankruptcy remote entity that will be unaffected by the insolvency of the Group. Under French applicable law, the issuer's assets may only be 'consolidated' into the insolvency proceedings of any other member of the Group if either (i) there is commingling of its assets (confusion de patrimoine) with the assets of that member of the Group or (ii) the Issuer is a 'fictitious' entity (société fictive).

A default (Borrower Event of Default) would be triggered in case one of the following events occurs:

- default in the payment of interest or principal on any borrower facility, breach of the asset cover test (ACT), breach of the amortization test (AT) breach of the pre-maturity test
- failure to comply with any of the borrowers' material obligations under the Borrower Facility Agreement
- occurrence of a Borrower Insolvency Event
- failure to enter into any hedging agreement within 30 days following a Hedging Rating Trigger Event.

If a Borrower Event of Default is triggered, the specialized covered bond issuing bank is entitled to exercise all rights, actions and privileges with respect to the borrower collateral security assets. This includes that the borrower advances become due and payable and the enforcement of the borrower facility leads to a transfer of the assets.

Following a borrower event of default, an amortization test (AT) has to be conducted. Complying with the AT means that at any AT date the transferred aggregate asset amount must be at least equal to the aggregate amount of principal outstanding. Non-compliance will not constitute an issuer event of default. However, the failure by the issuer to cure non-compliance with the test within the time period of the next test calculation date leads to a borrower event of default. This also triggers an acceleration of payment of all covered bonds.

Upon enforcement of the borrower collateral security, the administrator will take ownership of the residential loans and substitution assets on behalf of the issuer automatically by operation of French law, and notify the debtors to pay the issuer amounts due under the residential loans. The parent bank also acts as the issuer bank account provider and calculates the ACT and the amortization test. Recourse may result from other mechanisms, e.g. the internal financing mechanism in case of Banque Populaires. *The system guaranteeing the liquidity and capital adequacy of the Banque Populaire*

network has been organized under a framework decision by Banque Fédérale des Banques Populaires, in its capacity as central body in accordance with Art. L.511-30, L. 511-31, L. 511- 32 and L. 512-12 of the Monetary and Financial Code to which the bylaws of the Banque Populaire banks make explicit reference (Article 1).

No recourse to the parent bank

The issuer has full recourse against the parent bank. However, according to the prospectus, holders of French structured covered bonds do not have direct recourse against the parent bank of the covered bond issuing bank. This is similar to the structure of OF, where investors also do not have direct recourse to the parent bank. Recourse may result from other laws or internal financing mechanisms like in case of Banque Populaires.

The system guaranteeing the liquidity and capital adequacy of the Banque Populaire network has been organized under a framework decision by Banque Fédérale des Banques Populaires, in its capacity as central body in accordance with Art. L.511-30, L. 511-31, L. 511-32 and L. 512-12 of the Monetary and Financial Code to which the bylaws of the Banque Populaire banks make explicit reference (Article 1).

Risk Weighting

There were press reports that the French regulator may allow a privileged risk weighting also for French structured covered bonds. So far however, French structured covered bonds do not have a privileged risk weighting. Due to the security provided by the cover assets, French structured covered bonds may benefit from a significantly lower risk weighting than senior unsecured bank bonds under the Basel II/CRD internal rating based approach.

Some structural aspects of French structured covered bonds

	BNP CB	CM-CIC CB	BP CB
Collateral assets	Residential mortgages	Residential mortgages	Residential mortgages
Underlying properties	At first, located in France but may be located in other countries (in Italy in the short term with BNL)	Located in France but may be located in other countries	Located in France
Governing law of the assets	At first, French law but may be governed by other laws (Italian law in the short term with BNL)	At first, French law but may be governed by other laws	French law
In arrears	- Loans in arrears are not allowed to be added to the collateral pool - Loans that move into arrears while in the collateral pool remain but are no longer taken into account when computing the asset cover test	- Loans in arrears are not allowed to be added to the collateral pool - Loans that move into arrears while in the collateral pool remain but are no longer taken into account when computing the asset cover test	- Loans in arrears are not allowed to be added to the collateral pool - Loans that move into arrears (over 30 days in arrears) are removed from the collateral pool
House price index	INSEE	PERVAL	INSEE
Asset percentage applied in ACT	92.5% (8.1% OC)	92.5% (8.1% OC)	92.5% (8.1% OC)

Source: Rating agencies, Company data, Deutsche Bank

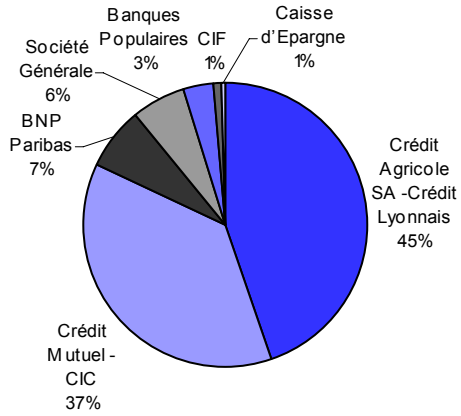
CRH'S COVERED BONDS

…based on a specific legal framework

Caisse de Refinancement de l'Habitat's covered bonds (CRH, Aaa/---/AAA) are not Obligations Foncières and also not French structured covered bonds but based on their own specific legal framework ('Engagement National pour le Logement' Act). Hence, CRH's covered bond issuance is not on a contractual basis but is governed by a specific law. CRH is subject to specific supervision by the Commission Bancaire, the French banking authority. Since its founding in 1985, CRH has issued bonds totalling EUR 50 bn (as of Dec 2007), of which EUR 6 bn were guaranteed by the French government. CRH' debt is rated Aaa by Moody's and AAA by Fitch.

Equity share of the bank depends on outstanding loans

French banks are shareholders of CRH



Source: CRH

Each borrowing bank must supply to CRH the equity capital required under banking regulations. Each year, equity is reallocated to the banks in proportion to their outstanding loans. CRH does not charge fees or interest on its refinancing transactions. It generates income by investing equity capital on the money market, which covers its modest operating expenses of approximately 0.008% of loans in 2006. CRH results are technical and depend largely on prevailing money market interest rates.

Issue structure

CRH's sole function is to refinance first rank residential mortgage loans granted by its participating banks. The refinanced loans remain on the banks' balance sheets, but are pledged as collateral for CRH' s loans to banks. CRH covered bond issues are backed by discountable bills ('billet de mobilisation') issued by the shareholder banks of CRD which in turn get funding from CRH. The discountable bills represent claims on a pool of residential mortgage loans and prêts cautionnes (loans guaranteed by specialized credit institutions). The borrowing banks that are beneficiaries of the funding raised by CRH's issues hold the cover pool.

Cover pool assets – residential home loans, no RMBS

CRH loans are backed by a cover pool (the pledged portfolio) comprising several hundred thousand French residential loans secured by first rank mortgages or, under certain conditions, guarantees. By law neither substitution assets nor assets from countries outside the EU are eligible in the cover pool. In CRH by-laws, only French residential loans with a maturity under 25 years and size under EUR 1 m are eligible in the cover pool. RMBS are not eligible in the cover pool. The total value of the pledged portfolio must equal at least 125% of the total amount of CRH loans (equal to the total amount of CRH bonds).

Matching requirements

The average life of the pledged portfolio must at all times match the residual life of CRH bonds. The average interest rate of the pledged portfolio must equal or exceed that of CRH bonds. If ineligible loans are identified in this pledged portfolio, CRH requires the bank in question to increase the pledged portfolio to compensate for the shortfall identified. If the bank's outstanding loans are insufficient to make up the shortfall, it is required to immediately acquire bonds corresponding to the borrowed funds and deliver them to CRH as repayment. Risk mitigating factors for CRH covered bonds are:

- interest rate risk is limited due to fully matched lending to member banks with issued covered bonds
- no foreign currency risk due to exclusively French loans
- CRH immediately gets full ownership in case of insolvency of a shareholder bank
- CRH does ad hoc audits at member banks, at least every two years
- liquidity risk is limited due to a back-up facility of 5% of borrowed funds from the member banks and a five day in advance payment period for the member banks

Cover pool monitor

CRH audits the portfolio pledged by borrowing banks notably by:

- Monthly electronic audits of the list of pledged loans inside the pledged portfolio
- Regular audits, on a sampling basis, of these pledged loans by a fully dedicated CRH's team carried out at the borrowing banks' offices.
- CRH is also subject to audit by its shareholder Banks

Bankruptcy remoteness and preferential claim

Upon a cover pool default, CRH has recourse to the borrowing bank's insolvency estate, pari passu with unsecured creditors and in the case of CRH's default CRH's bondholders have recourse to CRH's insolvency estate. In the event of default by a borrowing Bank, provisions of the law give to CRH the full ownership of the pledged portfolio, automatically and without any formality and notwithstanding any provisions to the contrary. When CRH becomes owner of the pledged portfolio, CRH may sell the portfolio and use the proceeds to buy and then cancel the bonds corresponding to the loan made to the defaulting Bank. In such a case, CRH may also, if required, call on the banks that are its shareholders to provide cash, in an amount up to 5% of its outstanding loans.

CRH's covered bonds risk weighted 10%

The amendment to article 13 of Act No. 85-695 of 11 July 1985, explicitly stipulates the creditor privilege ('privilège') of CRH investors. This matches the credit privilege granted to Obligations Foncières in article L 515-19 of the French Code Monétaire et Financier. Before the amendment, the French banking supervisory authority had refused to grant CRH bonds a privileged risk weighting, its rationale being that they did not provide for an explicit creditor privilege. The legislator rectified the situation and a formal decision on the part of the French banking supervisory followed in Nov 2006. Hence, CRD covered bonds fulfil UCITS 22 (4). CRH covered bonds also fulfil CRD. Hence, CRH covered bonds benefit from a privileged risk weighting.

Germany

HISTORY OF GERMAN PFANDBRIEFE

The origins of the German Pfandbrief system can be traced back to 1769, when the aristocrats in Prussia found themselves short of credit after the ravages of the Seven Years' War (1756 – 1763). To help them out, Frederick the Great issued a 'Cabinets-Ordre', which laid the foundation for the Pfandbrief system.

On the basis of this royal decree, so-called regional 'Landschaften' were set up in Prussia from 1770 onwards. These 'Landschaften' were compulsory public-law associations of aristocratic landowners in the individual principalities (provinces) of Prussia, which issued debentures to refinance the loans extended to their members. Economically speaking, these debentures more or less corresponded to today's mortgage Pfandbrief, because the creditor acquired a direct charge over one of the estates given in pledge as security through this paper. The Pfandbrief system rapidly spread throughout Europe.

Towards the end of the 19th century, this system was extended to include the refinancing of loans extended to public-sector borrowers and loans guaranteed by public-law institutions and agencies (public loans).

The second key impetus for the development of today's Pfandbrief was the fact that the 'Landschaften' established outside Prussia began to issue Pfandbriefe for which all estates for which they had extended loans were used as a shared collateral pool. However, the loans were still not paid out in cash, but in the form of Pfandbriefe (loans in kind), which borrowers themselves had to place.

Frankfurter Hypothekenbank as first mortgage bank

By senate resolution of 8 Dec 1862, the first German mortgage bank in today's mould was established in Frankfurt am Main – Frankfurter Hypothekenbank (one of the predecessors of Eurohypo). Numerous others were founded in rapid succession in nearly all German States, leading to the existence of 40 private-law mortgage banks at the beginning of the 20th century. From the outset, these mortgage banks focused on real estate finance, with special emphasis on financing residential construction and commercial projects in urban areas, which were growing rapidly on the wings of industrialization.

In 1900, these developments culminated in the passing of the Mortgage Bank Act, which created a uniform, still tried-and-proven legal framework for the organization of a specialized group of credit institutions, mortgage banks, and its hallmark, the Pfandbrief.

Abolition of the specialist bank principle

Since 19 July 2005, the German Pfandbrief Act is in force. Pfandbrief issuers have to obtain a license from the Federal Financial Supervisory Authority (BaFin). The Pfandbrief Act abolished the specialist bank principle so that all banks holding a license are allowed to issue Pfandbriefe. Hence, all of the around 2000 banks in Germany can apply for a Pfandbrief license. New issuers like Hamburger Sparkasse and Deutsche Postbank have tapped the Pfandbrief market.

From a quality perspective, the abolition of the specialist bank principle is compensated for by safeguarding measures like the specific risk management requirements stipulated in the Pfandbrief Act. These measures aim to ring-fence Pfandbrief investors from the risks of a universal bank. The Pfandbrief Act contains a quasi-special banking principle to preserve the Pfandbrief as a business model. All former mortgage banks automatically got a universal bank license.

Even taking into account that the specialist bank principle has been largely undermined in practice the new legal framework resulted in an expansion of the permissible business activities of former mortgage banks.

The Pfandbrief Act introduced eligibility as cover assets for mortgage loans on real estate in the US, Canada and Japan. In the case of public Pfandbriefe, eligibility as cover assets was granted to claims against public-sector debtors subject to a written confirmation that these claims are not 'subject to any defense' on the part of the debtor. Moreover, according to the new Pfandbrief Act, bank bonds are permitted as substitute cover.

Furthermore, under the Pfandbrief Act, the 10% limit on foreign loans, where the preferential claim of Pfandbrief holders is not recognized, no longer applies to EU countries. It is only relevant for borrowers outside the EU, i.e. the US, Canada, Switzerland and Japan. Hence, a maximum of 10% of the loans in the cover pool can be granted in these countries and 90% in EU countries.

PPPs are eligible as collateral for public Pfandbriefe

Under the German Pfandbrief Act, claims against government bodies arising from the financing of public projects by means of public private partnership (PPPs) are eligible as cover assets. Various models can be used for PPP financing. Only some of the claims arising from PPP

agreements (an unconditional and irrevocable guarantee is needed) are eligible as collateral for Pfandbriefe.

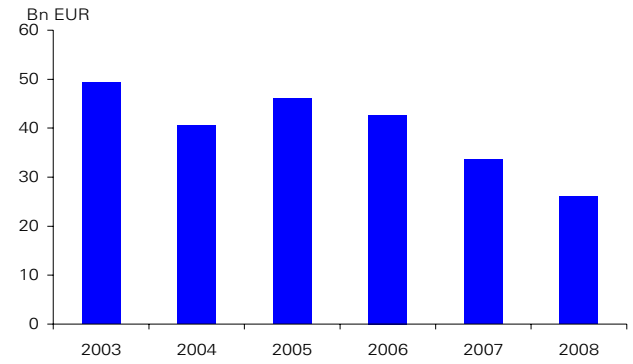
Longer dated mortgage Pfandbrief issuance possible
According to the Pfandbrief Act, mortgage Pfandbriefe with initial bullet maturity without a call right for the issuer longer than ten years are allowed. Under the former German Mortgage Bank Act, only public-sector Pfandbriefe with an initial bullet maturity over ten years had been possible.

GERMAN PFANDBRIEF MARKET OVERVIEW

Outstanding volume of Pfandbriefe declining – due to structural reasons and adverse market conditions
While the volume of public Pfandbriefe is constantly decreasing as a result of the maturing of grandfathered state guaranteed bonds, we expect an even stronger decline in the next two years due to the massively reduced new business of public sector lenders and the fact that most issuers (like Eurohypo, Hypo Real Estate and Depfa) are in restructuring.

Redemptions of German Jumbo Pfandbriefe amount to EUR 58 bn in 2009 (2008: EUR 63 bn). As new issuance will most likely be significantly lower, probably even close to zero, the outstanding volume of German Pfandbriefe is likely about to shrink much stronger than suggested by redemptions of grandfathered savings bank and Landesbank debt alone. As the business model for mortgage Pfandbriefe is likely to be less impacted by increasing funding cost, mortgage Pfandbriefe are likely to play a more important role going forward.

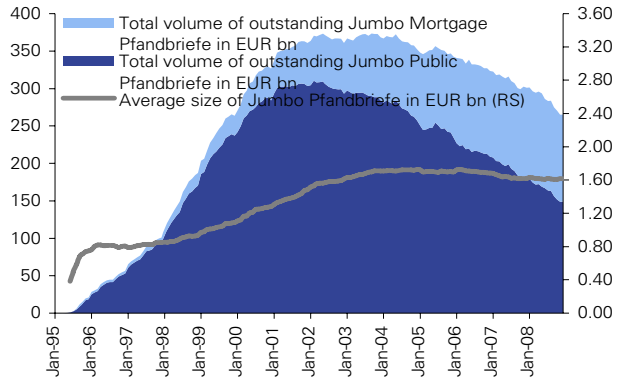
Yearly new issuance volume of EUR Jumbo Pfandbriefe decreased (EUR bn)



Source: Deutsche Bank

Public Pfandbriefe dominate the Jumbo market

Jumbo public Pfandbriefe still dominate (EUR bn)



Source: Deutsche Bank

One reason for the high share of public Pfandbriefe is the high share of loans to public sector banks in the public cover pools of Pfandbriefbanks, former mortgage banks. Debt (loans and bonds) from public sector banks account for 30% of the cover pool of former mortgage banks. In the cover pools of Landesbanks these account for around 50%. Furthermore, loans to federal states account for around 40% of the public cover pools of private mortgage banks. Again, the amount is around 50% in the case of public Pfandbriefe of Landesbanks. Both loan types, though for different reasons, are expected to decline in the cover pools of public Pfandbriefe.

Public Pfandbriefe are expected to decline signficantly
Independent from the financial market crisis, loans to public sector banks in the cover pools should shrink dramatically as a consequence of the abolition of the state guarantee for Landesbanks and savings banks in Germany. Until 18 July 2005, loans to (and bonds from) public sector banks were eligible as collateral for public Pfandbriefe. According to the Pfandbrief Act, claims against public-sector corporations and institutions are eligible as cover assets, provided they are subject to legally enshrined maintenance obligation ('Anstaltslast'), guarantor liability ('Gewährträgerhaftung'), refinancing guarantee or have the legal right to impose fees or other charges. The provision was necessary because guarantor liabilities and maintenance obligations were abolished (since 18 July 2005) to the detriment of various public-sector institutions, notably Landesbanks.

As a result of the high share of state guaranteed loans to public sector banks in the cover pools of public Pfandbriefe which become by 2015 at the latest, the aggregate volume of public sector cover pools is expected to decline significantly in the future. In order to

forecast exactly the future volume of public Pfandbriefe one would need to know:

(1) The average maturity of (grandfathered) bonds and loans to public sector banks in coverpools;

(2) Any compensatory increases in other loans or bonds in the cover pools, for example foreign public-sector lending.

Until 18 July 2005, savings banks had the possibility to refinance granted mortgage loans by issuing savings bank certificates (senior unsecured bonds of savings banks), which have been subject to the mentioned state guarantee mechanisms. As these state guaranteed bonds are eligible as cover assets for public Pfandbriefe, public Pfandbriefe have been indirectly used to refinance mortgage loans. With the loss of the state guarantee mechanisms, newly issued bonds by public sector banks are no longer eligible as collateral. Therefore, we expect that public-sector banks will increasingly issue mortgage Pfandbriefe to refinance mortgage loans going forward.

Pfandbrief issuance from public sector banks to increase

Following the elimination of the maintenance obligation and guarantor liability, the group of Pfandbrief issuers from the savings bank sector will be enlarged. More than 20 savings banks have already made their debut in the Pfandbrief market by issuing Pfandbriefe. Most Pfandbriefe from savings banks have not yet been assigned a rating. As the margins in the public sector lending business are low and savings banks are generally not very active in this business, we do not expect to see a lot of public Pfandbrief issues from savings banks. Regarding the issues of mortgage Pfandbriefe, it is a different story. Besides the direct Pfandbrief issues of mortgage banks, mainly from the bigger savings banks, we see the so-called 'pooling model' as an alternative for mortgage Pfandbriefe issues from the savings bank sector in the future.

LEGAL FRAMEWORK OF GERMAN PFANDBRIEFE

German Pfandbrief Act to be amended in 2009

Liquidity risk is one of the main topics which will be addressed in the upcoming amendment. Pfandbrief banks will be required to cover the maximum cumulated liquidity needs of the cover pool assets within the next 180 days. There will be a 6 month transition period to implement the new requirement.

Aircraft Pfandbriefe will be introduced. As this will be a new asset class which seems in a cyclical low currently, this is not impacting outstanding Pfandbriefe at all. Eligible loans need to be secured by aircrafts which are entered into a register. As in case of mortgage Pfandbriefe, the maximum LTV is 60%.

Some changes are more technical, but will also have consequences for the operating business of Pfandbrief issuers:

- Addressing conflicts between cover register and refinancing register in case of syndicated loans, e.g. the LTV 60% range included in the cover pool can be split between different banks.
- In the event of Pfandbrief bank insolvency, property insurances will be included in the cover pool, even if they are not registered in the cover register. The same will hold true for rents receivable from properties if the mortgages are registered in the cover pool.
- The duration limit for ship mortgages will be increased from 15 to 20 years
- Possibility of fleet financing
- The insurance obligation for ships will be reduced to 110% from 120% of the mortgage loan.
- The cover pool administrator can use the refinancing register to get liquidity in case of insolvency of a Pfandbrief bank.

The amendment of the Pfandbrief Act is likely to become effective in Q2 2009. As the legal framework for Pfandbriefe is perceived as very strong anyway, the market impact should be limited.

Issue structure

The German Pfandbrief Act which came into effect on 19 July 2005 abolished the specialist bank principle and opened the Pfandbrief market to all banks. Hence, the issuer of Pfandbriefe no longer needs to be a specialist bank. There are minimum requirements to get and keep the special license. These are, e.g. a banking license to engage in lending business, a core capital of at least EUR 25 m, specific risk management systems, a regular and sustainable business plan regarding mortgage and public sector lending and its refinancing via Pfandbriefe and the necessary organizational structure. A universal bank with the necessary Pfandbrief license is called a Pfandbrief bank. Already under the old legal framework, mixed mortgage banks issued the majority of Pfandbriefe.

As the German outsourcing guidelines of BaFin do not allow outsourcing of important parts of the business, the issuer of Pfandbriefe needs to have its own employees. In addition, the Pfandbrief Act requires Pfandbrief banks to manage their risk themselves and take loan decisions on

their own. Hence, Pfandbriefe cannot be issued out of a special purpose vehicle. The Pfandbrief bank holds the cover assets on its balance sheet. A transfer of cover assets to another legal entity, e.g. a special purpose vehicle, is also not taking place. A direct legal link between single cover assets and Pfandbriefe does not exist. All obligations from Pfandbriefe are obligations of the issuing Pfandbrief bank as a whole. In the case of insolvency, the cover pool is segregated by law from the general insolvency estate and is reserved for the claims of the Pfandbrief holders. Moreover, Pfandbrief holders have a claim against the insolvency estate.

COVER POOL CREDIT QUALITY

Mortgage lending

A maximum loan-to-value (LTV) of 60% applies to both residential and commercial property. The 60% LTV limit is a relative limit, i.e. when the loan exceeds the 60 % limit, the part of the loan up to 60 % LTV remains eligible as collateral for Pfandbriefe.

Mortgage loans guaranteed by the state can be put either in the mortgage cover pool or in the public sector cover pool. In practice, such state guaranteed mortgage loans are usually put in the public sector cover pool as this leads to cheaper funding.

Property valuation

The Pfandbrief Act refers to the mortgage lending value ('Beleihungswert') as opposed to the market value. German law provides guidance to Pfandbrief issuers on the valuation of real estate. Usually, the mortgage lending value to which the LTV applies will be distinctly lower than the market value of the property. When establishing the mortgage lending value only the permanent features of the property and the yield that can be ensured on a long-term basis by proper management can be taken into account.

Details about the valuation process and the qualifications of valuers are regulated in secondary legislation on the mortgage lending value ('Beleihungs-wertermittlungsverordnung'). Monitoring requirements result from the Capital Requirement Directive (CRD): once a year for commercial real estate and once every three years for residential real estate. In addition, the secondary legislation in Germany requires a review of the underlying assumptions when the market declined significantly. A review of property values is also necessary when the mortgage loan has defaulted. Moreover the German secondary legislation requires personal and organizational independence of the valuer. At least every two years, the regulatory BaFin examines the cover pool and the cover register.

Ship lending

To cover the ship Pfandbrief, a mortgage claim has to be covered by a first-order ship mortgage:

- Only ships and unFinnished ships which are registered in a public domestic or non-domestic register of shipping are eligible
- Mortgaging is limited to 60% of the lending value. BaFin has defined the method of how to asses the lending value through a separate value estimation regulation. The principles of the calculation of the ship mortgage lending value are methodologically comparable to the mortgage lending value of real estate properties
- Only repayment mortgages are eligible where the repayments have to be made regularly within a maximum time of repayment or term of the loan of 15 years. The repayments have to be distributed among the single years.
- Mortgaging has to end with an age of the ship of 20 years. A usual lifespan of a ship is assumed to be between 25 and 30 years, depending on the type of ship and maintenance measures

Ships that are registered in a non-domestic register of shipping are also eligible, according to the criteria in the Pfandbrief Act:

- Rights on ships within the EU or in countries outside the EU where the priority of Pfandbrief creditors in case of an insolvency are secured, are eligible for the cover pool without limitations
- If the priority for Pfandbrief debtors in case of an insolvency is not secured, then rights on ships in countries outside the EU, are only eligible up to 20% of the volume of ship mortgage loans where the priority rights are secured

Major shipping registers

Major EU registers of shipping	Major non-EU registers of shipping
Germany	Liberia
Cyprus	Marshall-Islands
Malta	Panama
Greece	Antigua-Barbuda
UK	Hong Kong
Netherlands	Bahamas
Italy	
Sweden	

Source: Deutsche Schiffsbank, vdp – The Pfandbrief 2006

Ship mortgages are mostly floating-rate agreements, and therefore may be repaid in part or as a whole on every adjustment date. A large proportion is granted in foreign

currencies, often with the possibility to switch currency on every adjustment date.

Public sector lending
Public sector lending may either be conducted via the granting of loans or the purchase of bonds. Central governments, other public sector entities and institutions guaranteed by one of these government entities whose BIS risk-weighting does not exceed 20% are eligible as collateral for public Pfandbriefe. Article 20 of the German Pfandbrief Act regulates which assets are eligible as collateral for public Pfandbriefe.

Geographical scope
Cover pool eligible mortgage and public sector lending is restricted to the EU, the EEA, the US, Canada, Japan and Switzerland. The German Pfandbrief Act imposes a 10% limit on foreign mortgage and public sector lending activities where the priority claim of the Pfandbrief holder is not guaranteed in case of ship Pfandbriefe, this restriction is 20%). Currently, the '10% limit' applies to USA, Canada, Japan and Switzerland. According to legal opnions on behalf of the Association of German Pfandbriefbanks (vdp), there is the possibility of a contractual arrangement such that US mortgage and public sector lending, Japanese public sector lending and Swiss public sector lending is exempt from the 10% limit. So far, no German Pfandbrief issuer has made such contractual arrangements for US and Japan and only one issuer seems to work on it regarding Switzerland. Hence, even though this may change going forward, against the backdrop of increased unsecured funding costs. However, in the short term, it seems unlikely that US, Canadian, Japanese and Swiss exposure will be significant in cover pools of German Pfandbrief issuer.

Under the former Mortgage Bank Act, the volume of loans not securing Pfandbrief holders' preferential claim was limited to 10% of the cover assets. In the meantime protection of Pfandbrief holders' preferential claims can generally be assumed for collateral located in EU member states. Article 9 of Directive 2001/24/EC on the reorganization and winding-up of credit institutions stipulates that only judicial authorities of a bank's home member state shall be empowered to decide on the opening of insolvency proceedings concerning said bank's assets.

Pursuant to article 10 of the Directive, the law of the bank's home member state shall be applicable to these uniform proceedings. This means that a Pfandbrief issuer would always be wound up in accordance with German insolvency law in the event of bankruptcy. Hence, Pfandbrief holders' preferential claim would be secured. With the passing of the above-mentioned EU Insolvency Directive in the individual countries, the grounds for the 10% rule no longer apply in EU member states. Therefore, the hitherto valid 10% lending limit would have been restricted to non-EU countries within the framework of the Mortgage Bank Act, too. Under the Pfandbrief Act, EU member states are exempt from the 10% clause. Given the enormous differences between individual EU countries, notably between old and new EU member states (and the fact that not all countries may have introduced the EU Directive into national law), this may be regarded as a risk.

MBS/covered bonds
MBS are not eligible as collateral for Pfandbriefe. One reason is to make sure that only mortgage loans based on the conservatively calculated mortgage lending value are used as collateral for mortgage Pfandbriefe. Covered bonds are not eligible as ordinary collateral for Pfandbriefe. Like other bank bonds, covered bonds (issued by banks) are eligible as substitute assets for Pfandbriefe.

Substitute collateral
Up to 10% of the nominal cover pool volume of the outstanding volume of Pfandbriefe may consist of claims against the European Central Bank or central banks in the European Union or against suitable credit institutions. A suitable credit institution is defined as a bank with good credit quality allowed to take deposits. Up to 20% in total of the nominal volume of the collateral pool may consist of cover assets suitable for public Pfandbriefe (claims against public sector institutions).

Transparency requirements
The amount of outstanding Pfandbriefe, the maturity structure, the amount of cover pool assets on a nominal and on a net present value basis, and the fixed interest periods all have to be disclosed on a quarterly basis. Also, the stressed net present value of outstanding Pfandbriefe, the cover pool, and the OC has to be published on a quarterly basis. Moreover, the amount of non-performing loans (loans more than 90 days in arrears) has to be published quarterly, split-up by countries.

In addition, the percentage of derivatives in the cover pool has to be published on a quarterly basis. The annual report has to disclose the number of foreclosure procedures and property takeovers. Moreover, the amount of loans in arrears has to be published on a yearly basis.

COVER POOL RISK MANAGEMENT

Prepayment risk
The cash flow mismatch between mortgage loans and mortgage Pfandbriefe is reduced by the prepayment rules

applicable to fixed interest rate mortgage loans. Prepayments of mortgage loans during fixed rate periods are only permitted in cases of legitimate interest of the borrower (without prepayment penalty) or after a period of ten years at the earliest. If the mortgage loan is prepaid, the borrower has to fully compensate the mortgage lender. Prepayment penalties tend to be high and consequently actual prepayments are low. In public sector lending the right to early prepayment can be ruled out for more than ten years.

In Germany early repayment is always possible after the initial fixed rate period. Prepayment during this fixed period is also possible but only under specific conditions which include: 1) house sale or 2) if the borrower wants to increase his loan, but this is refused by the existing lender. The borrower then has the option to repay early and take out a loan with another lender. Thus, in Germany early repayment regulations reduce some of the risks associated with long term fixed rates for lenders and therefore enable lenders to offer a greater range of long term fixed rate products.

Mortgage Pfandbriefe with bullet maturities longer than ten years are allowed if issuers comply with the matching cover criteria. Because of the matching criteria with regards to the cover pool, we do not expect a lot of issuance with maturities longer than ten years.

Matching requirements
The nominal value of the cover assets must permanently be higher than the respective total value of the Pfandbriefe (nominal matching calculation) and the interest yield (interest payment calculation) must at least be the same. The Pfandbrief issuer has to provide an OC of at least 2% on a net present value basis. Interest rate and foreign currency stress tests stipulated in a secondary legislation ('Net Present Value Regulation', 'Barwertverordnung') have to be carried out weekly.

Taking derivatives into cover
Interest rate and currency derivatives can be taken into the cover pool. Derivatives registered in the cover register must not have termination clauses in case of issuer default. Thus in case of insolvency of the issuer both the cover assets and the cover asset hedge contracts will be continued. Accordingly, the German master agreements for cover derivatives stipulate that the insolvency of the Pfandbrief issuer does not mark a termination event.

Derivatives must not exceed 12% on a net present value basis of (1) the cover assets if the hedge results in a claim and (2) the outstanding volume of Pfandbriefe if the hedge results in a liability. The 12% limit is not relevant under the interest rate and currency stress tests. Deregistration of derivatives in the cover register is only possible with consent of the cover pool monitor and the derivative counterparties. In case of issuer insolvency, derivative counterparties have claims ranking pari passu with claims of Pfandbrief holders.

According to the German Association of Pfandbriefbanks (vdp), credit derivatives are not eligible as collateral for Pfandbriefe. Only certain kinds of credit linked notes, i.e. credit derivatives that are in form of a bond, may under certain conditions be eligible as collateral.

Cover pool monitor
A cover pool monitor ('Treuhänder') supervises the cover pool. He is appointed by BaFin and must possess the expertise and experience necessary to fulfil all duties. The qualification as certified auditor suggests that the necessary expertise is given. The cover pool monitor has to ensure that the prescribed cover for the Pfandbriefe exists at all times and that the cover assets are recorded correctly in the cover register. Without his approval, no assets may be put in or removed from the cover pool. Generally, the cover pool monitor has more a formal than a material function.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
The cover assets are segregated from all other balance sheet assets and held in the respective cover pool (mortgage, public, ship). Cover assets must be listed in separate cover registers. A cover pool monitor ('Treuhänder') oversees the adherence to regulation in respect of the cover pools. The legal effect of registration of cover assets in cover register is that in the case of the issuer's insolvency, the assets which form part of the separate legal estate ('Sondervermögen') can be identified: All values contained in the cover register would be qualified as part of the separate legal estate. The cover pool is a part of the general estate of the bank as long as the issuer is solvent.

Preferential claim and bankruptcy remoteness
Pfandbrief holders have absolute priority on the claims in the cover pool and rank pari passu with unsecured creditors for assets outside the cover pool. Pfandbriefe do not automatically accelerate when the issuer goes insolvent. Once the insolvency proceedings start, the assets recorded in the cover registers are legally separated from the insolvency estate. The cover pool assets will not be affected by the insolvency proceedings, but form a separate legal estate without necessary further legal action. A special cover pool administrator ('Sachwalter') will be named by the insolvency court.

With the appointment of the cover pool administrator by the court, the right to administer, manage and dispose of the assets registered in the cover register will be transferred to him by law. Fees that have to be paid to the cover pool administrator rank senior to the Pfandbrief holders. BaFin has the right to appoint the cover pool administrator even before the start of the official insolvency proceedings.

As long as the cover pool as a separate legal estate has sufficient liquidity, a moratorium on the insolvency estate cannot delay the cash flows and, therefore, put the timely payment of Pfandbrief holders at risk. Only in the case of over-indebtedness or insolvency of the cover pool could a special insolvency procedure on the cover pool and the covered bonds be opened. Before starting this insolvency procedure, the BaFin could pronounce a 'moratorium' according to the German Banking Act and take measures with respect to individual cover pools. Insolvency of the cover pool is the only reason that could trigger acceleration of the Pfandbriefe.

In case of insolvency of the issuer, the cover pool administrator may transfer all or a part of the assets registered in the cover register as well as the outstanding Pfandbriefe entirely or in part to another Pfandbrief bank. This transfer requires the prior written approval of the supervisory authority. The cover pool administrator may also agree with the other Pfandbrief bank that the insolvent bank's cover pool administrator continues to manage the insolvent bank's cover assets in trust for the other Pfandbrief bank.

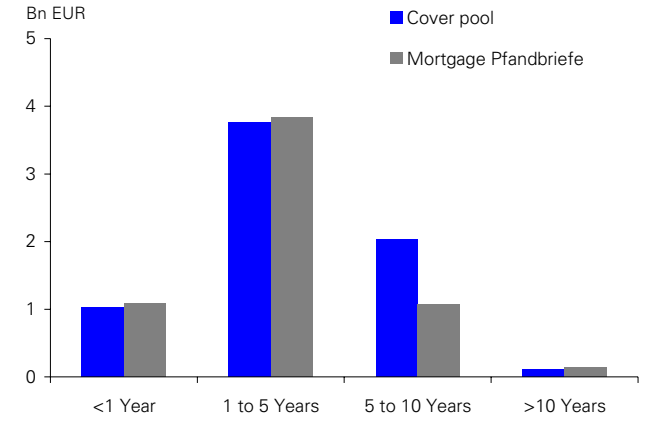
Legal protection for OC

There is a 2% OC in German Pfandbriefe. That 2% minimum OC is legally protected until the last Pfandbrief has been redeemed. In our view, even voluntary OC is legally protected.

OVERVIEW OF PFANDBRIEF COVER POOLS' ASSET LIABILITY MISMATCH

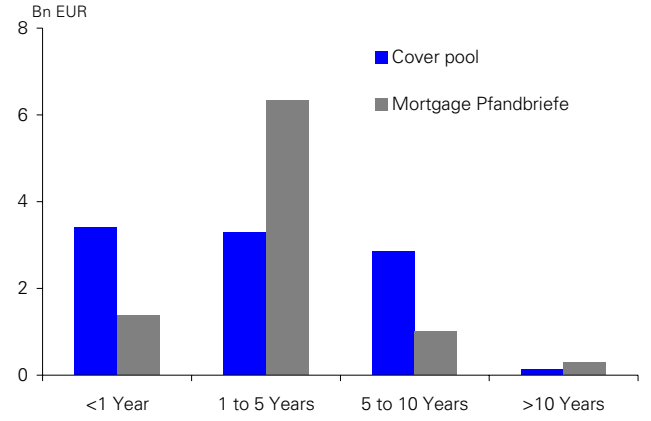
It has to be taken into account that some issuers do not publish maturity brackets of assets but interest rate fixing periods. Hence, the asset liability profile is likely to be worse, particularly in case of mortgage Pfandbriefe, than suggested by the published figures. The following data is based on the latest data available in Fitch covered bond database of 31 Dec 2008.

Aareal Bank mortgage Pfandbriefe



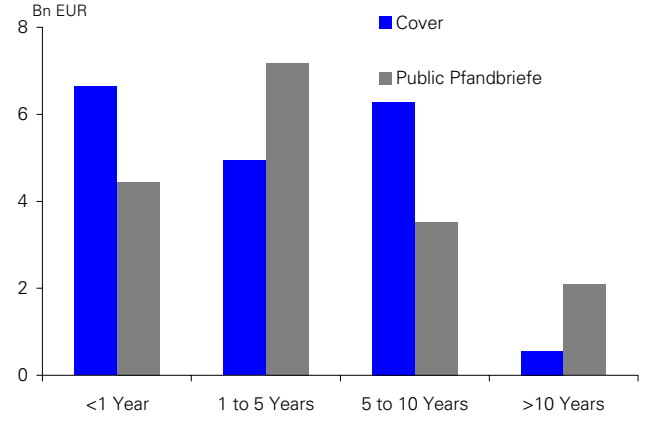
Source: Company data, Deutsche Bank

BHH mortgage Pfandbriefe



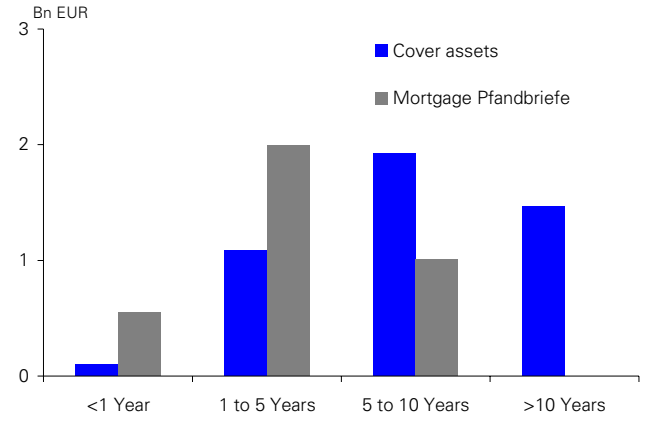
Source: Company data, Deutsche Bank

BHH public Pfandbriefe



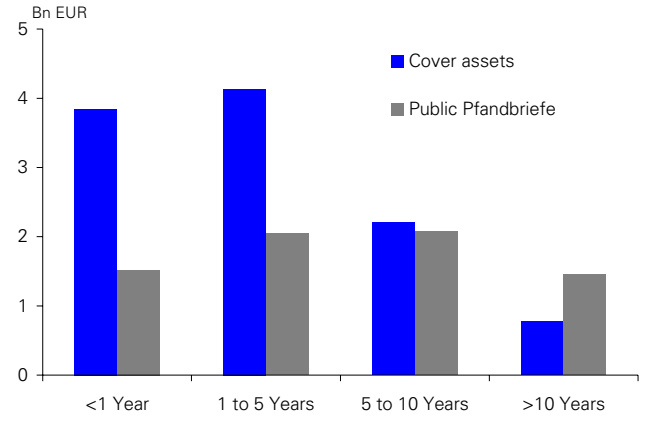
Source:Company data,, Deutsche Bank

Deutsche Postbank mortgage Pfandbriefe



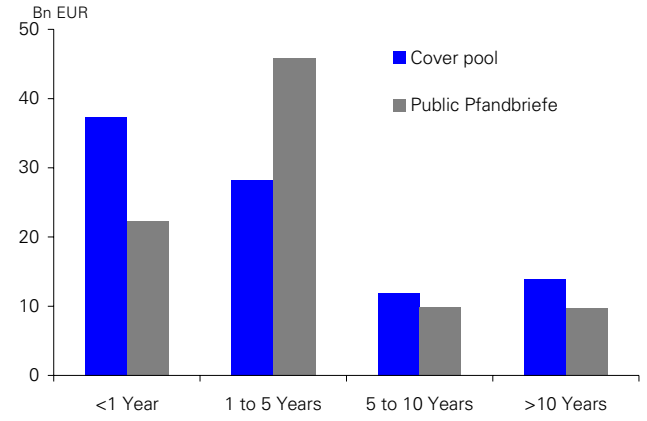
Source: Company data, Deutsche Bank

HVB pubic Pfandbriefe



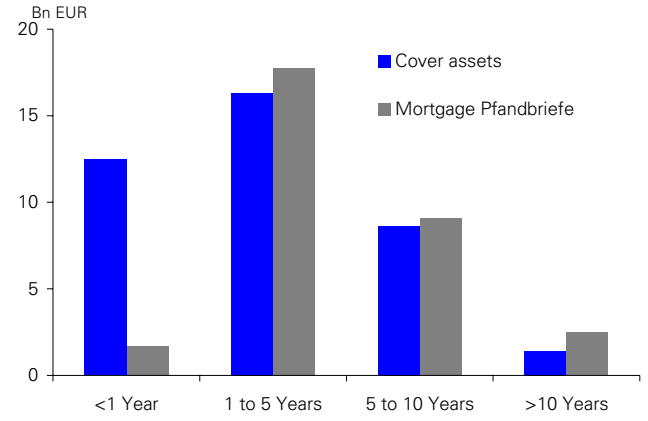
Source: Company Data, Deutsche Bank

EURHYP public Pfandbriefe



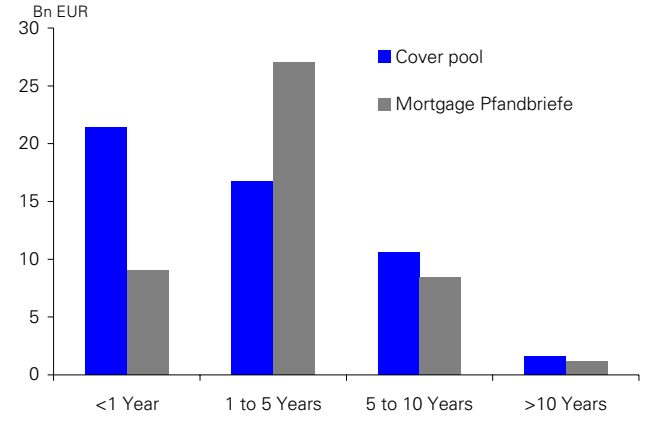
Source: Company data, Deutsche Bank

HVB mortgage Pfandbriefe



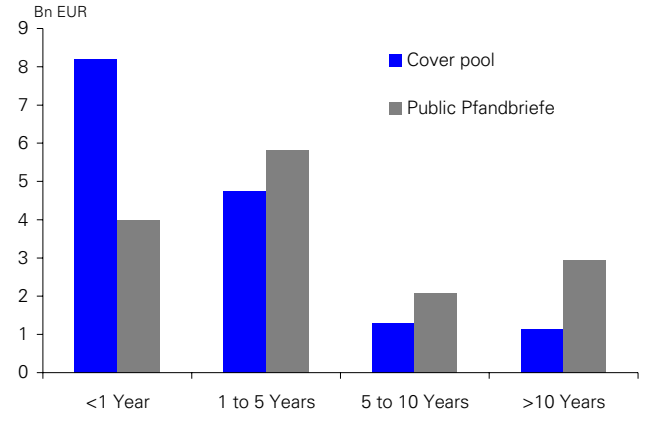
Source: Company data, Deutsche Bank

EURHYP mortgage Pfandbriefe



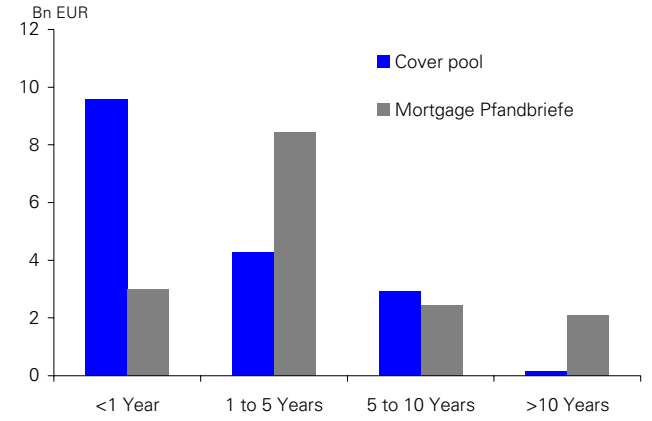
Source: Company data, Deutsche Bank

HYPORE public Pfandbriefe



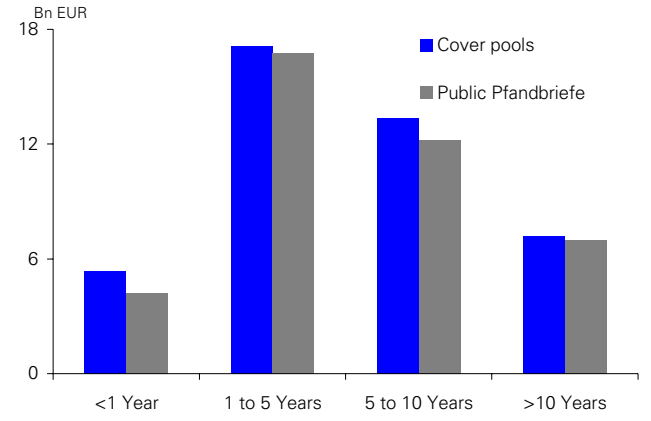
Source: Company data, Deutsche Bank

HYPORE mortgage Pfandbriefe



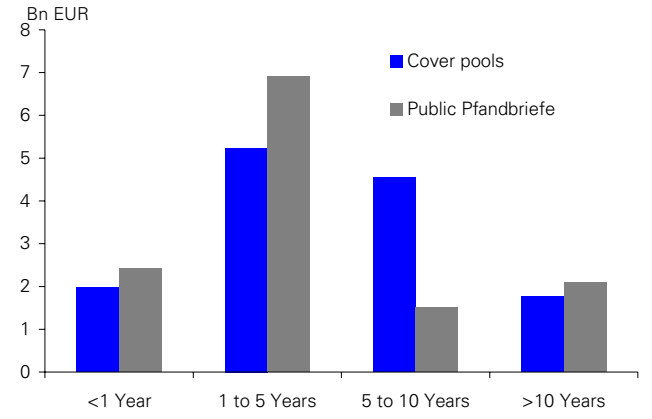
Source: Company data, Deutsche Bank

DGHYP public Pfandbriefe



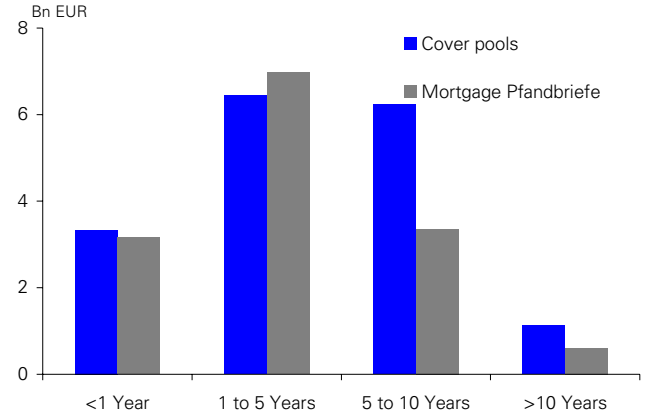
Source: Company data, Deutsche Bank

MUNHYP public Pfandbriefe



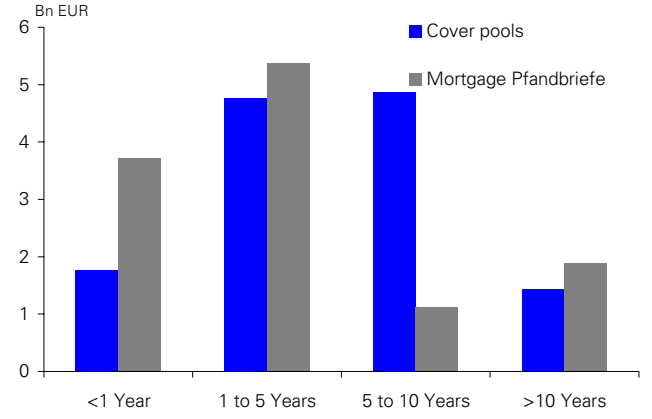
Source: Company data, Deutsche Bank

DGHYP mortgage Pfandbriefe



Source: Company data, Deutsche Bank

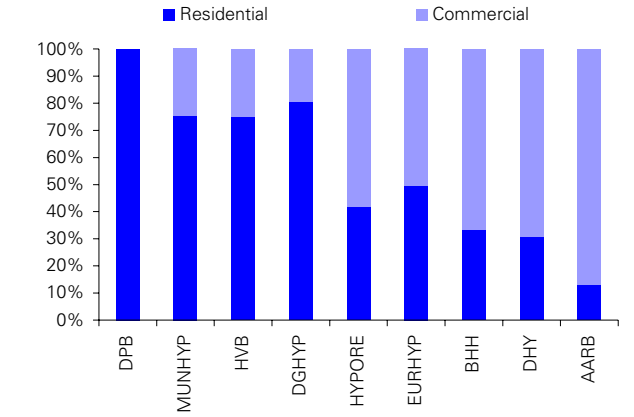
MUNHYP mortgage Pfandbriefe



Source:Company data, Deutsche Bank

A lot of Pfandbrief issuers have considerable commercial exposure. E.g. EURHYP has EUR 24.87 bn of commercial exposure in their mortgage cover pool. In absolute terms this is the highest commercial exposure. In relative terms, other Pfandbrief issuers have even more commercial mortgage loan exposure.

German Pfandbrief pools are heterogeneous – much more commercial exposure than widely percieved



Source: Company data

REGULATIONS FOR GERMAN PFANDBRIEF INVESTORS

Among the most important investors on the German bond markets are:

- Banks
- Insurance companies
- Pension funds
- Investment funds
- Central banks
- Home loan banks (Bausparkassen)
- Other institutional investors

Institutional investors are typically subject to regulation, limiting their possible types of investments or setting caps for amounts invested. The regulations have in common that UCITS 22 (4) compliant covered bonds are privileged compared to unsecured securities.

Regulations for insurance companies

German insurance companies are subject to supervision, which is represented by the 'law on Supervision of Insurance Companies' (VAG). The VAG specifies investment guidelines for the fixed capital of these companies in article 54. Insurance institutions have to invest in a manner that safeguards the security, profitability and liquidity of the company, taking into account a reasonable diversification. Furthermore, article 54 II VAG limits the possible forms of investment for fixed capital and article 54 III VAG points to the decree on investments for insurance companies ('Anlageverordnung', AnlV), which has more detailed guidelines concerning:

- Means of investment
- Limits on investment size
- Diversification
- Congruence
- Location and
- Asset and risk management

Approved forms of investment are specified in article 1 Anlageverordnung (AnlV). Among the approved forms of investment are covered bonds, with special prerequisites like the ones set out in Undertaking for Collective Investments in Transferable Securities, UCITS 22 (4) concerning supervision of the issuer and the preferred claim regarding the cover pool assets has to be fulfilled. Room for decisions is granted by the so-called 'opening clause', which grants investors the possibility to invest a certain percentage of the fixed capital independent of the regulations of the AnlV. Debentures are treated in a special way when it comes to concentrations on single borrowers. Up to 30% of the fixed capital may be invested in securities of a single issuer of covered bonds. Other forms of investment may only amount up to 10% of the fixed capital. Per definition, pension funds are by law independent life insurance companies, therefore the regulations of the VAG are applied.

Regulations for credit institutions

For banks, covered bonds are preferred within the regulations for large sized loans (Groß- und Menkredite). Covered bonds do not have to be considered for the calculation of the utilization of the large loan size limits. Covered bonds typically have a privileged (10%) risk weighting (under the Basel II/CRD standard approach) compared to the 20% risk weighting of unsecured debt. Covered bonds are eligible collateral for ECB refinancing transactions.

Relevant regulations for investment funds

Investment funds are subject to supervision of the Federal Financial Service Supervisory Authority (BaFin). Since the end of 2003, the regulations of the 'Investmentgesetz' (InvG) are binding. For investments in covered bonds, it specifies listing and diversification requirements. Securities purchased by investment funds for their investment funds have to be listed on an official market or have to be included in an organized market. Article 52 InvG is an exception, allowing 10% of the fixed capital to be invested in securities not listed on an official market or included in an organized market. There are regulations regarding the diversification of investments. Covered bonds are an exception as up to 25% of invested assets may consist of securities of a single issuer. Nevertheless, if this rule comes into play and more than 5% of fixed assets are invested in covered bonds of a single issuer, the total value of these covered bonds may not exceed 80% of the total volume of the investment fund. Article 64 InvG limits investments in single issuers, as an investor may only own up to 10% of the issuer's outstanding securities.

Relevant regulations for home loan banks

For home loan banks, the home loan bank law (Bausparkassengesetz, BauSparkG) is binding. According to this law, free capital can generally be invested in bearer bonds. Investments in bearer bonds are only applicable if the unregistered bond is accredited to an official or organized market in the EEA (European Economic Area).

Greece

GREEK COVERED BONDS

Already in 2007, Greece introduced a new legal framework for covered bonds substituting Law 3221 (8th Presidential Decree of 22/30 Sept 1931). Due to the adverse market environment there was no publicly issued Greek EUR Jumbo covered bond so far. All issues were done for direct or indirect ECB lending. Given the significant widening of Greek sovereign spreads versus Bunds this is unlikely to change anytime soon.

Issue structure
The legal framework for Greek covered bonds is part of the new Greek Banking Law (Article 91 and 92 refer to covered bonds). Typical for covered bonds, the cover pool is dynamic, i.e. cover pool assets can be substituted.

In Sept 2007, the Greek central bank published the secondary legislation on the Greek Covered bond Act. According to it Greek banks can issue covered bonds in two ways:

- Keeping the cover loans in their own books and issue covered bonds to refinance them.
- Selling the cover loans to a SPV which in turn issues coverd bonds. The SPV must be guaranteed by the bank and must be a subsidiary of it.

The Greek law permits the SPV's registered office to be within the EU. For tax reasons, some of the SPVs are registered in the UK (subject to the Greek covered bond law). Due to tax reasons Greek banks are likely to issue via SPVs. However as such covered bonds are SPV issues rather than bank issues, there is cause to doubt whether they are are CRD-compliant.

Issuers have a minimum capital requirement of USD 500m and a mandatory capital ratio of 9%. Certain Minimum requirements regarding risk management and technical conditions have to be met. The LTV limits are set according to European regulations with 80% for residential mortgages and 60% for commercial real estate loans. Further the regulation requires a minimum overcollateralisation of 5,3% on a nominal basis. The NPV of the cover pool has to exceed the NPV of outstanding cover bonds, which is also subject to stress tests.

COVER POOL CREDIT QUALITY

Eligible collateral
Only mortgages that are subject to Greek law will be accepted as cover assets. Accordingly, only domestic assets will be funded. In addition, the cover assets must comply with the provisions of the CRD. Greece's covered bond act also allows ship mortgage loans as collateral for covered bonds. MBS are only be permitted as replacement cover and therefore do not constitute regular cover assets.

Taking derivatives into cover
Derivatives can be used or included in the cover pool only for hedging purposes.

Cover pool monitor
A cover pool monitor is implemented to represent the interests of covered bond holders. A cover register is stipulated. The cover assets have to be listed by signing of the issuing bank and the cover pool monitor.

Transparency requirements
The central bank is responsible for supervising the covered bond issuers. The issuers will have to report on a quarterly basis. A report on the cover pool, certified by an auditor, must be presented on an annual basis. There is no transparency requirement to investors stipulated in the law.

COVER POOL RISK MANAGEMENT

Matching requirement
Greek covered bonds must be covered with eligible assets on a nominal and on a net present value basis. The required stress test includes a parallel 200 bp shift in the yield curve. OC must be at least 5% on a nominal basis.

Liquidity risk
A liquidity cushion for the payments of the next 12 months must also be maintained.

COVER POOL BANKRUPTCY RISK

Preferential claim and insolvency remoteness
Greek covered bonds do not accelerate in case of issuer insolvency. The legal framework for covered bond in Greece stipulates a preferential claim of covered bond holders on the cover pool assets and prevents an automatic acceleration of covered bonds in case of issuer insolvency.

The Greek covered bond law also stipulates a cover pool administrator in case of issuer insolvency who takes care of the cover pool assets for the benefit of covered bonds holders.

Risk Weighting

With its ratings of A1p/A-s/As (Moody's/S&P/Fitch), Greece is one of the so-called step 2 countries according to the classification in the CRD. Hence, unsecured bank debt from Greece should receive a 50% weighting under option 1 of the standardised Basel II/CRD approach. A covered bond from a step 2 country would therefore be assigned a preferential risk weighting of 20% under the Basel II/CRD standardised approach.

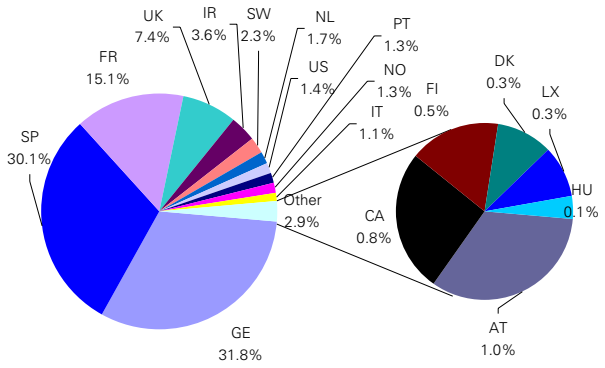
Characteristics of Greek Covered Bonds	
Covered bonds type	Legislation□based (both for direct and indirect issuance, ie through an SPV)
Legal background	Primary legislation: Article 91 of Law 3601/2007 Secondary legislation: Governor's Act 2598/2 Nov 2007
Issuer	Greek Banks or SPVs guaranteed by Greek banks. No specialist bank status but several minimum requirements eg: · Risk management/internal control system · Own funds > EUR 500m, capital ratio ≥ 9%
Supervisor	Bank of Greece
Dynamic/static cover pool	Substitution of assets of the issuing bank or on basis of eligibility criteria (SPV issuance) allowed
Cover register	Receivables of cover pool must be listed expressly in a document executed by the issuer (Art.91 of Law 3601, No.5), summary has to be registered
Eligible collateral	Residential mortgage loans (max. 80% LTV) · Commercial mortgage loans (max. 60% LTV) · Shipping loans (max. 60% LTV) · Government securities · Derivatives (hedging purposes only) (more detail see BoG Act 2588/20 Aug 07) · Substitute assets: other marketable assets (as described in Act of Monetary Policy Council No. 54/27 Feb 04) For SPV issuances: additional contractual predefined eligibility criteria Loans with higher LTV's can be included in the pool but will only be eligible up to the maximum LTV limit.
Mandatory asset coverage (OC)	Nominal value plus accrued interest must not exceed 95% (~5.3% OC) of the value of the assets comprising the cover pool throughout the entire term of the issue (excluding derivatives)
Interest rate, currency risk and maturity matching requirements	· NPV of liabilities must not exceed NPV of assets (including derivatives) during the term of issue – basis: stressed NPV's (parallel shift of 200bp) · Interest payments to investors must not exceed expected interest of cover pool during a period of 12 months
Access to liquidity	Substitute assets allowed Extendible maturities allowed Sale of cover assets possible No further issuance of CBs allowed
Inclusion of derivatives in the pool	Derivatives can be included as collateral but solely to hedge interest rate risk, foreign□exchange risk or liquidity risk Requirements for swap counterparties in Act 2598 Must not exceed 15% of nominal amount of covered bonds outstanding
Acceleration features	No early redemption in case of insolvency of issuing bank or guarantor as long as cover is sufficient
Cover pool monitoring	Quarterly reviews by the servicer of the pool. Review has to include: · NPV ratio · Interest payment matching Yearly audit of quarterly reviews by an independent chartered accountant
Substitute manager	Before insolvency of the issuer/guarantor: trustee with clearly defined responsibilities must be appointed. At commencement of insolvency proceedings: trustee may assign or undertake servicing of pool. If not, BoG is entitled to appoint a servicer
Transparency requirements	· Before issuance: request has to be sent to BoG including terms, characteristics, internal organisation, composition of cover pool and derivatives, as well as either the servicer or trustee. If programme is approved, information for each issuance under the programme has to be provided to BoG. Changes of programmes have to be approved by BoG · Quarterly information on results of servicer reviews · Yearly information to BoG: audit report and cover pool asset data, information on revaluation of mortgages, weighted interest rates, mortgage values, hedging policy and maturity mismatch table · Quarterly public disclosure on internet website of issuer and annual disclosure in bank's financial statements: nominal amount of assets and bonds, portion (%) of derivatives per counterparty collateral, maturity analysis (last year as comparison)
Other	· Restriction of bond issuance (max. 20% of available bank assets) – issuance > 20% may cause additional capital requirements · Preferential risk weighting in Greece

Structural & Legal Summary		
Event	**Trigger**	**Consequences**
Initial situation	**Prior to any of the following events**	**The portfolio is replenished by the guarantor to maintain compliance with the statutory tests Covered bonds are paid by the issuer based on the revenues from the borrower facility. Potential shortfalls will be compensated for by the guarantor**
Guarantor event of default	**· Default on payments due under the guarantee (two days) · Breach of statutory test which has not been revoked by the next calculation date · Default by the guarantor on any other obligation under the covered bonds · Guarantor defaults on any other obligation in any payment of indebtedness that exceeds EUR15,000,000 (14 days) · Winding□up, administration, bankruptcy, etc of the guarantor · Guarantor ceases to carry on the whole or a substantial part of its business**	**· Service of a guarantor event of default notice · Acceleration of amounts due under the covered bond guarantee · Intercompany loan facility will be cancelled · No further covered bonds can be issued · Amortisation test has to be calculated monthly · Payments are made according to the relevant priority of payments**
Issuer event of default	**· Failure of amortisation test · Default by the issuer on covered bond principal or interest (seven days) · Default by the issuer on any other obligation under the covered bonds (30 days) · Winding□up, administration, bankruptcy, etc. of the issuer · Issuer fails to carry on its business**	**· Service of an issuer acceleration notice · Covered bonds become due and payable against the issuer · Payments are made according to the relevant priority of payments**

Ireland

MARKET OVERVIEW

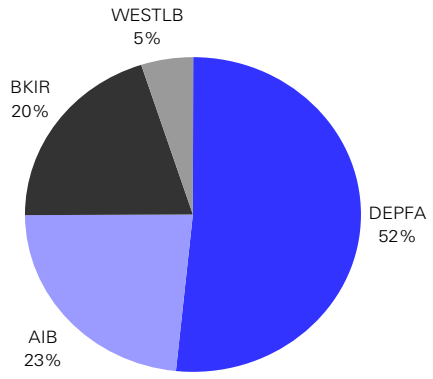
Irish ACS account for 3.6% of the EUR Jumbo covered bond market



Source: Deutsche Bank

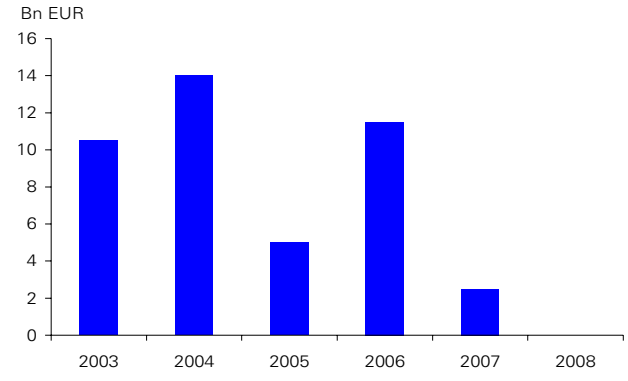
There are four banks which have public Irish EUR Jumbo ACS outstanding: Depfa ACS Bank, WestLB Covered Bond Bank, Bank of Ireland Mortgage Bank and AIB Mortgage Bank. Other Irish banks also wanted to tap the EUR Jumbo covered bond market, but have not done so due to the deterioration in market conditions. Given the significant pressure on Irish sovereign spreads, issuance of EUR Jumbo covered bonds by Irish banks seems very unlikely any time soon. As Depfa and WestLB are in the process to run down their Irish business, new issuance in public Jumbo format can also be excluded.

Depfa still dominates the Irish EUR Jumbo covered bond market in terms of outstanding volume



Source: Deutsche Bank

Yearly new issuance volume of Irish EUR Jumbo ACS (EUR bn)



Source: Deutsche Bank

LEGAL FRAMEWORK FOR IRISH ASSET COVERED SECURITIES

Issue structure

The Asset Covered Securities Act that came into effect in March 2002 (amended in Aug 2007) governs the issuance of Irish covered bonds. Ireland confers the right to issue covered bonds upon a specialist bank, a designated credit institutions (DCI). A DCI needs to apply for registration as a designated (residential and commercial) mortgage or designated public sector credit institution. A DCI may apply for both licenses and carry out both types of business. The specialist bank principle of the Irish legislation restricts the business activities of the DCI and intends to offer investors protection against increased insolvency risk as a result of riskier businesses. The amount of public credit ACS issued may not exceed total liable own funds by more than 50 times.

Additional technical changes implemented in Aug 2007 are mainly technical. These include requirements regarding regular valuation of property in the cover pool in line with the CRD, the introduction of a separate register for derivatives as well as enhancing the duration gap test towards more transparency.

COVER POOL CREDIT QUALITY

Mortgage lending

The maximum LTV stipulated in the Asset Covered Securities Act is 75% for residential mortgages and 60% for commercial mortgages. Prudent LTV levels for mortgage loans in the cover pool can exceed the 75% threshold, however the balance of the loans above 75% is not considered for eligibility purposes. Hence, the LTV limit is relative, not absolute. The LTV limit for all mortgage loans held by a DCI is 80%, limiting the amount of non-eligible business.

Under the Irish law, mortgage loans must relate to complete buildings, not those under construction. Before the amendment of the legal framework in 2007, the share of commercial mortgages was limited to 10% of the total mortgage collateral pool. The same restriction exists e.g. in the Swedish and Finnish legal framework for covered bonds. The rationale of this restriction is the assumed higher risk of commercial mortgage lending compared to residential mortgage lending.

With the amendment of the legal framework in 2007, a third type of ACS that is collateralised by commercial loans was explicitly introduced to the two existing types of ACS (public-sector and residential mortgages). Hence, commercial cover assets are bundled in a separate cover pool. In our view, there will be differences in spread between the two types of mortgage ACS. Commercial loans are considered to be of higher risk, which is reflected, for example, in spread differentials between CMBS and RMBS. In contrast to that, there is no significant spread differentiation in the German Pfandbrief market where commercial focussed cover pools pay only a small pick-up versus residential focussed cover pools. One could argue that this is partly compensated for by other quality criteria such as the use of loan syndication to increase granularity.

Regarding the introduction of a separate cover pool for commercial collateral, there is a secondary legislation under development which will be very similar to the existing framework for mortgage ACS. Key issues being considered include monitoring/valuation framework and diversity requirements.

Non-performing loans are not allowed as cover pool assets at the start. However if loans in the cover pool become non-performing the issuer does not have to replace them. Nevertheless, in practice most issuers do so.

Property valuation

A mortgage ACS issuer is required to calculate the prudent market value (haircut applied to increases in value) of each property asset at the time of inclusion in the cover pool and also at least once a year as specified by the regulator. It is market practice for a mortgage ACS issuer to have received a valuation report on the underlying property from an independent mortgage valuer before the loan is extended.

The regulatory authority specifies the methodology for establishing prudent market value. The prudent market value of the mortgage loan is based on the indexed value of each property at the time they are included in the pool, using the index published by a well known provider (e.g. in case of AIB ACS the index of Irish Life & Permanent is used). The prudent market value is indexed to take into account the higher house price volatility in Ireland. The regulator will continue to issue regulatory notices which govern the collateral pool valuation procedures.

Public sector lending

Public credits defined as 'any kind of financial obligation in respect of money borrowed or raised, where the person who has the obligation is' an EEA country, a G7 country or Switzerland are eligible as cover pool assets for public sector ACS. Lending to public bodies and public companies which are controlled by public sector authorities is also eligible as collateral, even if there is not explicit state guarantee.

Geographic scope

While Irish issuers could use unlimited quantities of assets from members of the EEA as collateral, assets out of the USA, Canada, Switzerland and Japan were previously subject to an upper limit of 15% of the pool value. This limitation which was applicable to both public-sector and mortgage assets was dropped by the latest amendment of the law. The new law restricts the inclusion of assets in a mortgage sector cover pool to those located in the EEA and category A countries (Australia, Canada, New Zealand, Japan, Switzerland and the US). Since the introduction of the new legal framework, unlimited volumes of EEA public sector assets are eligible

Unlimited volumes of non-EEA public sector assets are eligible, provided they are assigned external ratings of AAA or AA. There is a 20% restriction for non-EEA public sector assets with an external rating of A.

No non-EEA public sector assets rated below A are permitted in the cover pool. Assets out of Australia and New Zealand as well as international development banks as defined by the CRD are eligible as collateral.

MBS/covered bonds

RMBS and CMBS can be used as cover assets for ACS, in line with the definition of covered bonds as laid down in the CRD. Covered bonds are not eligible as collateral for ACS.

Substitute collateral

The total prudent market value of the registered substitute collateral must not exceed 15% of the total nominal/ rincipal amount of the specific Asset Covered Securities outstanding. The Central Bank of Ireland can approve a higher limit on substitute collateral

Deposits with eligible financial institutions and exposures to institutions with minimum ratings of at least Credit

Quality Step 2 and with a maximum time-to-maturity of three months.

Eligible financial institutions are financial institutions authorised in an EEA country or those located in Canada, Japan, Switzerland or the US with a minimum rating of A1.

Tier 1 assets accepted by the ECB for repo transactions with a maximum time-to-maturity of three months.

Cover pool cover monitor
Every DCI is required to appoint a qualified person as a covered asset monitor. The cover asset monitor has to be approved by the regulatory authority The asset cover monitor is responsible for monitoring the DCI's compliance with the provisions of the act relating to the cover pool management, financial matching criteria for the pool, inclusion of substitution assets in the pool, maintenance of the institution's register and such other matters as may be stipulated by regulations made by the authority.

The cover asset monitor has the power to access any information required to perform its duties as monitor and also has the power to enter the issuers' business premises to carry out its responsibilities. He must also provide reports to the regulator.

COVER POOL RISK MANAGEMENT

Prepayment risk
While prepayment is possible, the fees tend to be high and hence actual prepayment experience is low.

Matching requirements
The prudent market value of the assets must exceed that of the liabilities at all times.

For commercial ACS pools, the Irish law lays down minimum OC of 10%, compared to 3% for residential real-estate and public-sector cover pools. In the case of mortgage ACS, OC is calculated on a nominal basis, for public-sector ACS on a present-value basis. Each ACS issuer has committed to a minimum level of 5% OC by contract (on a nominal basis).

Regulation stipulates that changes in the net present value of assets and liabilities under defined stress scenarios shall not exceed 10% of the DCIs own funds. The currency of the assets has to match that of the ACS after hedging. Hence, DCIs are not allowed to incur currency risk.

The Irish covered bond law stipulates that the duration of the assets must not be less than that of outstanding ACS and not more than three years longer than that of the ACS. Moreover, interest receivable on the cover assets over the next 12 months must not be less than interest payable on the ACS over the same period.

The amendment of the legal framework in 2007 stipulated some changes in the duration gap calculation. The test was simplified to ensure transparency and will assess the weighted average time to maturity of the assets and liabilities in the pool.

Liquidity risk
The legal limit and the stress scenario on the amount of interest rate risk that can be incurred as well as the interest cover requirements also serve to reduce liquidity risk. The Irish legal framework provides for the possibility to enter into hedge contracts designed as liquidity facilities. These would then be treated like any other hedge contract.

Taking derivatives into cover

Interest rate, currency and credit derivatives can be taken into cover. In case of insolvency of the issuer both the cover assets and the cover pool asset hedge contracts will be continued. Possible claims of the derivative counterpart rank pari passu with those of ACS holders. The wide geographical scope of lending in Ireland suggests an increasing use of derivatives to hedge foreign currency risk, with higher levels of counterparty risk.

The amendment of the legal framework introduced a separate register of pool hedge collateral which will clarify the rights of hedge counterparties and make it easier for issuers to enter into ISDA and CSA agreements for the benefit of the cover pool and covered bond holders.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
Cover assets are split into three separate (residential mortgage or commercial mortgage and public sector) asset cover pools. Like other cover assets, derivative contracts used to hedge the cover assets need to be entered into the cover register. Pool hedge collateral needs to be registered in a separate register. Cover pools are exempt from bankruptcy proceedings.

Preferential claim and insolvency regulation

Irish law gives ACS holders a priority claim on assets in the cover pool. Any claim of an owner of an ACS remains unaffected by the actual or potential insolvency of a DCI or its parent. If the claims of the preferred creditors are not met, their residual claim will rank as a senior unsecured claim, alongside other unsecured creditors, against the rest of the DCI's assets. There is no recourse to the parent company of the DCI.

The National Treasury Management Agency is obliged to find a suitable back-up servicer in case of issuer insolvency, and failing this, to assume the task of servicer itself. Fees to the back-up servicer rank senior to the ACS holders.

Legal protection for OC

Upon issuer insolvency the ACS holders benefit from any coverpool assets that make up the OC. Hence, explicit legal protection for OC should be given (if the OC is available at time of issuer insolvency).

Risk Weighting

The eligibility criteria of cover assets set out in the ACS Act match the criteria for the preferential risk weighting of covered bonds set out in the CRD. Hence, ACS meet the requirements of UCITS 22 (4)/CRD and hence benefit from a privileged risk weighting.

Italy

CDP COVERED BONDS

History

Cassa Depositi e Prestiti (CDP, Aa2s/A+s/AA-s) was founded in 1850 to collect funds of provinces, municipalities, public administrations and deposits paid to the Kingdom of Sardinia, which were in turn lent as low-interest loans to municipalities and provinces. On 13 May 1983, CDP was granted full organizational autonomy within the Italian Ministry of Economy and Finance. In 1999 CDP was granted an independent legal status. Nevertheless, the Italian Banking Law does not fully apply to CDP. In 2004, the Italian Finance Ministry sold a 30% stake in CDP to 66 banking foundations, but still owns 70% of the institution and is required by law to keep a majority stake. The 66 banking foundations have an option to return their stake in 2009. CDP does not benefit from a guarantee of the Republic of Italy.

As the current structure of CDP requires high nominal OC and hence is not efficient for the issuer, it seems possible that CDP will be restructured. It also seems likely that, in case of a market recovery, CDP would issue covered bonds under the new Italian legal framework. For the time being, given the significant stress on Italian government bonds, issuance of CDP in EUR Jumbo format, in whatever structure, is unlikely.

Outstanding volume

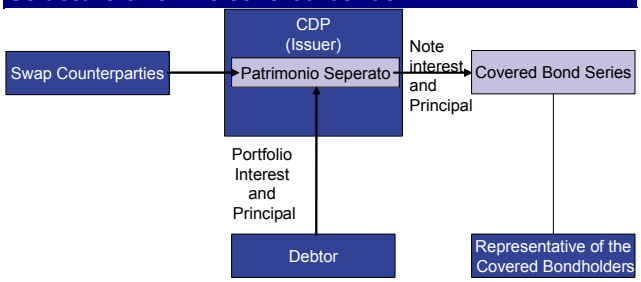
In 2005 and 2006 EUR 4 bn were issued in two benchmark bonds. There was no CDP covered bond issue in 2007. As of 31 Dec 2008, CDP had EUR 8 bn in covered bonds outstanding. The longest maturity is January 2013. CDP has not issued covered bonds in 2008.

LEGAL FRAMEWORK OF CDP'S COVERED BONDS

Issue structure

CDP has a special legal framework for issuing covered bonds (Article 5.18 of Law No. 296, dated 30 September 2003). The special legal framework applies only to CDP. CDP's covered bonds are issued pursuant to article 5.18, under which CDP can segregate part of its assets (patrimonio separato) for the benefit of specified secured creditors. Unlike other European covered bonds regimes, CDP covered bondholders will have no residual claim against CDP's other assets in the event of its insolvency. Insolvency of the cover pool is the only reason that could trigger an acceleration of CDP's covered bonds. In the event that the payment of interest and the repayment of principal are not made when due under the covered bonds, all outstanding covered bonds become due and payable.

Structure of CDP's covered bonds



Source: CDP, Deutsche Bank

COVER POOL CREDIT QUALITY

Collateral – public sector assets

The collateral pool of CDP consists of loans to/or guaranteed by Italian regions and local entities. Nevertheless, central and local government debt from EEA countries is also eligible as collateral. Such assets would be put in the cover pool with the agreement of rating agencies.

This includes the possibility to include receivables generated in the context of public-private partnerships. Furthermore, prime securitization tranches fulfilling the same rating criteria, and other governmental entities also can be included in the collateral pool if previously agreed with rating agencies. Derivatives are permitted in the cover pool for hedging purposes. The cover pool is dynamic until the occurrence of certain trigger events including the insolvency of the issuer.

According to the CDP Covered Bond Program terms, the cover pool needs to meet granularity criteria in terms of the maximum exposure to a single debtor; e.g. exposure to the Italian State must not exceed 5% of the total principal amount of the collateral forming part of the Patrimonio Separato.

Taking derivatives into cover

Derivatives are eligible as cover pool assets. There is specific documentation in place in case of CDP's covered bonds for derivatives to be taken into the cover pool and providing for continuation in case of insolvency.

Cover pool monitor

A qualified third party entity monitors the cover pool. As programme calculation agent, the third party monitor performs the asset cash flow coverage test (ACFCT). The agreement by which the programme calculation agent has undertaken to carry out the abovementioned activities, together with any rights and obligations arising therefrom

(Intercreditor Agreement), has been segregated in favour of the covered bond holders and will continue to be in force in case of issuer insolvency.

COVER POOL RISK MANAGEMENT

Asset cash flow coverage test (ACFCT)
The asset cash flow coverage test (ACFCT), performed each payment date, targets the matching for the next payment date of cash inflows from the cover assets and cash outflows due to covered bondholders including both interest and principal. CDP is obliged to replenish the collateral portfolio by adding/replacing assets to prevent a breach of the ACFCT.

The calculation is performed net of delinquencies and expected defaults. Moreover, a default buffer is established, sufficient to cover defaults expected by rating agencies under a triple-A scenario. Furthermore, the ACFCT is performed seven days before each semi-annual payment date of the assets, plus whenever assets are added or removed or when loans within the pool are renegotiated.

In detail, the ACFCT monitors that:

- The principal amount of the eligible portfolio, which is the subset of the portfolio fulfilling the eligibility criteria, net of claims in arrears, is higher than the aggregate principal amount of covered bonds.
- The cash flows from the eligible portfolio, net of claims in arrears but including any amount provisioned for the redemption of the bonds, have to be higher than 115% of the amounts due under the covered bond program. This must hold true on each payment day and leads to a minimum OC requirement of 15%.
- In the event of CDP's insolvency, the asset manager shall be entitled to sell cover assets in order to fulfil the payment obligations towards the covered bondholders. This sale must be (a) in the interest of the covered bond holders; (b) at a 'fair price' (c) if in full, for a price not lower than the amount necessary to pay interest and repay principal on the relevant due dates on all outstanding covered bonds. With the insolvency of CDP, a third party back-up servicer will undertake the activities to be performed by the issuer as asset manager (being already nominated upon CDP losing its investment-grade rating).

Asset cash flow deficiency (ACFD)
If the ACFCT test is breached and the situation is not remedied within two business days, an asset and cash flow deficiency (ACFD) occurs, which triggers a 'Termination event' if it has not been remedied by the second payment date after the test was first breached.

An ACFD occurs when

- The aggregate eligible portfolio amount is less than the amount outstanding on the covered bonds
- The expected available funds for covered bonds are insufficient to cover the cash outflows to covered bondholders.

In case of issuer insolvency the segregated assets and legal rights are exclusively secured for the repayment of the covered bondholders and constitute separate assets from those of CDP ('patrimonies destination').

COVER POOL BANKRUPTCY RISK

Before initial rating event
Until a trigger has been breached, CDP is entitled to employ the cash flows from the segregated assets ('patrimonio separate') for its own purposes. Hence, as typical for covered bonds the obligations due to the bondholders are met by liquid funds held by CDP itself. In case of a deterioration of CDP's credit quality, a set of triggers have been defined to allow for a smooth transformation of the covered bond from a bond issued, serviced and paid by CDP into a stand alone secured bond.

Initial rating event
The trigger for the 'Initial rating event' is CDP's senior unsecured rating falling below A1 at Moody's or the short-term rating of S&P or Fitch falling below the threshold of A-1+/F-1+. In this scenario, CDP may still use the cash from the segregated portfolio but it has to pay within 30 days following the downgrade into a cash reserve ledger an amount equal to:

- The payment obligation due to holders of covered bonds on the next payment date.
- The debt service reserve that, in turn, equals amounts borrowed by CDP and is still to be reimbursed but is not yet payable to the holders of covered bonds.
- One percent of the portfolio outstanding to cover prepayment risk.
- A prepayment penalty reserve that equals the difference between the net present value of the segregated loans and the principal outstanding of the loans.

Segregation event
Should the senior unsecured rating of CDP fall below A3/A- by Moody's or Fitch or short-term below A-1 by

S&P, this would trigger a so-called 'Segregation event'. After a 'Segregation event' has occurred, all payments to holders of covered bonds will be performed from the segregated ledger.

The consequence of such a 'Segregation Event' would be that CDP:

- Opens the segregated cash ledger, if not already opened.
- Notifies the borrowers to pay directly into the segregated ledger.
- Deposits an amount equal to the expected cash collection on the following payment date. This should safeguard the timeliness of payments endangered by technical problems in redirecting the flow of funds from the borrowers into the new ledger.

Termination event
As long as there is no termination event, CDP is allowed to withdraw excess interest from the segregated ledger. On the other hand, CDP cannot change terms and conditions of segregated loans anymore. A 'Termination event' is triggered by a breach of the asset and cash flow coverage test (ACFCT). A 'Termination event' is also triggered if CDP voluntarily terminates the programme when CDP becomes insolvent, materially distressed or when Italy experiences financial hardship. After a 'Termination event', CDP can longer issue bonds. Moreover, excess interest can no longer be withdrawn from the segregated ledger and is solely for the benefit of the holders of covered bonds.

Trigger event
Should CDP fail to pay on any of its obligations in the context of the covered bond programme, this constitutes a 'Trigger event'. The consequence is that available covered bond funds are distributed to the respective stakeholders based on their priority, which is defined as follows:

- Fees, taxes and other costs associated with the transaction itself (not including payments generated by hedging agreements).
- Interest payments to covered bondholders (pari passu and pro rata) and amounts associated with hedging agreements.
- Principal payments to covered bondholders and amounts associated with principal accumulation for redemptions due in the future.
- Amounts associated with subordinated hedging agreements.
- Hedging termination payments

CDP is able to issue covered bonds as long as it has not breached a 'Termination event' or a 'Trigger event' always provided that an issuance (a) does not cause an asset cash flow deficiency (ACFD) (b) the new issue is not harmful to the rating of the outstanding issues and (c) currency and interest rate risk is properly hedged.

Risk Weighting
CDP's covered bonds do not fulfil the criteria of UCITS 22 (4). As CDP does not have a banking license, CDP's covered bonds do not meet the requirement to be issued by a 20% risk-weighted credit institution registered in the EU. The Bank of Italy supervises CDP. In Germany a 20% risk weighted was granted by BaFin. Prerequisite to get a 20% instead of 100% risk weighting are that swap counterparties rank subordinated to covered bond holders and that claims can be directly enforced by the trustee.

Conclusion
Despite having a structure without ultimate recourse to the issuer in case of insolvency, investor protection in CDP's public sector covered bonds has to be considered strong. This is mainly due to the ACFCT leading to a very high nominal OC requirement. Insolvency of the cover pool is the only reason that can trigger an acceleration of covered bonds.

ITALIAN COVERED BONDS

On 14 May 2005 Italy introduced the law 80/2005. With two new articles in the existing legal framework for securitizations set by Law 130, Italian banks have a legal basis to issue covered bonds. Secondary legislations were published in 2007 by the Italian Ministry of Economy and Finance (www.tesoro.it) and the Bank of Italy (www.bancaditalia.it).

So far, due to the adverse market conditions, only Banca Popular Milano tapped the EUR Jumbo covered bond market.

Outstanding volume of Italian EUR Jumbo Obbligazioni Bancarie Garantite

	Maturity	Coupon	Supply Date	Volume	Issue spreads(bp)
PMIIM	15-Jul-11	5.5	07-Jul-08	1	40

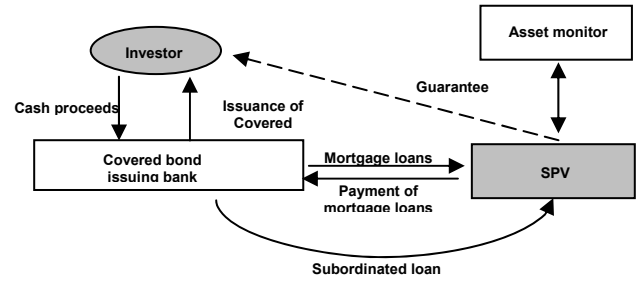
Source: Deutsche Bank

LEGAL FRAMEWORK FOR ITALIAN COVERED BONDS

Issue structure
An issuer of Italian covered bonds based on Law 80/2005 has to be a bank with ordinary business activities. Hence,

no special banking principle is implemented in the Italian legal framework.

Structure of Italian Covered bonds



Source: Italian Ministry of Finance, Deutsche Bank

In some European countries like Germany and Sweden, the issuance of covered bond is subject to a "licence" granted by the supervisory authority upon the fulfilment of specific requirements. The Italian legislator has instead made a different choice. Rather than introducing a 'licence' system, it has defined a series of requirements and limitations to issuance which together can be de facto considered as the objective basis upon which to grant an issuance authorization.

According to Law 80/2005, the collateral portfolio is separated from the originating party within a different legal entity, a special purpose vehicle (SPV), which can be used for an unspecified number of transactions. If the servicer of the transaction is an entity different from the originating bank, it must be published in the Italian Official Gazette (Gazzetta Ufficiale della Repubblica Italiana). The SPV is structured to be a bankruptcy remote company. Hence, the Italian legal framework stipulates a structure similar to the UK structured covered bonds. The reason is that otherwise it would have been difficult to achieve bankruptcy remoteness of on-balance sheet collateral assets under Italian insolvency regulation.

The law foresees the possibility that the bank originating the collateral assets, the bank issuing the bonds, the bank granting the loan to the SPV and the entity owning the SPV can be different institutions, giving the Italian banks a flexible framework for structuring their covered bonds issues, e.g. implementing multi-seller structures.

The minimum share capital of the SPV has to be EUR 120 000. The transfer of the collateral assets is done via a purchase funded by a subordinated loan granted to the SPV. The bank transferring the assets or any other bank issues the bonds. The SPV, backed by the registered assets, underwrites an assignment in favour of the bonds. The assignment holds for three claims:

- The amounts payable to the holders of covered bonds
- The amounts payable to hedge counterparties
- The amount sufficient to cover the costs of the transaction

The secondary legislation of the Bank of Italy contains a minimum capitalization for issuers of covered bonds and an issuance limit for the total amount of covered bonds a bank is allowed to issue. The regulatory capital must amount to at least EUR 500 m. The minimum capital of EUR 500 m compares with EUR 25 m in Germany and EUR 7.5 m in Portugal. The minimum level for the consolidated total capital ratio is 9%. The minimum Tier 1 ratio is at least 6%.

- In case the total capital ratio is >=11% and the Tier 1 ratio >= 7%, no issuing limit applies.
- In case the total capital ratio is >= 10% and <11% and the Tier 1 ratio >=6.5%, covered bonds up to 60% of eligible assets can be issued.
- In case the total capital ratio is >= 9% and <10% and the Tier 1 ratio is >= 6%, covered bonds up to 25% of eligible assets can be issued.

The limits regarding total capital and Tier 1 have to be fulfilled jointly. Hence, if a bank has a total capital ratio of 10.5% and a Tier 1 ratio of 6.1%, the volume of eligible assets which can be funded by covered bonds is limited to 25%.

COVER POOL CREDIT QUALITY

Mortgage lending

In case of mortgage covered bonds, collateral assets consist of residential mortgage loans with a maximum LTV of 80% or commercial mortgage loans with a maximum LTV of 60%. In contrast to Germany, the LTV limit is absolute in Italy. A splitting of the mortgage loans in an eligible and an ineligible part would lead to problems in case of issuer insolvency. Hence, a mortgage loan with a LTV exceeding the stipulated limit is not even partly eligibly as collateral for Italian covered bonds.

Geographical Scope

Lending is limited to the EEA and Switzerland.

Property valuation

Property valuation has to be done by a professional valuer appointed by the bank extending the mortgage loan. The valuation basis is the market value. Secondary regulation rules the valuation of the properties at the moment of the transfer of the collateral assets to the SPV.

Public sector lending
In case of public sector covered bonds, collateral assets are allowed to consist of public sector loans or bonds from the EEA or Switzerland with a maximum risk weighting of 20%. Loans or bonds from other sovereigns with a risk weighting of 0% are allowed up to 10% of the cover pool. Loans or bonds from other local entities with a maximum risk weighting of 20% are allowed up to 10% of the cover pool.

MBS/covered bonds
Securitization notes consisting of 95% of the above assets provided the tranches are risk weighted 20% are eligible as collateral. Covered bonds are not eligible as collateral.

Substitute assets
Substitute assets include public sector loans and bonds that are eligible as cover assets for public sector covered bonds, bank deposits (and bonds with a remaining life not greater than one year) at a bank in the EU, Switzerland and other 0% risk weighted countries under the revised standard approach. There is a 15% limit regarding the sum of desposits and bank debt. There is no limit for public sector assets.

Cover pool monitor
The issuer has to appoint an asset monitor, which is an independent accounting firm and which has to report on an annual basis to the issuing bank's supervisory board. In addition, the bank has to monitor activities at least every six months.

Italian regulation prescribes that the monitoring of the regularity of the transaction and of the integrity of the collateral securing investors must also be performed by an external asset monitor appointed by the issuer. The asset monitor must be an auditing firm possessing the professional skills required to perform such duties and must be independent from the bank engaging it (e.g. it cannot be the same firm appointed to audit the accounts of the issuing bank) and of any other person participating in the transaction. The monitor has to report on an annual basis to the issuing bank's supervisory board. Although no specific reporting to the Bank of Italy is prescribed by law, in practice the asset monitor will report to the supervisor any material anomaly found.

COVER POOL RISK MANAGEMENT

Prepayment risk
In Italy, in the past, the sum of the costs associated with early repayment, such as the early repayment fee, notary fees (e.g. fees for the cancellation of the mortgage from the mortgage register) and other administrative costs detered customers from prepaying. In 2007, a new law eased prepayment. However, customer behaviour has not changed. Moreover, Italian mortgage loans are predominantly floating rate. Hence, prepayment is not considered a risk for Italian covered bond issuers.

Matching requirements
The Ministry of Finance's decree does not stipulate an explicit minimum OC requirement. However, full collateralisation is required after adjusting the assets for all operational costs and derivative positions at all times. Moreover, interest and the other proceeds generated by the collateral net of the costs pertaining to the issuer have to be sufficient to cover the interest and the costs which have to be paid by the issuing bank.

Taking derivatives into cover
Derivatives are allowed as cover pool assets. There are no limits or requirements by the law.

COVER POOL BANKRUPTCY RISK

Preferential claim and bankruptcy remoteness
Covered bondholders have a preferential claim on the cover assets of the SPV and a direct and unconditional claim against the issuer. Italian covered bonds will not accelerate in case of insolvency of the issuer, as an alternative they will be paid out of the assets in the SPV. The provisions set in Law 130/1999 supersede the general bankruptcy regulation.

Legal protection of voluntary OC
The assets transferred to the SPV cover the guarantee for the covered bonds assigned by the SPV. This includes any OC held in the SPV at the time of issuer insolvency.

Risk Weighting
Italian covered bonds issued under the new legal framework do fulfil UCITS 22 (4)/CRD and hence benefit from a privileged risk weighting.

Main Characteristics of Italian Covered Bonds (Obbligazioni Bancarie Garantite)

Issuers	Any bank or market credit institution whose regulatory capital is not less than EUR500m and whose total capital ratio is not less than 9%. These Bank of Italy (BoI) requirements apply at an individual bank level for those entities belonging to a banking group.
Supervision	The BoI acts as regulator for covered bond issuance. All issuers and programmes must be approved by the BoI. Annual reporting to BoI is required explaining valuation guidelines and confirming compliance with collateral requirements and overcollateralisation (OC) ratios set down by the law. Six□monthly reporting is carried out by an asset monitor, which must be an independent auditing firm. BoI imposes broad matching rules, but does not require the application of specific interest rate and foreign currency stresses.
Issuer requirements	Covered bonds may only be issued by banks with total regulatory capital of at least EUR500m and with a total capital ratio of at least 9%. These requirements must be met at individual bank level if the bank is not part of a banking group. The assignment of assets to the cover pool is also subject to certain limits based on the bank's total capital and Tier 1 ratios (both ratios need to be met jointly or as follows:

Total capital ratio (%)	Tier 1 ratio (%)	Transfer limit
≥11	≥7	None
≥10 and <11	≥6.5	Up to 60% of eligible assets on balance sheet
≥9 and <10	≥6	Up to 25% of eligible assets on balance sheet

Mortgage collateral	Eligible assets include: Mortgages on real estate intended for residential or commercial use subject to LTV restrictions; and Securitisation notes subject to the following conditions: i)maximum risk weighting of 20%; and ii) a minimum of 95% of the securitised receivables consists of residential or commercial mortgages or public sector loans eligible for cover pools.
Loan□to□value limits for mortgage loans	≤80% for residential real estate mortgage loans; and ≤60% for commercial real estate mortgage loans.
Real estate valuation	Valuations of all types of properties must be undertaken on an individual basis and reviewed by a qualified professional auditing firm appointed as asset monitor, and must refer to market values. These are reviewed on a semi□annual basis.
Public sector collateral	Eligible assets include the following assets: Public sector loans or bonds guaranteed by i) EEA and Switzerland state authorities, subject to a maximum 20% risk weighting and ii) non-EEA or local authorities with a maximum risk weighting of 20% and limited to 10% of the nominal value of total cover pool assets. Securitisation notes subject to the following conditions: i)maximum risk weighting of 20%; and ii) a minimum of 95% of the securitised receivables consists of public sector loans eligible for cover pools.
Substitute collateral	Substitute assets may be composed of regular eligible assets as well as (i) deposits with banks in eligible states and which have a 0% risk weighting and (ii) bonds issued by such banks with a maturity of less than one year. Substitute assets under options (i) and (ii) are limited to 15% of the total cover pool and may only be included to maintain the OC ratios prescribed by the law.
Transfer of assets	Yes, the cover pool is transferred to an SPV.
Cover register	No. There is no requirement for a specific register of the cover assets.
Asset monitor	An external, independent asset monitor □ which has to be a recognised auditing firm □ will verify that: The cover assets meet the eligibility criteria; Properties backing mortgage loans are valued on the basis of appropriate external appraisals and are in line with the guidelines used by the issuing/assigning bank to draft its financial reports; The matching rules are complied with; and the issuer must send an annual report to BoI based on the evaluation provided by the asset monitor.
Protection against mismatches	The nominal value of the cover assets must always exceed the nominal value of outstanding covered bonds. The net present value of the cover assets must exceed the net present value of outstanding covered bonds on a daily basis. Cash flows with respect to the assets in the cover pool and derivatives agreements must at all times enable the issuing bank to meet its payment obligations towards the covered bondholders and derivatives counterparties, although it is not expected that there will be complete matching between asset and liability cash flows.
Interest rate and currency stresses	None specifically prescribed by the legislation.
Treatment of swap counterparties	Registered swap counterparties benefit from the same priority of payments as covered bondholders.
Bankruptcy remoteness	If a covered bond issuer becomes insolvent and is subject to compulsory liquidation, the covered bondholders may exercise rights against the issuing bank, the guarantee granted by the SPV and the cover assets securing the guarantee. Outstanding covered bonds and derivatives counterparties will continue to be paid according to the original contractual terms and will have recourse to the cover pool through the guarantee. The asset pool will not be available to any other creditor of the issuer until the claims of the preferred creditors are met. If the claims of the preferred creditors are not fully satisfied from the pool, they retain an unsecured claim against the issuer.
Alternative servicer	No alternative or dedicated independent manager or servicer is appointed after an issuer's insolvency according to the law. Fitch will review this on a case by case basis and give credit where the inclusion of a provision for a back□up servicing arrangement for the cover assets is addressed by contract. The administrators□in□bankruptcy of the issuer will act in the interest of both the covered bondholders and the senior unsecured creditors. However, no conflict of interest issues are expected given the nature of the "true sale" of the assets to the SPV.

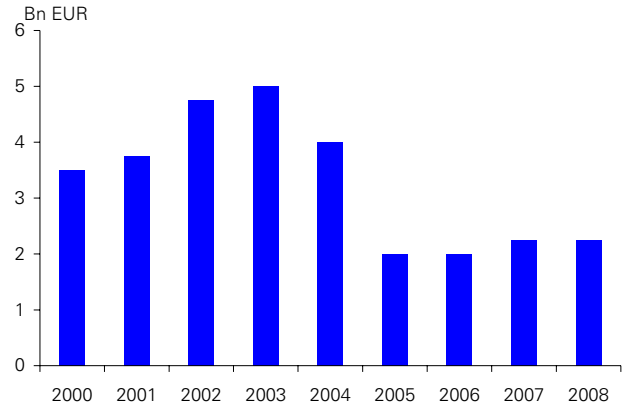
Structural & Legal Summary		
Event	Trigger	Consequences
Initial situation	Prior to any of the following events:	The portfolio is replenished by the sellers/issuer to maintain compliance with the mandatory tests. Additional loans can be purchased with the guarantor's available funds. Covered bonds' principal and interest are paid by the issuer. No notice is served.
Master Servicer termination event	The master servicer fails to transfer any monies to the guarantor for 10 business days following from formal request. The servicer defaults on a material obligation under the transaction contracts and this is not remedied for 10 business days following formal request. Liquidation, insolvency, administration or winding up of the master servicer, or restructuring of its obligations. It becomes unlawful for the master servicer to perform its obligations. The master servicer does not meet legal or BoI requirements to perform.	The master servicer appointment shall be terminated along with each of the sub□servicers. The representative of the bondholders shall appoint a new servicer.
Issuer event of default	The issuer defaults on the covered bond payments following written demand from the representative of the covered bondholders. The issuer defaults on any obligation under the transaction contracts for more than 30 days following written notice from the representative of the covered bondholders. The issuer is declared insolvent or a liquidator is appointed. Any of the statutory tests is breached and such breach is not remedied within one month. The issuer's payments are suspended pursuant to Article 74 of the Italian Banking Act.	The representative of the bondholders will serve an issuer default notice on the issuer and the guarantor. No further covered bonds can be issued. Covered bonds are not accelerated against the issuer. Covered bonds are payable by the guarantor when originally due for payment. The entire purchase price of additional loans has to be funded via drawing on the subordinated loans. The guarantor will start liquidating the pool to the extent necessary to fund the repayment of the covered bonds of each series maturing from time to time. Upon cure of any such event of default, unless another event of default has occurred, the representative of the bondholders can revoke the issuer default notice.
Guarantor event of default	Following service of an issuer default notice: the guarantor defaults on the covered bond payments following written demand from the representative of the covered bondholders any of the statutory tests is breached the amortisation test is breached the covered bond guarantee is not in full force and effect liquidation, insolvency or winding up of the guarantor.	The representative of the bondholders will serve a guarantor default notice on the guarantor. Covered bonds will be accelerated against the guarantor. Because an issuer default notice has already been served, the guarantor is already in the process of liquidating assets.

Luxembourg

MARKET OVERVIEW

The outstanding volume of Jumbo Lettres de Gage (LdG) amounts to only EUR 2.25 bn (as of 31 Dec 2008). Currently, Eurohypo Lux is the only bank which has EUR Jumbo Lettres de Gage outstanding. LdG are typically issued in non-Jumbo format.

Outstanding volume of Jumbo Lettres de Gage



Source: Deutsche Bank

In 2007, NordLB Covered Bond Finance Bank tapped the market for Lettres de Gage. Also Dexia Banque SA entered the market but has so far not publicly issued but issued inside its own group, e.g. put its Lettres de Gage in the cover pool of DEXMA's Obligations Foncières as substitute cover. Regarding foreign currency issues, the LdG market is the leading European covered bond market in relative terms.

In 2006 EEPK, issued the first LdG Hypotecaire, backed by mortgage covered bonds from other European countries that fulfil UCITS 22 (4). This is a speciality of the Luxembourg legal framework for covered bonds, which allows the inclusion of covered bonds in the collateral pool. This allows the bundling of small issues, including those denominated in a non-euro currency.

EUR still dominates as a currency regarding outstanding volume, but USD and CHF follow quite closely. GBP and CAD are also used, but both are under 10% in tems of market share.

Broad geographical scope

The main characteristic of Luxembourgian LdG is the broader geographical scope of eligible assets. EU, EEA and all OECD (e.g. Turkey, Mexico, South Korea) countries are eligible as collateral to an unlimited extent. However, current issuers restrict their public sector lending to high quality OECD countries and do not make full use of the legal possibilities.

Moreover, the legal framework for covered bonds in Luxembourg allows including debt of public sector bodies like German Landesbanks and savings banks in the cover pool, even if there is no explicit state guarantee. Expectations that there will be high issuance volumes of LdG Publiques issuance, exclusively covered with German savings bank and Landesbank debt is exaggerated in our view.

This in turn would reduce the margin for the LdG issuing banks. Moreover, if unguaranteed Landesbank and savings bank debt would be classified as 'claims against credit institutions', it is not allowed to account for more than 15% of the cover pool. If it accounts for more than 15%, this paper would no longer qualify for a privileged risk weighting under CRD.

LEGAL FRAMEWORK FOR LETTRES DE GAGE

Issue structure

Luxembourg passed its covered bond law on 1 Nov 1997 and amended it in 2000, 2003 and 2008. Luxembourgian mortgage banks which are set up as specialist banks can issue two types of covered bonds: Lettres de Gage Publique (LdGP) backed by public sector assets and Lettres de Gage Hypothécaire (LdGH) backed by mortgage assets. For both kinds (LdGH, LdGP), covered bonds backed by the respective collateral are eligible as cover pool assets. The issuing banks are specialized in mortgage and public sector lending and funding with LdG issues, licensed by the Luxembourg Financial Service Supervisory Authority (Commission de Surveillance du Secteur Financier, CSSF). Auxiliary activities are allowed, e.g. funding of asset side by deposits and uncovered or subordinated debt bonds buying of shareholdings with a maximum of 20% of liable capital if these shareholdings are intended to support the core business. LdG issuers employ their own staff.

COVER POOL CREDIT QUALITY

Mortgage lending

Residential and commercial mortgage lending can be used as collateral. Also other comparable rights in the mentioned properties (e.g. long lease) used as securities for lending are eligible collateral.

The LTV ratio is fixed at a uniform maximum for residential and commercial lending of 60% and 80% respectively of the estimated realization value. The actual loan, however,

can exceed the 60% limit. In this case, only the first 60% or 80% respectively of the mortgage lending value are eligible as collateral for LdG. Hence, the LTV limit is relative, as in Germany. There is no limit on non-eligible business.

Property valuation
Law defines the principles underlying the valuation of property. The mortgage bank has to estimate a realization value for the property, calculated conservatively, only taking into account the durable characteristics and yield of the property. Valuation rules have to be approved by the CSSF. Generally valuation practices in Luxembourg draw on German practice.

Public sector lending
Lending to public authorities within the meaning of the Luxembourgian legal framework for LdG refers to the member states of the EU, the EEA, and the OECD, their institutions or bodies, in central government, regional or local authorities and other public authorities, other public bodies or enterprises of member states. According to the CSSF, other public bodies or enterprises are institutions dominated by public authorities.

The dominance is assumed, e.g. if the public authority holds a majority and represents more than 50% of the board. Hence, German public sector credit institutions like savings banks and Landesbanks are eligible as collateral for LdG Publiques even if they are not explicitly state guaranteed. In Luxembourg, there is no limit in terms of risk weighting of public assets inside or outside the collateral pool.

Also regarding US state guaranteed student loans, the Luxembourgian framework is more flexible than the German Pfandbrief Act. Such loans are eligible for LdG Publiques according to the percentage of the guarantee. Hence, 98.5% guaranteed student loans eligible as collateral. In Germany, only 100% guaranteed student loans are eligible as collateral for public Pfandbriefe. The normal practice in Luxembourg is to charge a bigger haircut, resulting in an implicit OC.

MBS/covered bonds
Covered bonds which fulfill the requirements of UCITS 22 (4) are eligible as collateral for LdG. The issuer must be a bank and the creditor must enjoy preferential status. In case of LdGH backed by covered bonds, the issuer has to make monthly reports of the collateral, the regional distribution and the net present value matching to the CSSF. MBS and public sector ABS are eligible as cover pool assets. Securitisations have to be true sale transactions. At least 90% of the securitised assets or 50% - if a maximum of 20% of the cover assets are securitisations - must meet the eligibility criteria for LdG.

Aircraft loans
Aircrafts and other movable properties registered public register are eligible for Lettres de Gage. Such assets are in a separate cover pool and cannot be mixed with mortgage or public sector loans. The LTV limit for loans secured by a mortgage on, or other right in, movable property is 60%.

Geographic scope
LdGP and LdGH are backed by claims against the public sector and against real property, respectively, from within the OECD area.

Substitute collateral
Substitute collateral can represent up to 20% of total collateral for both mortgage and public sector cover pools. Eligible assets include cash, term deposits with central banks or with other appropriate EU, EEA and OECD banks and securities and claims on public authorities or debt instruments guaranteed by a public authority.

Transparency requirements
There are no explicit transparency requirements regarding investors stipulated in the law. Nevertheless the issuers voluntarily provide regular cover pool data on their web sites. The calculation of the nominal value and of the net present value of the collateral pool as well of the outstanding LdG volume must be reported to the supervisory authority on a monthly basis. ´

Cover pool monitor
A special cover pool monitor (réviseur special) is proposed by the mortgage bank and appointed by the supervisory authority (CSSF). The cover pool monitor must have the qualifications of an independent auditor and is not allowed to be identical to the auditor of the bank. The cover pool monitor is responsible for ensuring that appropriately registered collateral covers LdG in issue and is obliged to check that the mortgage bank complies with the law in managing the cover pools.

Legally the cover pool monitor is not personally liable; however, the special auditor is obliged to inform the supervisory authority immediately should any of the prudential limits be violated.

COVER POOL RISK MANAGEMENT

Prepayment risk
Currently only LdGP and LdGH backed by mortgage covered bonds have been issued, where the possibility of early repayment can be ruled out. Hence, prepayment risk is considered to be low.

Matching requirements
There is a nominal and NPV matching requirement between the collateral and the corresponding LdG outstanding. Interest rate and currency risks arising from mismatches between the LdG outstanding and their collateral have to be hedged. The total interest revenue from the collateral in the cover pool has to be at least as high as the interest expenses on the outstanding LdG. Issuer of LdG have to provide for a minimum OC of 2% on a nominal and net-present-value basis.

Liquidity risk
The law does not foresee back-up liquidity facilities. However, as the legal framework in Luxembourg stipulates nominal and net present value cover as well as interest expense coverage, pre-insolvency liquidity risk is limited. The law does not have specific rules in place regarding the sale and transfer of mortgage assets to other issuers in case of insolvency. Nevertheless, it seems likely that the supervisory authority, which is the administrator of the cover pool and the outstanding LdG in case of issuer insolvency, will permit the issuer to raise liquidity for the purposes of the collateral pool.

Taking derivatives into cover
Following the 22 June 2000 amendment Luxembourgian mortgage banks are allowed to take derivatives into cover if these are hedges for the cover assets. There is no limitation on the volume and the types of derivaties used as long as they are used for hedging. Derivatives have to be entered into the cover register. Counterparties on registered derivatives are preferred creditors. Moreover, the law makes no provision for netting derivatives with the same counterparty relating to both core and ancillary activities or between derivatives with the same counterparty but relating to different collateral pools. It is the responsibility of the bank to ensure that either separate netting agreements are drawn up or that different counterparties are used. The cover pool monitor and the CSSF have to observe that agreements do not endanger the security for LdG creditors.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
Cover assets remain on the balance sheet but are entered into a cover register. There is a separate cover register and cover pool for each covered bond category (mortgage, public). Derivative contracts used to hedge the cover assets also need to be entered into the cover register.

Preferential claim and bankruptcy remoteness
The creditors of LdG and derivative counterparties have a priority claim on the assets in the cover pool. The default of a LdG issuer does not imply early redemption. Assets within the cover register are exempt from insolvency proceedings. The CSSF would be in charge of the administration of the cover pool and associated LdG in the case of insolvency of the issue. The cover pool will be separated from the other assets of the issuing bank. The CSSF may name a new backup servicer, which could be another covered bond issuer within the EU, the EEA or the OECD, monitored by the competent authorities of that country. Even in such a case, CSSF retains responsibility. The law does not cover the cost associated with paying a servicing fee to the backup servicer and who would have to pay for this.

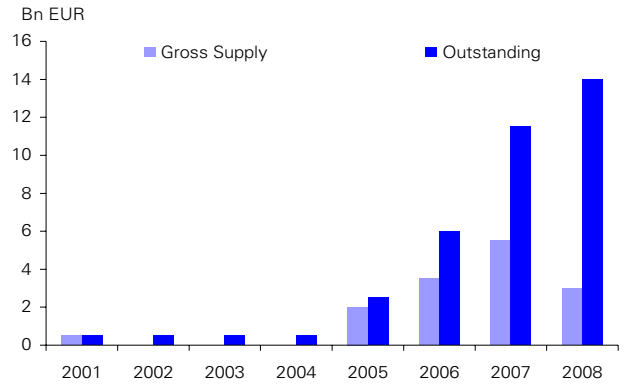
Risk Weighting
The LdG legislation does not completely fulfill the criteria of CRD Directive, Annex VI, Part 1, Article 68 a) to f). According to that, the share of claims against banks in the cover pool is not allowed to be higher than 15% of the total volume of outstanding covered bonds. In the Luxembourgian law, substitute assets can include claims against banks up to 20%. In case of LdG that are backed by more than 15% with mortgage covered bonds, claims against banks account for more than 15% of the cover pool. However, it should be possible for the issuers to make their outstanding LdG 'CRD compliant' by limiting their cover pool exposure on an issue specific basis. Hence, it is very likely that LdG benefit from a privileged risk weighting under Basel II/CRD if the cover pool of the respective LdG meets the requirements of CRD.

Netherlands

MARKET OVERVIEW

So far, ABN, Achmea and ING Bank tapped the market for EUR Jumbo covered bonds. SNS Bank and NIBC Bank planned to do so in 2008 but postponed their issues due to adverse market conditions.

Issuance and outstanding volumes (EUR bn) of Dutch EUR Jumbo covered bonds



Source: Deutsche Bank

Besides publicly issued EUR Jumbo covered bonds, like other countries, Dutch issuers made significant use of retained issues for central bank lending reasons.

LEGAL FRAMEWORK

As of 1 July 2008 a new legal framework for covered bonds, together with ministerial regulation, has come into effect. Similar to the UK, the legal framework contains little regulation compared to those present in other countries.

The new legislation applies to banks located in the Netherlands and requires issuers to apply for permission for a covered bond issue at the Dutch Central Bank (DNB). Furthermore the DNB has been assigned the role of a public supervisor which maintains a register of all covered bonds issued. No specialist bank principle is introduced. According to the Dutch banking association (NVB) the main aims of the legislation were to:

- facilitate a flexible enough structure to ensure applicability to existing programms
- create two types of covered bonds: those that satisfy requirements of UCITS 22(4) and those that are also CRD-compliant.

Whether a covered bond will be CRD-compliant and receive a favourable risk-weight of 10% depends very much on the LTV which, under CRD, is required to be 80% for residential mortgages and 60% for commercial mortgages. However the new framework does not set any provisions for the LTV which is typically very high in the Netherlands due to tax incentives. Hence, Dutch mortgage portfolios will usually not meet the maximum LTV requirements of the CRD for residential mortgage lending, thus preventing a privileged risk weighting. However, with a legal framework in place in the Netherlands, covered bonds not meeting the LTV limit of 80% stipulated in CRD can still be UCITS 22 (4) comliant.

Regarding the structure, the framework requires cover assets to be transferred to an unspecified legal entity, which pledges the assets to another legal entity. Different structures might be approved by ministerial regulation which highlights the regulatory flexibility within this framework. There is no explicit provision limiting the substitute cover.

One crucial provision of the new legal framework is that swap counterparties might (depending on the documentation of the specific issue) rank senior to covered bond holders regarding the cover pool assets. The UK framework in comparison states that all creditors rank equally. Hence, swap counterparties cannot be senior in case of UK covered bonds. There is also no further restriction on the type of cover assets or a minimum overcollateralisation in case of Dutch covered bonds. Thus investors will still have to focus on contractual provisions to assess Dutch covered bonds.

UCITS compliant but not CRD compliant

As Dutch covered bonds are in line with UCITS 22 (4) but necessarily in line with CRD (as the law does not stipulate a LTV limit), Dutch covered bonds will benefit from extended investment limits for funds, insurers and banks, but not necessarily from a privileged risk weighting.

The official announcement stated: *'It has therefore been decided to create two legal categories to provide sufficient leeway concerning the type of collateral to be tied to covered bonds. In actual practice, this difference also resides in the two existing Dutch structured covered bonds, which underscores the importance of having two categories.'*

To benefit from extended investment limits, the respective covered bonds have to be registered at the Dutch Central Bank (DNB) as special-law based covered bonds. To benefit from a privileged risk weighting under CRD, the respective special-law based covered bond must also fulfil the requirements set in CRD. This has to be assessed on an individual basis

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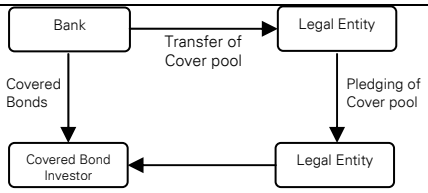
Dutch Covered Bonds – Legal Framework	
Name	NL Covered Bond – Geregistreerde Gedekte Obligatie
Legal background	• Legislature amended on 01.07.2008 – Besluit prudentiële regels Wft, Besluit gedragstoezicht financiële ondernemingen Wft • Minsiterial Order of July 2008
Special Bank principle	No
Supervisor	De Nederlandsche Bank (DNB) – The Dutch Central Bank keeps a register of all covered bonds issued
Issuer	Credit institution headquartered in Netherland
Eligible collateral	Generally no restriction; constraints on certain asset classes in case of CRD-compliant covered bonds
Loan-to-Value barriers	Not specified
Geographical scope of cover assets	Cover assets have to be subject to the jurisdiction of an EU-member state, USA, Canada, Japan, South Korea, Hong Kong, Singapore, Australia, New Zealand or Switzerland.
Interest rate, currency risk and maturity matching requirements	Nominal value and interest rate matching; additionally costs arising from an insolvency of the issuer have to be covered No other legal requirements like overcollateralisation, cash-flow matching between outstnanding bonds and cover pool, etc.
Substitute assets	No explicit restrictions; in case of CRD compliance substitute collateral representing claims on financial assets, is constraint to max. 15% of the cover-pool
Seniority	It is possible that other creditors (e.g. swaps counterparties) rank senior to covered bond holders
CRD compliance	Depending on structure
OGAW Article 22 (4) compliance	Yes
Basic structure	 Dutch Law demands the transfer of the cover assets to a not specified legal entity which in turn has to pledge the assets to another legal entity. The pledge has to be compliant with the Dutch jurisdiction or a similar jurisdiction of another country. Other structures are possible when approved.

Source: Deutsche Bank

So far, there are five banks with a Dutch covered bond program (ABN Amro Bank, Achmea Hypotheekbank, SNS Bank, ING Bank, NIBC Bank). To date, only ING Bank is registered as special-law based covered bond issuer. Other Dutch covered bond issuers are also interested to get their program registered. However, with the market for public EUR Jumbo issuance almost completely shut, it does not seem to be a real point from an issuers' perspective.

A bank has to apply to DNB for its covered bonds to be added to the covered bond definition under the Dutch law and then registered as special-law based covered bond. The DNB checks if the legal rules stipulated in the covered bond law and certain requirements regarding systems and risk management are met.

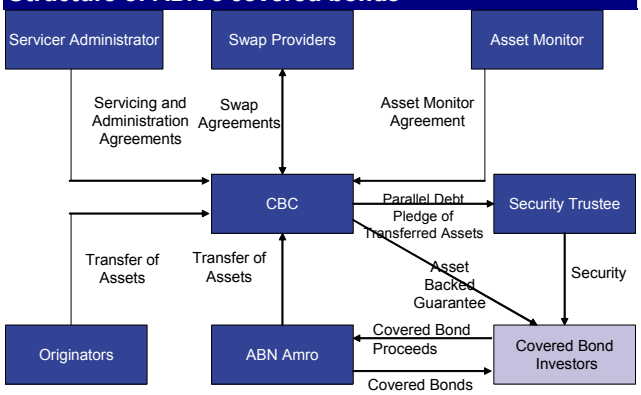
ABN COVERED BONDS

ABN launched the first Dutch structured covered bond backed by residential mortgages in Sept 2005. Old issues of ABN Bouwfonds are structured in a different way and are not impacted by the structured covered bond issues. ABN established a bankruptcy remote special purpose entity, ABN Amro Covered bond Company (Amro CBC) to which it transfers mortgage loans.

The transfer is done in the form of an assignment and without a notification of the borrower of the mortgage loans (mortgagor). In contrast to UK covered bond structures, no payments will thus be necessary. ABN has commissioned a legal opinion confirming that such assignment is bankruptcy remote. Amro CBC will thus not be affected in the event of ABN's insolvency. Amro CBC is a 100% subsidiary of ABN and as such will be fully consolidated. Amro CBC is owned by Stichting Holding ABN Amro Covered bond Company, a foundation established under Dutch law. Neither Amro CBC nor the owning foundation has any employees.

ABN Amro Bank acts as the issuer of the covered bonds, while Amro CBC guarantees the payment of the obligations. Hence, a dual claim of investors is stipulated, one against the issuer and one against the cover pool. Amro CBC pledges the transferred assets to a trustee. The guarantee would only be called following an issuer or AMRO CBC event of default. As a consideration for granting the guarantee, the originators have committed to transfer the eligible receivables to AMRO CBC.

Structure of ABN's covered bonds



Source: ABN Amro, Deutsche Bank

ABN Amro Bank is the initial servicer for the mortgage loans in Amro CBC but will have the option of delegating its servicing functions to another entity. If the rating falls below BBB-/Baa3/BBB-, a replacement server should be found. Notably, the Dutch market has developed a third party servicing market.

COVER POOL CREDIT QUALITY

Mortgage lending
The collateral pool consists of 100% first lien residential mortgages with no buy-to-let, commercial or non-confirming exposure. The maximum LTV is 80% for private mortgage loans and 100% for mortgage loans that are guaranteed by Nationale Hypotheek Garantie (NHG). Moreover, according to the documentation, the maximum individual loan size of ABN's covered bonds is not more than EUR 1.5 m.

According to Dutch law, an insurance of the property is required. A life insurance of the mortgagor is only required if the LTV is above 100%. The maximum individual LTV of the foreclosure value of a mortgage used as collateral is 130% but this level will decline to 125% if more than 5% of all mortgages used as collateral have a LTV ratio above 125%. At the time of the first issue, the weighted average LTV of the mortgage collateral pool was 78% and therefore well below the average of about 125% for Dutch mortgages. The weighted average original loan to foreclosure value of the cover pool of ABN RMBS, e.g. Shield 1 is typically at around 90%.

In the Netherlands, so called bank mortgages are usually used. The bank mortgage not only secures the mortgage loan but all other receivables. Hence, there are further claims that are not pledged to Amro CBC. Nevertheless, there is a trigger regarding ABN Amro's rating at which the other claims would also be pledged to Amro CBC.

Property valuation
Mortgages registered as collateral in Amro CBC will be re-valued quarterly using the Kadaster House Price Index. It is asymmetrical where increases account for 85% only, whereas decreases account for 100%. In the Netherlands, there is a forced sale value (Executiewaarde) concept, which reflects the higher transaction costs and the limited marketing period attached to a forced sale situation. Hence, the forced sale value is not comparable to the mortgage lending value, even if the resulting value may be similar, e.g. like the German mortgage lending value and is usually between 80% and 85% of the market value.

The forced sale value in residential mortgage lending is often determined together with the market value. In commercial mortgage lending, the forced sale value is of subordinate importance. For residential mortgages, most lenders require valuation reports from VastgoedCert (Institution for certifying valuers) certified valuers.

Geographic scope
ABN's issuance programme leaves room to use non-Dutch assets. Nevertheless, there are no indications for the inclusion of non-Dutch assets in the cover pool of ABN covered bonds.

Substitute collateral
Public assets benefiting from a zero percent risk weight are allowed as substitute collateral. Also UCITS 22 (4) and CRD eligible covered bonds, 20% risk weighted bank debt and AAA rated RMBS denominated in EUR are allowed as substitute assets. Substitute collateral is limited to 10% of the cover pool assets.

Covered pool monitor
There is no specific regulatory supervision of ABN Amro's covered bond. This is due to the lack of a dedicated legal framework and corresponds to the situation faced in the UK. An asset monitor, in case of ABN it is Ernst&Young, will perform quarterly reviews verifying whether all requirements laid down in the documentation of the covered bond have been complied with.

COVER POOL RISK MANAGEMENT

Prepayment risk
The total return swap, converting the mortgage interest payments, will hedge interest rate and prepayment risks in the cover pool. It does not secure the credit risk of the mortgage loans. Its purpose is to safeguard a margin of Euribor+70 bp. Hence, covered bondholders will not be subject to margin risk. The risk of 'negative carry', i.e. early redemption of mortgage loans with the need to pay the corresponding funds on an account yielding low interest, is eliminated and therefore not a concern for the holders of ABN's covered bonds. On the other hand, covered bondholders will not have any upside either if the margin increases in the (dynamic) cover pool.

Matching requirements
Besides the so-called asset coverage, amortization and the pre-maturity tests, there is no specific provision regarding asset and liability matching in case of ABN's structured covered bonds. However, in practice interest and currency risks will be hedged. The interest payments on mortgages and the coupon of the covered bond will be swapped into floating. ABN Amro is the initial swap provider. In addition, the minimum OC of ABN Amro's covered bonds is 8.1%, the reciprocal of the asset percentage in the asset coverage test.

The goal of the asset coverage test is to safeguard the predefined level of OC. The test is performed on a monthly schedule. The calculation specifically takes set-off risk into account. Should the coverage at any calculation date fall below the amount of bonds outstanding, ABN is obliged to transfer further assets to Amro CBC. In addition, no more covered bonds can be issued. As

mentioned above, the total return swap protects covered bond investors from margin deterioration in the cover pool.

Set-off risk
Set-off risk is the risk resulting from the possibility that a mortgage borrower sets off the loan against other assets, e.g. a credit balance in a current account. Such other assets are also the share of interest-only mortgages where principal payments are covered by life insurances which are common in the Netherlands. The life insurance is usually also pledged to the lender of the mortgage loan (mortgagee). If the insurance company does not serve the claim of the holder of the life insurance he may have the legal possibility to defend the claim of the mortgage with the failed payment of the life insurance contract. This is also a form of set-off risk.

Liquidity risk
If ABN's short term rating by Moody's falls below P1, ABN shall pay to Amro CBC an amount necessary to ensure that at all times Amro CBC has a reserve fund from which it can make the next interest and/or redemption payments under its guarantee for the outstanding covered bonds.

Moreover, there is a pre-maturity test to safeguard the liquidity status within the cover pool before bullet redemption. In case of insolvency of ABN, there is the risk that AMRO CBC would not have enough time to realize sufficient collateral to meet its payments coming due. This could lead to an event of default of Amro CBC. As long as ABN meets the P-1/A-1+/F1+ rating requirement, the pre-maturity test is in a stand-by status. Should the rating fall below this level, the pre-maturity test is performed on a daily basis within a 6- to 12-month period before a bullet repayment date. Hence, Amro CBC is monitored in the crucial phase of the process of realization of cover assets. Should the pre-maturity test fail, Amro CBC can choose one of the following or a combination of the following measures:

- Randomly select cover assets and liquify them. The funds from the liquidation have to be held in a pre-maturity ledger
- Cash transfer from the originator to Amro CBC. These funds have to be held in the pre-maturity ledger.
- Sign a takeout facility agreement with a suitably rated credit institution.

Taking derivatives into cover
The structure of ABN's covered bonds allows using derivatives as cover assets to hedge interest rate and currency risk. Derivatives are not considered in the calculation of the volume of the cover pool. Derivatives terminate in case of default of Amro CBC but not in case of ABN Amro case of default. The counterparty of the total return swap has to maintain a minimum rating of A1/P1/F1 by Moody's, S&P and Fitch, respectively. If this is no longer the case, the counterparty has to either post cash collateral or has to be replaced by a qualifying counterparty. Amro CBC will be allowed to replace the total return swap by either an active asset liability management hedging methodology under the form of a portfolio test or alternative swap arrangements subject to approval by the rating agencies. Derivative counterparties rank senior to covered bondholders.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
Cover assets will be transferred to Amro CBC in the form of an assignment. In contrast to UK Covered bond structures, no payments will thus be necessary. ABN has commissioned a legal opinion confirming that such assignment is bankruptcy remote. Hence, even though Amro CBC is a consolidated subsidiary of ABN Amro Bank, cover assets are segregated in an SPV in form of a LLP (Amro CBC). Amro CBC will not be affected in the event of ABN's insolvency.

Preferential claim and bankruptcy remoteness
If ABN is assigned a rating of BBB- or below, a third party will be entrusted with cover pool management. This party will then be responsible for the operational aspects of cover pool management. Review of compliance with the requirements laid down in the documentation will continue to be Ernst&Young's responsibility.

Should ABN fail to remedy a lack of coverage according to the asset coverage test before the next calculation date it will breach the asset coverage test and the trustee will serve a notice to pay. Instead of the asset coverage test, an amortization test is performed when the guarantee of the Amro CBC is triggered i.e. in the event of issuer insolvency.

As a successor of the asset coverage test, the amortization test again safeguards the sufficient coverage of bonds outstanding. The balance of the cover portfolio including cash and substitute cover has to match the outstanding covered bonds on a set-off risk adjusted basis. Should the balance fail to cover the bonds outstanding, the trustee is entitled to accelerate the covered bonds.

Early redemption of covered bonds is possible only if the amortization test fails, i.e. if the issuer, ABN Amro, is insolvent and the conditions of the amortization test are not fulfilled.

Legal protection for OC

As all mortgage loans in Amro CBC are considered insolvency remote, any OC available at the time of issuer insolvency is also considered insolvency remote.

ACHMEA COVERED BONDS

Structure very similar to ABN

Achmea Hypotheekbank uses a structure very similar to those of ABN Amro. The transfer of mortgage receivables to the Covered bond Company which guarantees the covered bonds issued by Achmea Hypotheekbank were completed using the Dutch law effected 1 Oct 2004. This allows for the transfer of legal title by registering a Deed of Assignment with the Dutch tax authorities. The borrowers will not be notified of the transfer unless Achmea Hypotheekbank's rating falls below Baa1 or, for as long as Achmea Hypotheekbank is not rated, its solvency level falls below the trigger level, which has been set higher than the level required by the Dutch Central Bank.

Covered bonds with soft bullet maturity

In contrast to ABN Amro covered bonds, Achmea covered bonds, have a soft bullet maturity. The extendable nature of the covered bonds mitigates the refinancing risk associated with the portfolio. The structure uses swap collateralisation or replacement triggers and servicer and GIC replacement triggers mitigate rating migration and the credit risk associated with each of the respective counterparties. The minimum OC is 10.5% which along with credit risks, market risks and refinancing risks caters for set-off risk associated with savings and certain life insurance mortgages in the cover pool.

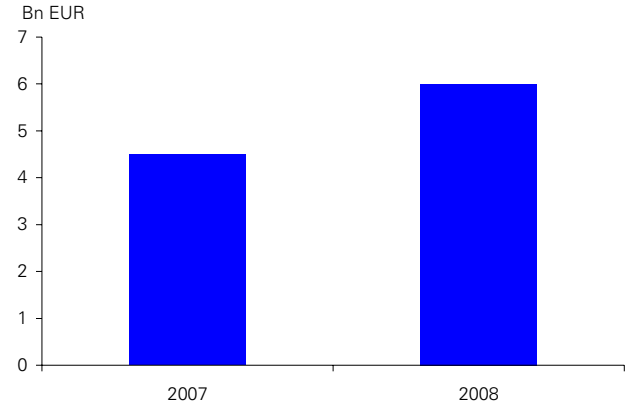
Norway

Outstanding volume of Norwegian EUR Jumbo covered bonds

	Maturity	Coupon	Supply Date	Volume	Issue Spread
SPABOL	10-Sep-13	5	03-Sep-08	1	48
DNBNOR	16-May-11	4.5	07-May-08	2	15
SPABOL	15-Jun-11	4	26-Feb-08	1	8
DNBNOR	01-Feb-13	4.125	18-Jan-08	2	11
DNBNOR	15-Nov-10	4.375	07-Nov-07	1.5	2
SPABOL	01-Oct-10	4.375	25-Sep-07	1.5	NA
DNBNOR	03-Jul-12	4.625	26-Jun-07	1.5	-4

Source: Deutsche Bank

Issuance volume of Norwegian EUR Jumbo covered bonds



Source: Deutsche Bank

As bank lending has increased more rapidly than bank deposits for several years, banks experienced an increasing funding gap, and therefore searched for alternative funding sources. Covered bonds were considered the best answer to this funding need. Appropriate laws and regulations have been adopted and thus cleared the way for covered bonds in Norway. Necessary amendments to the Financial Services Act (Articles 2-28 to 2-35) were adopted by March 2007, and complementary regulations by the Ministry of Finance (MoF) have been published in June.

Issue structure

In Dec 2002 the Norwegian legal framework for covered bonds was established by amendments to the Law on the Financing Business. The necessary secondary legislation was established in 2007. The specialist banking principle, allowing only specialised institutions restricted in their business to issue covered bonds, applies in Norway. These specialized credit institutions, so called

Kredittforetak, are limited to origination/holding of eligible assets and refinancing these assets by issuing Norwegian covered bonds. These institutions are licensed credit institutions, supervised by the Financial Supervisory Authority (Kredittilsynet) of Norway, in accordance with European banking legislation. A commercial bank or a savings bank cannot be allowed to issue such bonds in its own name, but has to establish a mortgage institution as a wholly owned subsidiary. The subsidiary can also be jointly owned by banks (Sparebank1 and Terra). Existing mortgage institutions have to restrict the scope of their business in order to comply with the law. The term 'covered bonds' (Obligasjoner met fortrinnsrett) or literally 'bonds with preferential claim' is protected by law. In line with the UCITS 22(4) requirements, the issuer will be subject to specific public supervision. Issuers have to inform the regulator Kredittilsynet no later than 30 days before the first issue. The regulator may refuse the mortgage credit institution the right to issue covered bonds due to credit quality reasons.

COVER POOL CREDIT QUALITY

Similar to the French and Swedish legal framework for covered bonds, mixed pools of public sector and mortgage assets are allowed.

Mortgage lending
Eligible mortgage assets are: Loans secured on residential property, on a document of proprietary lease of a housing unit or on a certificate showing that the lessee owns a share in the housing cooperative that owns the housing structure of which the unit forms part (residential mortgages) loans secured on other real estate (commercial mortgages) and on other registered assets. Residential mortgage loans qualifying for the cover pool may be secured on property to a maximum LTV of 75%, commercial loans with 60%. Lending activity is restricted to EEA and the OECD in case of mortgage loans. Loans with a higher LTV are allowed in the cover pool, however only accounted for up to the specified LTV limit. The Norwegian law does not require non-performing loans to be removed from the cover pool. However, only performing loans are accounted for in the matching calculation. LTV's in excess of 75% and defaulted loans create some hidden OC.

In case of the biggest issuer, DnB NOR Boligkreditt, only residential mortgage loans are in the cover pool. Moreover, DnB NOR Boligkreditt committed itself contractually that only residential mortgage or public sector loans will be used in the cover pool.

Public sector lending
Loans to municipalities and loans guaranteed by the state, a municipality or corresponding public body in other states (public sector loans), assets in the form of derivative agreements which meet further requirements set in regulations. Public sector loans can only be included if they are extended to states or local governments in the EEA or in the OCED. Exposures to debtors within the OECD but outside the EEA that fall into Credit Quality Step 2 must not exceed 20% of the nominal value of the covered bonds outstanding.

As Norwegian public bodies have very little debt and the banks are not very active in international public sector lending, public sector cover assets will not be important in Norwegian covered bonds.

Property valuation
The valuation of cover assets must be carried out in a prudent manner not exceeding the market value and the assessment must be on an individual basis by an independent valuor prior to their entry in the pool.

MBS/Covered bonds
In accordance with the CRD, RMBS/ CMBS are eligible as cover assets if backed by eligible cover assets qualifying for credit quality step 1 and limited to 20% of the cover pool.

Eligibility Criteria
The cover pool may only consist of the following assets:

- loans secured on residential property, on a document of proprietary lease of a housing unit or on a certificate showing that the lessee owns a share in the housing cooperative that owns the housing structure of which the unit forms part (residential mortgages),
- loans secured on other real estate (commercial mortgages),
- loans secured on other registered assets,
- loans to municipalities and loans guaranteed by the State, a municipality or corresponding public body in other states (public sector loans),
- assets in the form of derivative contracts which meet further requirements set in regulations,
- assets which constitute substitute collateral under the provisions of the fourth paragraph.

Substitute assets
Only particularly liquid and secure assets may be employed as substitute collateral. Substitute collateral may constitute up to 20% of the cover pool at any and all times (or up to 30 % with the consent of the supervisor), and have to be of the same quality as the other cover assets.

Claims (exposures) on institutions etc as mentioned in the CRD section 5-6 which qualify for credit quality step 1, shall in aggregate not exceed 15% cent of the nominal value of outstanding covered bonds. Amounts due to operation and management of the cover pool, including settlement of loans, and transfers of payments to preferential creditors shall not be included for the purpose of the 15% limit. The same applies to covered bonds issued by other institutions, cf. fourth paragraph. Claims on institutions within the EEA with a maturity of up to 100 days shall qualify for credit quality step 2 or better.

Taking derivatives in cover

Derivatives are allowed as cover pool assets for hedging reasons, i.e. with the intention to meet the matching requirements. Derivative contracts may be entered into with the following types of counterparty:

1. Clearing houses established in the EEA or the OECD area

2. States and central banks in the EEA or OECD area

3. Credit institutions established in the EEA or OECD area

Derivative counterparties' claims rank pari passu with those of covered bond holders in case of issuer insolvency. Derivatives ensuring the balance principle are allowed to be part of the cover pool. If the derivative agreement is NPV positive, it will be part of the cover pool, if negative, the derivative counterparties will have a preferential claim over the pool, pari passu with the holders of covered bonds.

Transparency requirements

Mortgage credit institutions have to report the register on a regular basis to the Norwegian banking regulator, which checks the adequacy of cash flows, market risk exposure and the evaluation of cover pool assets. There are no transparency requirements to investors. However, most issuers regularly publish cover pool data on a voluntary basis.

Cover register

The mortgage institution shall maintain a register of the covered bonds it issues, and of the cover assets assigned thereto, including derivative agreements.

Cover pool monitor

The independent cover pool inspector (gransker) has to be appointed by the Norwegian supervisory authority. The inspector checks on a quarterly basis the issuer's compliance with the requirements stipulated in the law and reports directly to the supervisory authority.

COVER POOL RISK MANAGEMENT

Matching requirements

The law establishes a strict balance principle, i.e. the value of the cover pool assets including derivatives must at all times exceed the value of the covered bonds with a preferential claim over the pool. According to the law, the cover pool assets and the covered bonds have to be evaluated by the market value. Also net present value matching is stipulated, i.e. the net present value of the cover pool shall at all times exceed the net present value of the secured liabilities. On top of this, e.g. DnB Boligkreditt committed itself to nominal matching, i.e. that the nominal value of the cover assets will not at any time be less than the nominal value of the issued covered bonds.

Equally, the mortgage credit institution shall ensure that the payment flows from the cover pool enable the institution to honour its payment obligations. The mortgage institution will have to adopt strict internal regulations with respect to liquidity, interest rate and currency risk. The law does not explicitly require hedging of all currency risk. However, as the Norwegian Krona is quite volatile versus the EUR, issuers are expected to fully hedge the currency risk. Issuers of Norwegian covered bonds have to model prepayment risk and if necessary have to build a liquidity reserve.

The issuer must also set limits for interest rate risk under the consideration of 100 bp parallel shifts and twists of the yield curve (divided into maturity classes). Also, stress tests for the whole balance sheets are required.

The Norwegian legal framework contains a 5% maximum exposure limit to reduce concentration risk. This borrower limit on a cover pool basis is unique in covered bond legislations. Loans to the same borrower and loans secured on the same collateral can only be included up to 5% of the total value of the cover pool. The Norwegian regulator Kredittilsynet can define exceptions to the 5% limit in cases where additional collateral exists.

Liquidity risk

The mortgage credit institution shall establish a liquidity reserve to be included in the cover pool as substitute collateral.

In respect to liquidity risk, periodic stress tests are stipulated to make sure that there is a satisfactory liquidity reserve. With respect to liquidity requirements, section 2-32 of the revised Mortgage Act states that cash flow from collateral assets must at all time meet scheduled payments of the covered bondholders and derivatives' counterparts. Secondary legislation only states that an

issuer must not take on more liquidity risk than can be considered 'securely'. Thus, it is up to the separate issuers to set the liquidity limits. On top of this, e.g. DnB NOR committed itself to the cash flow of the cover pool and covered bonds (including redemptions) being positive on a 6 month horizon.

COVER POOL BANKRUPTCY RISK

Asset segregation and bankruptcy remoteness

The law explicitly defines the mandatory procedures to be followed in case of bankruptcy and procedures to ensure timely payments. The cover assets remain with the estate in case of bankruptcy, but the bondholders have exclusive, equal and proportionate preferential claim over the asset pool, and the administrator is bound to assure timely payment, provided the pool gives full cover to the said claims. In case of bankruptcy of the issuer an administrator shall be appointed by the court. Bankruptcy or insolvency in itself does not give the bondholders the right to accelerate their claims. In case of issuer insolvency, a cover pool administrator (bostyret) is appointed. He has broad legal competences to ensure that the covered bonds and derivative contracts are paid. Together with the creditors' committee, the cover pool administrator can decide to sell cover assets in order to be liquid to repay covered bonds becoming due. If case of need, even new covered bonds may be issued against the separated cover pool. Potential fees and administration costs have to be borne by the cover pool and are senior to the covered bondholders. Only payment default will give the holders of preferential claims the right to declare default. If the cover pool is not sufficient to cover all the preferential claims, the administrator shall declare default of the pool and halt of payments. The cover pool administrator must respect and honour the rights of the bondholders and derivative agreements counterparties.

Preferential claim and bankruptcy remoteness

In the revised act, the preferential right to cover assets is explicitly stipulated. Hence, in case of insolvency of the mortgage institution, the bondholders/derivatives counterparts have a statutory preferential right to the cover pool. As long as covered bonds receive payments in due time, the claimants have no right to declare default. Details about this will be reflected in the individual agreements between the issuer and the trustee of the bondholders. This will also apply to any netting agreement between the company and its counterparties.

Legal protection of OC

No mandatory overcollateralisation (OC) is stipulated, but any voluntary OC is protected if it is registered in the cover register.

Risk Weighting

Before Dec 2002 holders of bonds issued by mortgage lenders did not have preferential claims. However, the Norwegian legal framework for covered bonds is in line with UCITS 22 (4). UCITS 22 (4) is applicable to EEA countries. This is stipulated in article 36 in the contract of the European Economic Area. The legal framework for Norwegian covered bonds fulfils the requirements of UCITS 22 (4). Norwegian covered bonds also fully comply with CRD. Hence, Norwegian covered bonds benefit from a priveleged risk weighting in Norway. To get a privileged risk weighting in EU member states, the respective covered bonds have to be notified to the European Commission. The notification is a formal act only. The EU Commission does not check the requirements itself. This is the responsibility of the national financial regulator.

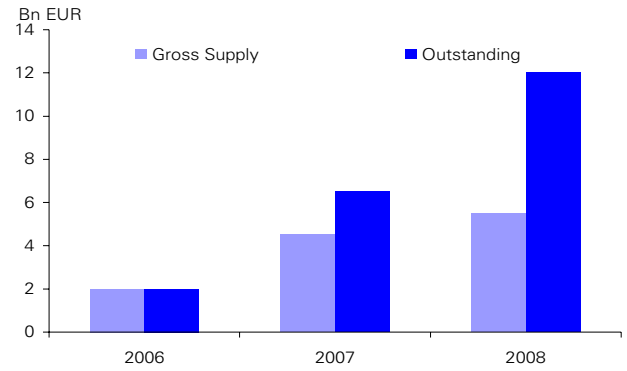
Besides the UCITS 22 (4), covered bonds have also to fulfil the requirements of CRD to get a privileged risk weighting. In our view, it will also be in line with Basel II/CRD. In the Norwegian legal framework for covered bonds, lending is geographically restricted according to risk classes. In line with the European Capital Requirement Directive (CRD), eligible countries have to be credit quality step 2 (equivalent to a minimum A- rating). In line with the CRD 'credit quality steps' as referred to in the MoF regulation imply the same credit quality steps as referred to in the CRD. Generally, the Norwegian law sticks closely to CRD. Hence, investors benefit from a privileged risk weighting.

Portugal

MARKET OVERVIEW

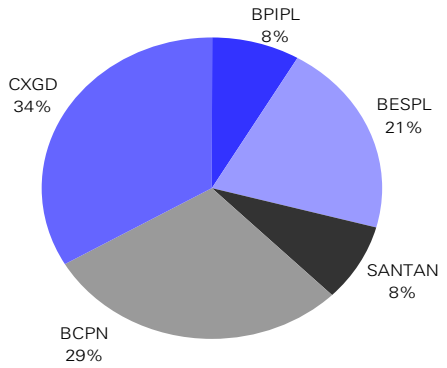
Caixa Geral Depositos (CXGD, Aa1s/A+s/AA-s), Millenium BCP (Aa3s/An/A+s), Banco Espirito Santo (Aa3s/An/A+s) Banco Santander Totta (SANTAN, Aa3s/AAs/AAwn) and Banco BPI (BPIN, A1s/As/A+s) are the banks which so far issued Portuguese EUR Jumbo covered bonds.

Outstanding volume of EUR Jumbo Portuguese covered bonds (EUR bn as of 31 Jan 2009)



Source. Deutsche Bank

CXGD the biggest Portuguese issuer of EUR Jumbo covered bonds (as of 31 Jan 2008)



Source: Deutsche Bank

LEGAL FRAMEWORK OF PORTUGUESE COVERED BONDS

The legal framework for covered bonds in Portugal was passed in March 2006 and differentiates between mortgage covered bonds (Obrigacoes Hipotecárias, OH) and public sector backed covered bonds (Obrigacoes sobre o Sector Público, OSP). The secondary legislation came into force 10 Oct 2006. The Portuguese covered bond law stipulates two possibilities to issue covered bonds. The issuer can either be a universal bank legally authorized to grant loans or a special issuer entity, a mortgage credit institution (MCI).

If the issuer is a universal bank the assets stay on the balance sheet. The bank is required to have an equity capital of at least EUR 7.5 m and be allowed to extend mortgage loans. There are no restrictions on business activities. In case the issuer is a mortgage credit institution (MCI), the originator will transfer the cover assets to the MCI. Assuming the MCI is wholly owned by the originator, cover assets will also remain on the originator's balance sheet as a result of the consolidation. The authorized business activity of the MCI is to grant and acquire mortgage or public sector loans and fund it through OH or OSP. MCI's may also undertake the management of assets that have been repossessed from defaulted credits, and undertake the activities necessary to obtain additional liquidity and manage the cover pool.

It is possible that the MCI has multiple owners. In such a case assets may not be consolidated back to the originators. This kind of issuance introduces the possibility of a pooling model in the Portuguese covered bond market. If the issuer is a universal bank it has its own employees. If the covered bonds are issued by a MCI, a subsidiary owned by the originator of the assets, it could be that the MCI has no own employees.

COVER POOL CREDIT QUALITY

Mortgage lending

First ranking performing mortgage loans in the EU are eligible as collateral for OH. They can be government-subsidized loans and the law considers the right to receive subsidies as part of the cover pool. Non-performing loans, meaning loans in-arrears for more than 90 days are not eligible as collateral. The maximum LTV is set at 80% for residential mortgages and 60% for commercial mortgages. Mortgage loans guaranteed by a credit institution or by an insurance company with counter guarantee for mortgage evidencing LTV limits also qualify as collateral. Non-first ranking mortgage loans granted by the same bank are eligible as collateral as long as the LTV limit is not breached. The underlying properties have to be fully insured.

Only credit institutions that are allowed to extend mortgage loans are allowed to assign mortgage loans to a MCI. The legal framework does not stipulate that the transfer of the asset needs to be registered in the land register or assigned by a public deed. The assignment does not need the acknowledgement, allowance or notification of the borrower. This generally eases the transfer of mortgage loans and improves liquidity of the secondary market for mortgage loans.

Property valuation
The basis of the valuation of underlying real estate properties is defined by the secondary legislation as the 'commercial value'. It is to be calculated by an independent valuer and is capped by the market value. It is determined according to criteria of prudence and taking into consideration the sustainable long-term characteristics of the real estate property. Hence the concept of the commercial value is quite similar to the concept of the mortgage lending value used e.g. for German Pfandbriefe. The valuation is subject to revision if there are indications that real estate values have been subject to a significant decline.

The issuer has to verify the value of the mortgage assets every three years for residential assets and on a yearly schedule for commercial assets, using statistical methods. This requirement is in line with CRD. Already existing valuations can be used, provided they are in-line with certain prerequisites of the law (independent valuer, written evaluation report, compliance with defined evaluation methods). The secondary legislation foresees that only cover assets exceeding certain limits (>5% of issuer's own funds or >EUR 500k for residential mortgages or >EUR 1 m for commercial mortgages) have to be revalued by the expert. The methods applicable to the valuation of the mortgaged asset are also defined by the secondary legislation.

Public sector lending
Debt of central governments, regional and local authorities in the EU or guaranteed by these entities are eligible as collateral.

MBS/covered bonds
ABS/MBS and covered bonds are not eligible as ordinary collateral. However, the cover pool can include substitution assets up to 20%. Substitute assets are bonds eligible within the scope of ECB credit operations. To the extent to which ABS/MBS and covered bonds are included in the credit operation of the ECB, they can be included in the cover pools of Portuguese covered bonds as substitution assets.

Geographical scope
Mortgage loans secured by property located in the EU or loans granted to central governments and regional or local authorities located in an EU member state. Hence, the geographical scope is quite strict compared to other legal frameworks for covered bonds.

Cover pool monitor
A common representative will be nominated by the board who, with the objective of acting in the interests of the holders of covered bonds will verify the compliance to applicable legal and regulatory requisites. An annual report must be released. The use of a common representative may avoid conflicts of interests amongst the note holders and speed up the process.

Transparency requirements
The Bank of Portugal has to be provided with a detailed composition of the cover pool. The covered bond issuing bank has to provide the Bank of Portugal with the minutes of the institution's management board meeting in which covered bond-related topics like the approval of the bondholder's representative, the appointment of the auditor or the evaluation expert etc. are discussed. Liquidity gaps have to be reported regularly to the Bank of Portugal. However, there are no transparency requirements concerning investors.

Substitute collateral
Substitute collateral is allowed up to 20% of the cover pool. Eligible substitute collateral is: Deposits with the Bank of Portugal, government bonds, ECB Tier 1 assets deposited with the Bank of Portugal, deposits in credit institutions rated at least A-/A3 which are not part of the same group as the issuing institutions and other low risk and high quality assets to be defined by the Bank of Portugal.

The secondary legislation limits the exposure to credit institutions to 15% of outstanding covered bonds, including derivatives, with a maturity of 100 days or more.

COVER POOL RISK MANAGEMENT

Prepayment risk
With prepayment penalties of up to 3% (prepayment fees, notary fees and commissions for new mortgage loans) of the initial mortgage loan amount and a market where variable rate mortgage loans overwhelmingly dominate, prepayment risk in the Portuguese mortgage market is limited.

Matching requirements
The amount of outstanding OH's is not allowed to exceed 95% of the amount of registered cover pool assets, leading to a minimum stipulated OC requirement of 5.3%. In case of OSP, the nominal amount of outstanding bonds is not allowed to exceed 100% of the respective cover pool assets.

The total interest to be paid on covered bonds cannot exceed the amount of interest to be received from the assigned mortgage loan pool (plus derivatives). Also, the average maturity of mortgage bonds cannot exceed the average life of cover pool assets. Currency risk must be

hedged. Covered bonds must not be issued with a maturity of less than two or more than 50 years.

According to the secondary legislation by the Bank of Portugal, covered bond issuing institutions must have adequate risk management and control systems and hence must have specific policies for risk limitation, namely currency, liquidity, interest rate, counterparty and operational risk.

On a net present value base the coverage has to sustain a parallel shift of the yield curve of 200 bp, a conservative mark compared to other legal frameworks. In Germany a 250 bp shift is used in the static approach, though the more common dynamic approach only requires a shift of typically around 100 bp. Furthermore, the Bank of Portugal has to be informed about the level of exposure to interest rate risk. In case of Caixa Geral, to hedge against any interest rate mismatches, the cover pool and the covered bonds are swapped into floating rate.

Liquidity risk

The task of liquidity management in the secondary legislation by the Bank of Portugal is tackled by the definition of a liquidity map. It defines <1M, 1M-3M, 3M-6M, 6M-12M, >12M brackets within which cash inflows from the loans have to exceed cash outflows to covered bondholders. Also, the original maturity date of the OH can been extended by up to 12 months to compensate for maturity mismatches between the amortising loans in the cover pool and the bullet redemptions of the securities. During the extension period, the securities would continue to accrue interest that would be paid monthly.

If needed and in order to cure a temporary lack of short-term liquidity, credit facilities could be contracted and activated and funds can be used only to pay interest and capital to bondholders. The liquidity reserve should cover at least six months of refinancing. Nevertheless each company can fix this in its articles of associations. The counterparties of these credit facilities have to be rated at least A-. The counterparties of the credit facility are subordinated to the covered bondholders and the counterparties of derivatives. There is no further specific regulation regarding these credit facilities in case of insolvency.

Taking derivatives into cover

Derivatives contracts are permitted in the cover pool for hedging reasons. With the registration of derivatives in the cover register, the counterparties have a preferential claim on the cover assets and hence rank pari passu with the covered bondholders. To be eligible the derivative contracts have to be traded in a regulated market in the EU, in a member state of the OECD or with a bank rated at least A-. The risks to be hedged are interest rate, exchange rate and liquidity risk.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools

The assets assigned to the covered bond issues as well as derivative contracts shall be in separated accounts of the issuer and be identified under a codified form in the issue documents. This information will be deposited in the Bank of Portugal in form of a code key.

In the case of insolvency of the issuer, the assets pledged to covered bonds will be separated from the insolvent estate for the purpose of its independent management until full payments due to the covered bond holders have been made. Despite this, the law stipulates that timely payments of interest and reimbursements should continue to be carried out. By stipulating a separation of the cover pool assets from the insolvency estate, the legal framework for covered bonds supersedes the general bankruptcy regulation.

Preferential claim and bankruptcy remoteness

The Bank of Portugal can appoint another credit institution to take over the management of the cover pool as well as the payments of interest and redemption payments to the holders of covered bonds. Being provided with access to the documentations of the underlying loans the bank taking over is to perform all acts and things necessary for the sound management of the receivables and relevant guarantees, for the purpose of ensuring due payment of all amounts due to the holders of the bonds, including the sale of the credits, as well as ensuring the collecting services.

If the issuer becomes insolvent, the covered bonds do not automatically accelerate, but a covered bond holders' meeting may decide by a majority of 2/3 to put the mortgage bonds, in which case, the administrator shall provide for the settlement of the estate assigned to their respective issue. If the assets from the cover pool are not enough to pay interest and reimbursements, covered bondholders rank pari-passu with unsecured creditors of the originator.

Legal protection for OC

The law stipulates a minimum OC of 5.3%. If the limits defined in the legal framework are breached, including the mandatory OC, the issuer shall settle this immediately by assigning new mortgage credits, repurchasing outstanding covered bonds in the market and/or assigning other eligible cover pool assets. There is no specific provision in the law regarding voluntary OC. But, if voluntary OC is made contractual by the issuer, then it is part of the cover pool, registered and becomes insolvency remote. Hence, the OC (mandatory and voluntary) is considered to be insolvency remote.

Risk Weighting

OH and OSP fulfil the requirements of UCITS 22 (4). OH and OSP benefit from a privileged risk weighting in Portugal and in most other EU countries. The compliance of OH and OSP with Basel II/CRD was in question before the Bank of Portugal issued the secondary legislation as the use of bank debt as substitute collateral is not restricted in the Portuguese covered bond law. As this was solved by the secondary legislation, OH and OSP are in line with Basel II/CRD. Hence, OH and OSP benefit from a privileged risk weighting under Basel II/CRD. Moreover, the secondary legislation itself made it clear that Portuguese covered bonds benefit from a privileged risk weighting.

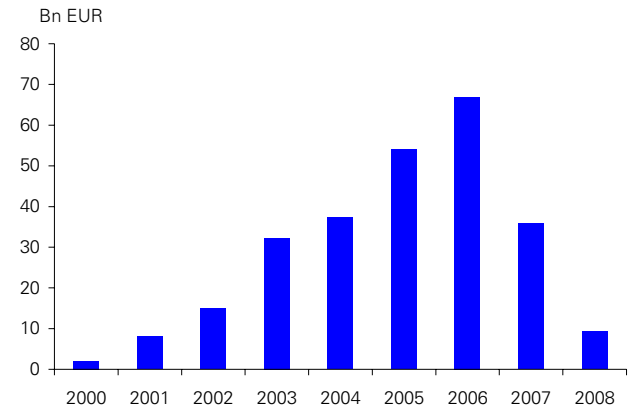
Spain

MARKET OVERVIEW

Since its start in 1999, the yearly new issuance volume of Spanish Cédulas continuously increased and took over the lead position for the first time in 2005 (EUR 54 bn) from Germany (EUR 47 bn) in terms of new issuance of EUR Jumbo covered bonds. With a total issuance volume of EUR 66 bn (including EUR 4 bn Cédulas Territoriales) and a share of 37%, Spain headed the new issues of EUR Jumbo covered bonds in 2006.

With around EUR 36 bn of new issuance in 2007, Spain ranked second in terms of new issuance (behind France) with a market share of 22%. Mainly due to the difficult market environment in H2 2007, the EUR Jumbo Cédulas supply declined significantly in 2007. With EUR 36 bn, 2007 supply was even lower than supply in 2004 (EUR 32.3 bn). New issuance of Cédulas collapsed completely in H1 2008 and the market was shut in H2 2008. Given the ongoing meltdown of the Spanish housing market, this is unlikely to change in 2009.

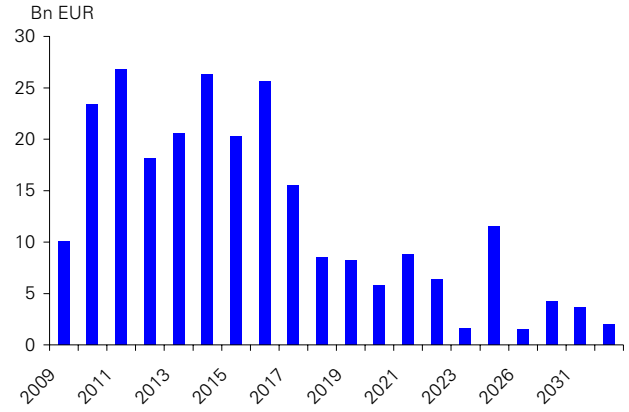
Gross issuance of EUR Jumbo Cédulas declined significantly in 2007 and 2008 (EUR bn)



Source: Deutsche Bank

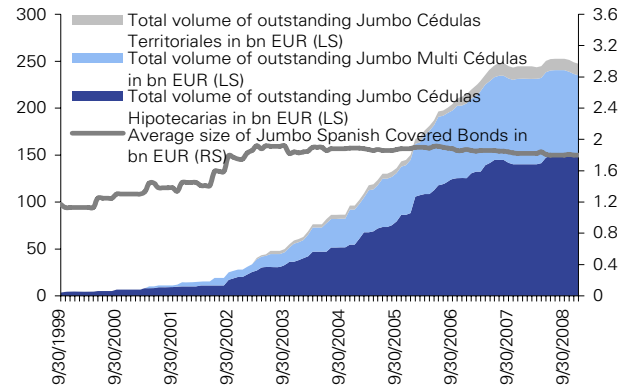
The fact that the Cédulas market only emerged in size from 2002 onwards leads to low redemptions in 2009. The high issuance volumes in the past (mainly long dated) suggests that Spanish banks funded mortgage loans on a long term basis and have little Cédulas refinancing to do in 2009.

As the Cédulas market is quite young, upcoming redemptions are low (EUR bn)



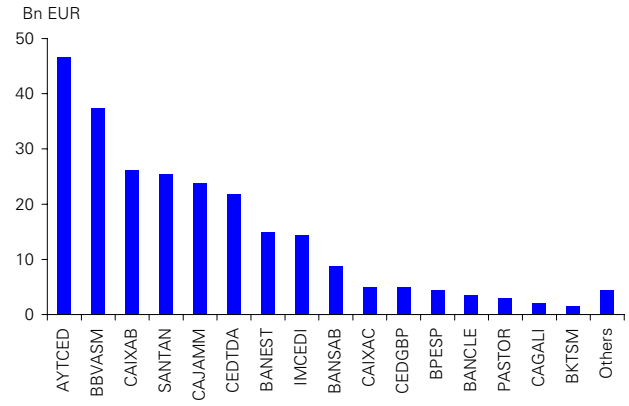
Source: Deutsche Bank

Growth in outstanding volume of Spanish Cédulas stopped in 2008 due to low issuance



Source: Deutsche Bank

With an outstanding volume of EUR 46 bn, AYT still ranks No 1 in the public Spanish Jumbo Cédulas market



Source: Deutsche Bank

LEGAL FRAMEWORK FOR CEDULAS

Issue structure

On 22 Nov 2007, the Spanish Parliament passed amendments to the Spanish Mortgage Market Law (Law 2/1981). A secondary regulation will develop some specific details on the amendments. The changes in the legislation have strengthened and clarified the credit position of the holders of CHs as well as the timely payment of the CHs following issuer insolvency.

Cédulas Hipotecarias (CH) and Cédulas Territoriales (CT) are issued by credit institutions regulated by the Bank of Spain. Issuers have no business restrictions, i.e. complete freedom of business areas. As there is no specialist bank principle stipulated, Spanish Cédulas can be issued by all banking groups (commercial banks, savings banks, cooperative banks and financial credit institutions). CH and CT are direct, unconditional obligations of the issuer. The cover assets are not transferred to a different legal entity, the issuer holds the collateral assets on the balance sheet. The issuer has its own employees. Being a credit institution, one of the requirements in order to be granted the authorisation for carrying out business is to have adequate human and material resources stipulated in the credit institution's legislation.

The legal framework allows the issuance of a second category of Cédulas: Multi-Cédulas, repackaged pools of single Cédulas Hipotecarias. These Multi-Cédulas are issued by a special entity and backed by a number of Cédulas issued by single banks allowing smaller banks to access the Cédulas market more easily. The special entity issuing the Multi Cédulas has the legal structure of a Fondos de Titulización (FTA) which, in line with Spanish mortgage securitization legislation, will be managed by a fund manager Ahorro y Titulización S.G.F.T (Sociedad Gestora de Fondos de Titulización), who represents the interests of Multi-Cédulas holders.

The fund has no own legal status and cannot enter into insolvency proceedings. According to Spanish law, the FTA has no owners. The SGFT is a special purpose management company with limited liability under supervision of the Comisión Nacional del Mercado de Valores (CNMV) and mandated to act for the holders of Cédulas issued by the FTA. The assets must be held separately from the fund manager's other assets to avoid the assets being included in the insolvency proceedings of the fund manger. The Bank of Spain can prevent the issuance of covered bonds if a breach of regulations is expected.

The new law promotes the issuance of Bonos Hipotecarios (BHs). Unlike CHs, BHs are collateralised by an earmarked eligible cover pool selected by the issuer and not by the whole mortgage book. This class of covered bonds was already an option before the amendment of legal framework but it has not been used to date in light of the onerous administrative and economic burden derived from the current requirement of registering all eligible assets in the property register. The amendments of the law removed this requirement and regulate BHs in the same way as CHs, but decree a minimum 2% OC on a net present value basis.

COVER POOL CREDIT QUALITY

Mortgage lending

Eligible mortgages are first lien mortgages on property wholly owned by the mortgagor. The maximum LTV is 60% for commercial and 80% for residential mortgages. Residential and commercial LTV ceilings may rise to 95% and 80%, respectively, if there are appropriate guarantees. The circumstances in which an LTV can exceed the respective limit have to be prescribed in a separate Royal Decree. Mortgage loans with an LTV over the limits are neither in total nor in part eligible ordinary collateral. Hence, there is no split of a mortgage loan in two parts, one of which is eligible as collateral and one of which is not, as is the case in Germany for example. Nevertheless, as a result of the amortization of the mortgage, the loan might qualify as collateral later.

With the amendment of the legal framework, the maximum LTV ratio (for eligible non-residential mortgages for the purposes of calculating the issuance limit) was lowered from 70% to 60%. Unlike other jurisdictions that allow loans of even 100% LTV to become eligible if only the first 60% percent of the value is included in the cover pool, in Spanish law mortgages are only eligible if the whole loan amount does not exceed 60% of the appraisal value of the property for non-residential and 80% for residential properties.

With the latest amendment, the geographical scope of eligible mortgages was extended to properties located in the EU on the condition that the security is equivalent to that under Spanish law. Substitute assets were permitted up to 5% of the outstanding CHs. Substitute assets may include CHs, Aaa-rated ABS or RMBS issued by entities not belonging to the issuer's banking group or any other lower-risk and liquid assets as stipulated in the forthcoming secondary regulation.

Property valuation

LTVs are applied to the appraisal value that is a long-term, less volatile concept than the market value. The so-called 'Sociedades de Tasación' who is a valuation agent registered and supervised by the Bank of Spain must have valued the mortgaged properties. The appraisal should pursue the mandatory rules, in particular, those issued by the Spanish Finance Ministry (Ministerial Order of 27 March of 2003 on appraisal of real estate goods and some rights for some financial aims).

The mortgaged assets must be insured against damages (excluding the non-insurable goods, such as the plot of land). If the value of a pledged property falls below 80% of its value at origination of the mortgage loan, the mortgage loan borrower could be required to provide additional collateral or prepay the loan in part after two months of not providing enough collateral.

Public sector lending

According to our understanding, the law does not stipulate any risk weighting restriction for public sector assets to be eligible.

Cover register

Cédulas issuers are obliged to maintain an internal cover register identifying eligible and non-eligible assets. The key elements of this information have to be publicly available in the annual reports.

COVER POOL RISK MANAGEMENT

Matching requirements

There are no legal requirements with respect to interest rate or cash flow matching. Hence, there is no limit on interest rate risk. For that CH that were issued as FRNs, the spread to the referring variable rate has to be fixed below the level of the respective mortgages. Currency risk is also not explicitly addressed in the Spanish legislation.

The maximum amount of CHs that can be issued was reduced to 80% of the bank's 'eligible mortgages' (vs. 90% before) – providing for 25% minimum OC. Moody's mentions that a key strength of Cédulas is that in case of issuer insolvency the whole pool of mortgages (excluding securitized mortgages) backs the bonds.

The outstanding amount of CT is limited to 70% of the nominal amount of eligible public sector loans, leading to a minimum OC requirement of 42.7%. If the minimum OC in case of CH and CT is at any time not met it has to be restored within a period of not more than three months via the addition of eligible collateral, the acquisition and/or redemption of outstanding Cédulas. Moreover, if the OC requirement is no longer fulfilled, an issuer has to deposit a respective cash amount or volume of government bonds at the Bank of Spain within 10 days.

In the following four months, the issuer would be required to add additional collateral or buy back Cédulas to meet the OC requirement. According to Article 60 Royal Decree

685/1982, the issuer has the right and the obligation to prepay Cédulas in a lottery procedure if the minimum legal OC requirement cannot be corrected otherwise. This prepayment and its procedure have to be announced beforehand in an official public paper (Boletin Oficial Del Estado). The prepayment date would be three months after the lot procedure.

Liquidity risk
Since there is no matching principle for interest payments and also no limit on interest rate risk, the potential liquidity risks are substantial. Uncertainty regarding liquidity results from the differing amortization profile between collateral assets and Cédulas. However, since the latest amendment of the law in Nov 2007, issuers can use derivatives to hedge interest rate and currency risk. Moreover, the high OC requirement also reduces the liquidity risk.

Taking derivatives into cover
Spanish issuers usually hedge their interest rate exposure resulting from floating rate mortgage loans and fixed rate Cédulas via swaps. While the preferential claim of Cédulas holders also refers to derivative contracts registered in the cover register, we have some doubts about how this works in practice.

Cover pool monitor
There is no special cover pool monitor in case of Spanish Cédulas acting in the interest of the Cédulas holders. Also in case of insolvency, there is no separate cover pool administrator. It is the normal insolvency administrator who administers the cover assets. Under Spanish Insolvency Law, the bankruptcy is directed by the commercial court of competent jurisdiction and managed by a specific body called the 'bankruptcy authority' ('administración concursal'), comprising three persons: an attorney, an auditor or economist, and a creditor with ordinary debt or general privilege.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
The assets eligible for Cédulas remain on the balance sheet of the issuer but have to be registered in a cover register. CH are backed by all mortgage loans on the balance sheet of the issuer, even if they do not fulfil the eligibility criteria. These ineligible mortgage loans might be above the LTV limit or not registered in the National Mortgage Registry.

Preferential claim and bankruptcy remoteness
CH (CT) creditors have a priority claim on all granted mortgage (public sector) assets. The preferential claim of Cédulas holders also includes substitute assets and derivatives. Hence, the preferential claim of CH holders is not restricted to eligible assets. Mortgage loans assigned to Bonos Hipotecarias and Participaciones Hipotecarias, which are other less usual types of mortgage backed covered bonds, are excluded from the preferential claim of Cédulas holders. Moreover, few claims like those of the issuer's employees for wages and salaries for the last 30 days and certain tax liabilities rank senior to the claims of Cédulas holders.

Three administrators will be appointed to run the insolvency and bankruptcy procedure of an insolvent or defaulted bank. After the insolvency declaration the involved parties are legally encouraged to seek solutions ensuring the continuity of the affected bank. Final decisions regarding insolvency proceedings are made by the commercial courts. None of these three administrators has special or sole responsibility for the outstanding Cédulas or the underlying collateral assets. The joint responsibility of the administrators for both secured and unsecured creditors can be seen as a potential source of conflicting interests

A crucial change in the amendment of the Spanish insolvency regime in Sept 2004 was the replacement of the 'retroactivity rule' with the 'reintegration rule'. This rule is relevant for the period between the date the court believes the bankruptcy initially arose and the date of declaration of bankruptcy. The period between these two dates is limited to a maximum of two years. All transactions entered within this period that have not been conducted at an arm's length basis would be declared void. Respective creditors of those transactions would turn into non-privileged creditors. The concern was that holders of Cédulas brought to the market during this period could lose their preferential claim. However, since only unlawful actions, such as fraud, and those transactions that are not regular business activities or were not concluded at market conditions, would be considered void, Cédulas issues are very unlikely to be impacted.

The legal amendment introduced in Nov 2007 includes the stipulations already contained in the Insolvency Code of 2003, whereby all cashflows stemming from the cover pool will be redirected to the Cédulas holders in an insolvency situation. The bankruptcy administrator has the obligation to avoid any payment shortfall on the Cédulas by selling the substituted assets and, if this is not sufficient, by entering into a funding agreement to ensure the payment. Any counterparty providing such funding ranks equally with any Cédulas holder. The bankruptcy administrator is thus more easily able to borrow funds against the cover pool in order to make payments under the Cédulas, as the lender should benefit from the security provided by the cover pool.

MULTI CEDULAS STRUCTURES

There are two kinds of Multi-Cédulas. Stand-alone Multi Cédulas and Multi-Cédulas issuance programmes. In case of stand-alone Multi-Cédulas, the number of the participating banks and the amount of their individual single Cédulas issues is fixed and stays unchanged until maturity. A new FTA has to be established as a closed fund, for each transaction. In contrast, in case of Multi-Cédulas programmes, the number and amount by each participating bank might change via taps. A stand-alone Multi-Cédulas has the same payment characteristics as the underlying Cédulas. Typically the payment date of the underlying ordinary Cédulas is two days prior to that of the stand alone Multi-Cédulas, easing the liquidity management. Moreover, coupons of the single issues are usually somewhat hgher to cover the costs of the transaction.

Liquidity support not a credit enhancement

Multi-Cédulas benefit from liquidity support provided by a cash pool or a liquidity facility. The liquidity facility must be sufficient to cover the interest payments for at least one year in case of default. The cash pool is applied in stand-alone Multi-Cédulas AYTCED I and AYTCED VIII and CEDTA 1 and CEDTDA 4. The cash pool supports the timeliness of payment, i.e. reduces the probability of default. The redemption of amounts paid under the liquidity support mechanism rank senior to the redemption Multi-Cédulas. Hence, the liquidity support mechanism is not a credit enhancement.

Until Nov 2004, the Multi-Cédulas regularly used a subordinated loan to safeguard liquidity of the structure. Again, the purpose is to provide security for coupon payments of Multi-Cédulas. In case the subordinated loan was not needed, the amount provided by the individual banks is paid back after the Cédulas issue is redeemed on maturity. The subordinated loan structure increases the balance of the respective FTA. Hence, it offers better credit enhancement than the liquidity line structure that offers no credit enhancement at all. A negative point is that the subordinated loan is provided from the banks itself and not from external institutions like Spanish agency ICO which provides the liquidity line for the AYT Cédulas Cajas Global.

As the subordinated loan increases funding costs and is penalized under Basel II from a risk weighting perspective, the liquidity line will dominate the future of Multi-Cédulas structures. Liquidity providers are ICO for AYT, IXIS, Banco Popular Espanol and HSBC for Intermoney, AIG Banque, IXIS and Caja Madrid for TDA and IXIS for Pitch.

Soft bullet structure

Generally, a plain vanilla bond defaults if it is not fully paid in time. To prevent a default in case of financial problems of one of the participating banks shortly before maturity, Multi-Cédulas have a soft-bullet maturity. This allows a maturity extension that is fixed for most transactions, enabling the realization of loan collateral to serve the outstanding Multi-Cédulas. In case of single Multi-Cédulas the maturity extension is fixed for three years.

MULTI CÉDULAS ISSUANCE PROGRAMMES

At the end of 2005, AYT and TDA set up structured Multi Cédulas issuance programmes to reduce issuance transaction cots. Via this AYT and TDA got the possibility for ongoing issuance of structured Multi Cédulas without the need to set up a FTA for every new issue.

The global issuance programmes established differ from the previous structures and also from each other. AYT Global is limited to the 43 Spanish savings banks. Like in other AYT structures, ICO is the liquidity provider. A tap of an issue made under the global programme can be executed via a different composition of savings banks than the original issue. Hence, as the tap is fungible with the original issue, a tap changes the percentage composition as well as the number of Cajas involved in the total issue. TDA's global program consists of six series. In TDA's programme the liquidity line is guaranteed by Caja Madrid, which itself is participating as Cédulas issuer. InterMoney Master Cédulas FTA enables Multi Cédulas issues up to 2009 without taps.

AYT Cédulas Cajas Global

AYT Cédulas Cajas Global is a FTA programme issuing fixed or floating rate Cédulas backed by single Cédulas issued by up to 43 Spanish savings banks. The main characteristics of AYT Cédulas Cajas Global are:

- An open fund capable of making new issues or taps of Multi Cédulas for a maximum of 20 years
- Brings up to 10 issues during the first three years to the market, and then up to five issues per year in the following 17 years. These issues are independent from possible tap issues
- The maximum amount to be issued by the fund is EUR 200 bn in total
- The maturity of the fund is the largest maturity of the issued Multi-Cédulas, which will not be larger than fifty years. The only one final legal maturity date is associated with the programme as a whole and not with each single issue. The final legal maturity is

shared by all the issued Multi-Cédulas. Hence, there may be the case of a particular tranche that is expected to mature in 10 years having the same legal maturity of a tranche with a 20 years expected maturity.

- The legal final maturity of the fund will be three years after the longest maturity of any current or future issue. The three years gap between the expected and the legal final maturity of the CH is to allow the required recovery time in case that defaults would crystallize just prior to maturity.

Hence, in case of the AYT Cédulas Cajas Global the soft bullet extension can be materially longer than in case of single Multi Cédulas where it is fixed for two or three years. E.g., the legal maturity of the two issues of AYT Cédulas Cajas Global AYT No. 8 is Nov 2022, whereas the expected maturity is Nov 2014 and 2019 respectively. But even the legal maturity can be extended. As mentioned above, the global programme of AYT foresees that the legal maturity is three years after the maturity date of the longest issue. This would be Dec 2025.

AYT's programme requires a minimum level of OC for the participating single Cédulas issuers on a contractual basis. The minimum collateral ratio, i.e. the whole mortgage portfolio collateralizing the respective individual Cédulas, has to be maintained at 150% at all times. If the collateral ratio falls below 150%, a deposit protection mechanism is triggered.

The individual Cédulas belonging to one issue will include the same terms and conditions, including coupon rate, payment date, and legal maturity. Payments on the individual Cédulas are made two working days before the payments on the Multi-Cédulas to avoid cash flow mismatching. Each Multi-Cédulas issue has its own treasury account provided by triple-A rated Spanish agency ICO. All the Multi-Cédulas of the global issuance programmes are supported by one of two liquidity lines provided by ICO, one to cover interest payments on floating Cédulas and the other one to cover payments on fixed Cédulas. There is adequate downgrade language for the liquidity line provider.

On behalf of the issuer (AYT), the fund manager (Ahorro Corporación Financiera) will enter into certain contracts to protect against certain credit losses and liquidity shortfalls assumed to arise in connection with holding the Cédulas. Each individual Cédulas needs to respect the expected maturity date that is originally stated. If not, the Multi Cédulas will default. In that scenario, the AYT SGFT will initiate legal actions against the defaulted single Cédulas issuer in order to obtain the recoveries.

Liquidation Events of AYT Cédulas Cajas Global

AYT Cédulas Cajas Global may be subject to liquidation before the legal maturity date of the notes. The programme documentation provides for an early amortization if:

- All of the assets and liabilities of a series have been fully amortized.
- As determined by AYT, there is a financial imbalance in that particular series and it does not affect the fund as whole.
- As determined by AYT, there are exceptional circumstances that make it impossible or extremely difficult to maintain the financial balance in that particular series and it does not affect the fund as a whole.

Early liquidation will take place only if there are sufficient funds to pay the outstanding principal and accrued interest on the Multi Cédulas in full. Partial redemption of the principal of the Multi Cédulas may occur if an individual Cédulas issuer chooses to buy back the individual Cédulas it issued from AYT Cédulas Cajas Global.

On each payment date and for each of the Multi Cédulas, AYT SGFT will allocate the available funds in the following payment order:

- Taxes, commitment fee amounts, and extraordinary expenses
- Interest on the notes
- Repayment of liquidity line
- Amortization of the notes (bullet payment)
- Repayment of the protection deposit fund

CEDULAS EXEMPT FROM WITHOLDING TAX

In Feb 2005, the Spanish Tax Authority issued a clarification which confirmed that the tax regulation stipulated in Law 19/2003 is applicable for debt instruments issued directly by Spanish credit entities. Hence, Cédulas bought by foreign non-EU investors are like non-Spanish EU investors exempt from Spanish withholding tax. Back then, the treatment of Multi-Cédulas was not clear.

Multi-Cédulas also exempt from withholding tax

Law 23/2005 as of 19 Nov 2005 made clear: All Multi-Cédulas issued after 7 July 2003 are exempt from Spanish withholding tax. The prerequisites for this tax-emption are the same as for debt instruments issued directly by Spanish credit institutions:

- The holder is not a Spanish resident
- The holder is not a resident of one of the countries defined as tax haven by Spanish law
- Disclosure of the respective notes, the identity and country of residence of the respective holder and the amount of income paid in each period

Hence, non-tax haven, non EU-investors in Spanish debt issues like single seller Cedulas and Multi-Cédulas, who fulfil the disclosure requirements do not have to pay withholding tax.

Tax haven countries under Spanish legislation

Andorra	Gibraltar	Monserrat
Anguilla	Granada	Naurú
	Guernsey and Jersey	
Antigua and Barbuda	Islands	Netherlands Antilles
Aruba	Hong Kong	Oman
Bahamas	Isle of Man	Panama
Bahrain	Jamaica	Salomón Islands
Barbados	Jordan	San Marino
Bermudas	Lebanon	Seychelles
British Virgin Islands	Liberia	Singapore
Brunei	Liechtenstein	St. Lucia
		St. Vincent and the
Cayman Islands		Grenadines
Cook Islands	Macao	Trinidad and Tobago
Cyprus	Malta	Turks and Caicos Islands
Dominican Republic	Mariana Islands	U.S. Virgin Islands
Falkland Islands	Mauritius	United Arab Emirates
Fiji	Monaco	Vanatau

Source: Clearstream, Deutsche Bank

Income obtained from either direct issues or securitization funds from Spanish issuers by non-EU holders, except those residing in a tax haven jurisdiction, is treated in the same way as income deriving from Spanish Public Debt. The law does not apply to those holders operating in Spain through a permanent establishment. Income obtained through tax haven territory, or non-resident investors who do not comply with the information requirements, will be subject to withholding tax, currently at a rate of 15%.

Guarantee mechanisms for Spanish banks

Some Spanish savings banks have been taken under special supervision by the Bank of Spain since provisions no longer cover non-performing loans. Therefore, the question of support is important.

The main function of the Deposit Protection Fund is to provide protection to depositors up to EUR 20,000. The Deposit Guarantee Fund is also able to provide financial support to any of its members in case of trouble. Support could include equity injections, subordinated lending, any other guarantee or merger with another other banks. The Deposit Protection Fund can require member banks to replenish the fund.

Exceptionally, when according to the information supplied by the Banco de España, the situation of a credit institution is such that it may be foreseen that the Fund shall be obliged to make payment, pursuant to article 8 of the respective Royal Decree, the Fund shall be able to carry out preventive measures and reorganization of the

institution concerned with a view to improve its viability and enabling it to overcome its crisis, within the framework of an action play agreed by the institution and approved by the Banco de España.

The action plan of the institution in crisis, provided it has the support of a Deposit Guarantee Fund, may include the following actions:

a) Financial aid, which may consist of subsidies, granting of guarantees, loans und favourable conditions, subordinate financing, acquisition for the fund of damaged or unprofitable assets that appear on the institution's balance sheet, together with any other types of financial support.

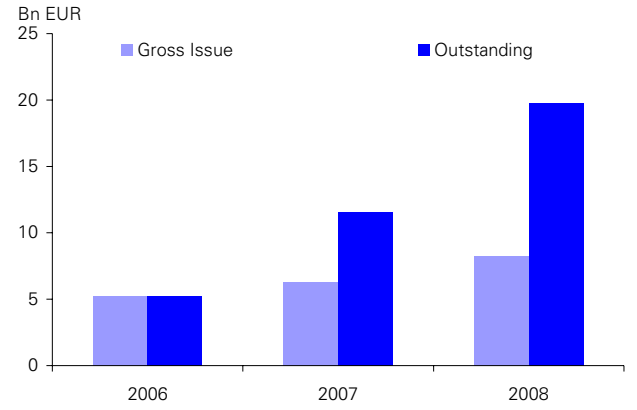
b) Restructuring of the institution's assets, which may entail, among other measures, the appropriate application of the institution's own resources in order to absorb its losses, in the light of the particular circumstances of each case; facilitating a process of merger with, or take-over by, another institution of recognised solvency or the transfer of its business to another credit institution; subscription of capital increases by the Banking Institution Fund, in accordance with the provisions of the following sections; and adoption by the relevant bodies of the institution concerned of all such resolutions as guarantee the appropriate application of the support given by the relevant Deposit Guarantee Fund.

c.) Management measures that improve the organization, procedural systems and internal control of the institution.

Hence, while the details of the support mechanisms and the current financial strength of the Deposit Protection Fund are not clear to us, it does appear that there is systemic support.

Sweden

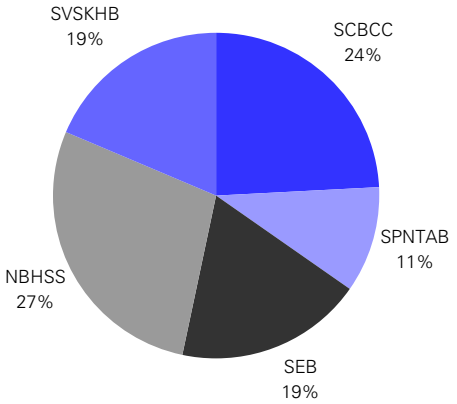
Supply and outstanding volume of Swedish EUR Jumbo covered bonds (EUR bn) (as of 31 Dec 2008)



Source: Deutsche Bank

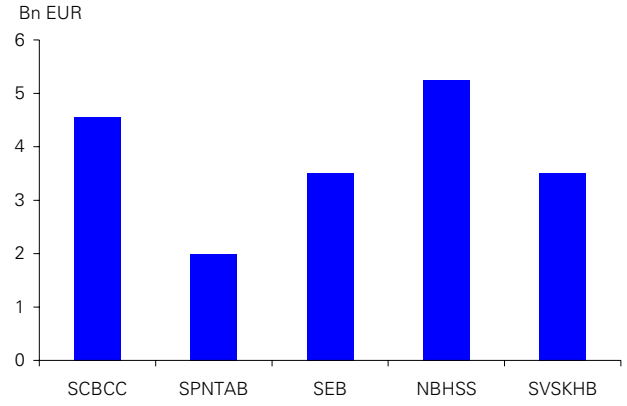
The Swedish covered bond market has considerable depth and is the most liquid sector in the Swedish bond market after the sovereign sector.

Market shares of Swedish issuers in EUR Jumbo covered bonds (as of 31 Dec 2008)



Source: Deutsche Bank

Outstanding volume of EUR Jumbo covered bonds per issuer as of 31 Dec 2008



Source: Deutsche Bank

SBAB issues covered bonds via a subsidiary

Although the Swedish framework does not stipulate a specialist bank principle, SBAB (SBAB, A1n/A+n) decided to use a wholly owned subsidiary Swedish Covered Bond Corporation (SCBC) as a funding vehicle. SCBC does not conduct mortgage lending itself but receives the cover assets by way of transfer from its parent company. The purchase of the mortgage portfolio is financed by a subordinated loan from SBAB.

LEGAL FRAMEWORK FOR SWEDISH COVERED BONDS

Issue structure

The law for Swedish covered bonds (Säkerställda Obligationer, SSO) came into effect on 1 July 2004. In the past, Swedish mortgage banks had funded themselves mainly through unsecured bonds (Bostard Obligationer) and more recently also through RMBS and CMBS transactions. The issuer of Säkasdälldaobligationer must be authorized as a bank or credit market institutions according to the Banking and Financing Business Act 2004 (lagen om bank- och finansieringsrörelse). Moreover, Swedish banks and credit market institutions willing to undertake covered bond business need to apply for a license from Sweden's supervisory agency, Swedish Finansinspektionen (SFSA).

There is no restriction on the business scope for covered bond issuers. Hence, every Swedish bank with a special covered bond license can issue covered bonds. Nevertheless, no significant change regarding the business model of the currently specialized character of Swedish mortgage lenders is expected.

To avoid subordination of unsecured bond holders (Bostard Obligationer), previously issued unsecured notes had to be converted into covered bonds (Säkerställda Obligationer) as one of the license requiements. If an issuer were to breach its obligations materially under the Swedish covered bond act, the Swedish FSA can revoke the covered bond license. The covered bond license can also be revoked if the issuer has not issued covered bonds within one year from the date it received the license. Like French Obligations Fonières, mixed pools of mortgage and public sector loans can back Swedish covered bonds. As both types of assets can be put in the same cover pool, there is no distinction between mortgage covered bonds and public covered bonds.

COVER POOL CREDIT QUALITY

Mortgage lending

Mortgage loans backed by residential, agricultural, office and commercial property are eligible as collateral. Site-leasehold rights designated for residential, office or business purposes and tenant-owner rights can also be used as collateral. The LTV applied is 75% for residential use, 70% for agricultural use and 60% for commercial use. Loans with higher LTVs may also be used as collateral, but the portion of the loan exceeding the eligibility criteria threshold cannot be refinanced with covered bonds.

Mortgage loans that are in arrears for more than 60 days do not count as collateral for Swedish covered bonds. Nevertheless, such loans can remain in the cover pool. Like the Finnish and the Irish legal framework for covered bonds, the Swedish one restricts the share of commercial mortgages within the cover pool to a maximum of 10%. In practice, Swedish issuers will have mixed pools – mortgage loans and public sector assets (loans to either municipalities or states, or mortgages guaranteed by states or municipalities).

The latter is similar in Germany. Mortgage loans guaranteed by the state can be put either in the mortgage cover pool or in the public sector cover pool. In practice, such state guaranteed mortgage loans are usually put in the public sector cover pool. That is one reason why one sometimes finds non-performing loans in the transparency reports of public Pfandbriefe of German Pfandbrief issuers.

Property valuation

Property valuation is linked to the market value and has to be carried out by an experienced appraiser. The market value is the price that would be achieved upon a sale where reasonable time is allowed for the transaction. The market value shall not take into account speculative and temporary circumstances. If market conditions in the respective region decline significantly, the bank has to review the valuation.

Public sector lending
Public sector assets are defined as those having a zero risk weighting and include claims

- Granted to the Swedish state, Swedish municipalities and state-owned companies
- Guaranteed by a foreign state or central bank, where the investment or claim is in the foreign state's currency and is refinanced in the same currency
- Guaranteed by the European Community, or any of the foreign states, or central banks, as prescribed by the Swedish government
- Guaranteed by foreign municipalities or public bodies that possess the authority to collect taxes. Credits bearing a guarantee issued by a borrower falling in one of the above categories are also eligible for inclusion in a cover pool.

MBS/covered bonds
ABS and covered bonds are not eligible as ordinary collateral. However, covered bonds issued under the Swedish Covered bond Act or other comparable legislation qualify as substitute collateral.

Substitute collateral
0% risk weighted assets, i.e. cash and public sector assets are eligible as substitute assets. Covered bonds issued under the Swedish Covered bond Act (or a comparable legal framework) are eligible as substitute collateral. 20% risk weighted assets are eligible as substitute assets on permission of the SFSA. The share of substitute assets is limited to 20% of the cover pool. Subject to regulatory approval this may be increased to 30%.

Transparency requirements
There are no transparency requirements to investors stipulated in the legal framework.

Cover pool monitor
An independent inspector ('Oberoende Granskare'), selected on the basis of professional qualifications, is appointed by the FSA. The inspector monitors that the cover register is in line with the regulations stipulated in the covered bond law, e.g. verifies that the covered bonds, the derivative agreements and the assets in the pool are correctly recorded. The inspector has to make sure that the cover assets meet the eligibility criteria. Moreover, he has to make sure that the matching requirements are met and ensure that cash flow matching requirements and market risk limits are complied with. The inspector reports to the FSA annually and also in case of significant occurrences. The SFSA has the right to remove/replace any inspector at its own discretion.

COVER POOL RISK MANAGEMENT

Prepayment risk
Prepayment is possible, but the borrower has to compensate the lender for the interest differential.

Matching requirements
The volume of cover assets has to be higher than the volume of outstanding covered bonds on a nominal and a net present value basis. However, there is no legal provision to define a mandatory minimum level of OC. The net present value cover must hold even after a 1% upward and downward shift in the yield curve. Where currency risk is not completely hedged, the net present value of the cover assets must exceed the net present value of the issued covered bonds after a 10% shift in the currency.

Cash flows with respect to the assets in the cover pool and derivatives agreements must at all times enable the issuing bank to meet its payment obligations towards the covered bondholders and derivatives counterparties. The fact that derivatives registered in the cover register do not terminate in case of insolvency of the issuer improves the ability to manage interest and currency risk.

Liquidity risk
The issuer has to ensure that the cash flows generated by the cover pool and respective derivative agreements are sufficient for full and timely payment of the outstanding covered bonds.

Taking derivatives into cover
Derivatives can be taken into cover. To mitigate counterparty risk, the SFSA sets forth a minimum risk weighting for derivative counterparties. The derivatives must not contain any clauses for automatic termination. In case of issuer insolvency derivative counterparts listed in the cover register rank pari-passu with covered bondholders.

Derivative counterparties need a risk weighting of no higher than 20%. Derivative counterparties must have a minimum rating of A3 (Moody's), A- (S&P), A- (Fitch), or a short-term rating of P-2 (Moody's) A-2 (S&P), F2 (Fitch). If these requirements are not met, the counterparty needs to post collateral or must be replaced by another counterparty.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
There is only one cover pool under Swedish law, backing both mortgage and public sector covered bonds. Cover pool assets (including derivative contracts) used to hedge the cover assets need to be entered into the cover

register. Segregation of the assets arises directly as a result of the registration in the cover pool register and following an issuer's default.

The Swedish Covered bond Act additionally requires that funds received from the registered asset must be kept separate from other funds of the issuer and, if received after insolvency of the issuer, be registered in the register. This cash must be clearly identifiable in the issuer's books. Although the Swedish Covered bond Act does not incorporate specific provisions stipulating how such separate accounts must be kept, the measure provides additional comfort that cash intended for the service of covered bonds would be easily identifiable and readily usable by any manager following issuer insolvency.

Preferential claim and bankruptcy remoteness

The Swedish Code of Execution (Utsokningsbalken) does not mention the priority of covered bondholders and registered derivatives counterparties. But the Swedish Covered bond Act gives covered bond holders and derivative counterparties a priority claim on assets in the cover pool and cash flows received thereafter from the cover assets and the registered derivatives agreements will have to be kept separate. In addition they rank pari passu with all other creditors with regard to assets outside the pool.

The cover pools will continue to be serviced after the default and liquidation of the mortgage bank by the administrator. The Swedish Covered bond Act does not provide for the appointment of any special or separate administrator, servicer, or other official for the cover pool assets of the bankrupt issuer. Instead, under general Swedish bankruptcy rules, two or more administrators-in-bankruptcy will be appointed for the bankrupt credit institution, one by SFSA and the other(s) by the relevant court. No alternative or dedicated independent manager or servicer is appointed after an issuer's insolvency. Under the Swedish legal framework, the administrator is not allowed to make bridge financings to close potential liquidity gaps. The insolvency administrator only has the possibility to sell cover pool assets to ensure the full and timely payment of the covered bonds.

The fees to the administrator rank senior to the covered bondholders. Although, neither the Swedish Covered bond Act nor any other piece of Swedish regulation foresees the appointment of an independent administrator, acting solely in the interest of covered bondholders, the bankruptcy administrators of a Swedish covered bonds issuer would have to comply with the rules set by the Covered bond Act.

There will be no acceleration of the covered bonds in case of insolvency of the issuer as long as the cover pool meets the stipulated coverage requirements. Also, temporary minor breaches of the matching requirements do not lead to acceleration.

Legal protection for OC

The Swedish law gives covered bondholders absolute priority over assets in the cover pool including any available OC. There is no legal requirement for OC in Sweden. Under Swedish bankruptcy law, an insolvency administrator who is satisfied that a cover pool contains more assets than necessary to repay outstanding covered bonds could use such excess assets to pay so-called advance dividends to unsecured creditors.

Before a bankruptcy administrator decides to pay advance dividends, he must ensure that the pool's integrity and compliance with the Act is not jeopardised. Unless the maturity of the covered bonds was imminent, this would be virtually impossible to prove. The risk is further mitigated by the fact that, since any payments would be made as advance dividends rather than definitive payments, the pool would legally retain the right to claim them back should it, at a later stage, lack the means to fully repay the covered bondholders and the derivative counterparties.

Risk Weighting

Covered bonds issued under the new Swedish covered bond law meet the art. 22 (4) UCITS/CRD and therefore benefit from a privileged risk weighting. To obtain a privileged risk weighting, a notification to the EU Commission from the Swedish regulator, the SFSA, was needed. With CRD, not only do the criteria of UCITS 22 (4) have to be fulfilled, but the assets backing the covered bonds have to be mentioned in the CRD eligibility list also. Hence, to be CRD compliant, the share of non-guaranteed bank debt in the cover pool of Swedish covered bonds must not exceed 15%.

United Kingdom

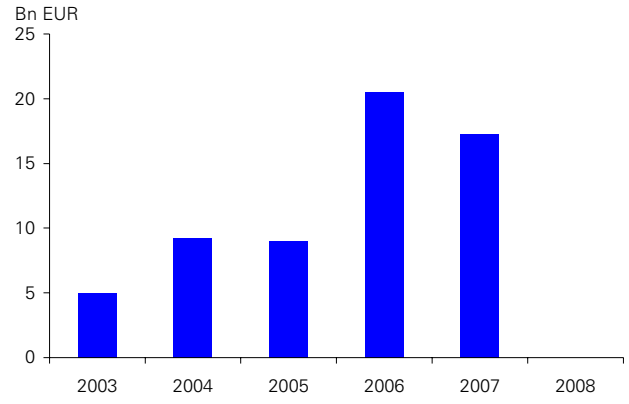
MARKET OVERVIEW

The UK EUR Jumbo covered bond market amounted to EUR 43.75 bn as of 31 Dec 2006 and grew to EUR 61 bn as of 31 Dec 2007. There has been no public EUR Jumbo covered bond issue out of UK in 2008. As there was no covered bond maturing either in 2008, the outstanding volume of publicly issued EUR Jumbo covered bonds was unchanged. Instead, GBP issuance for the Bank of England's SLS has been very strong in 2008.

Overall, there are 18 credit institutions with estabilished covered bond programs; most of them have not been active in the EUR Jumbo market but tapped the Bank of England's SLS. Hence, despite little public benchmark issuance, the total volume of UK covered bonds grew significantly from EUR 78 bn as of end 2007 to EUR 160 bn as of 31 Jan 2009.

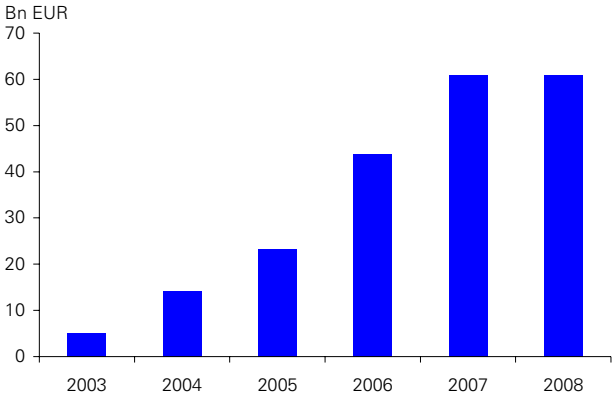
As of 31 Dec 2008, there were seven issuers of public UK EUR Jumbo covered bonds (Bank of Scotland, Northern Rock, Bradford & Bingley, Nationwide, Abbey, HSBC, Yorkshire Building Society). Since the first issue of UK covered bonds in 2003 by Bank of Scotland, yearly new issuance volumes have increased to EUR 20.5 bn in 2006. Due to the funding crisis of UK banks new issuance of EUR Jumbo covered bonds declined to EUR 17 bn in 2007.

No public UK EUR Jumbo covered bond issue in 2008



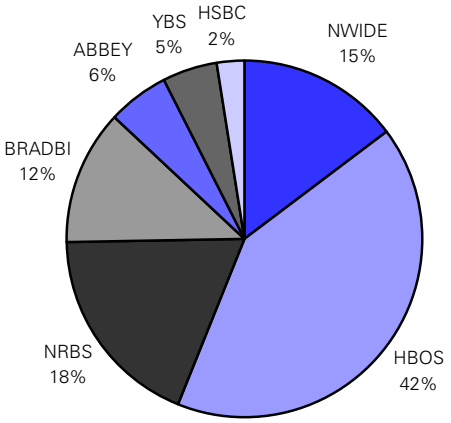
Source. Deutsche Bank

Outstanding volume of EUR Jumbo covered bonds unchanged, zero public issuance and no redemptions in 2008



Source: Deutsche Bank

Bank of Scotland dominates UK's EUR Jumbo covered bond market in terms of outstanding volume



Source: Deutsche Bank

Legal framework for UK covered bonds

The UK covered bond regime allows UK-issued covered bonds to benefit from options on EU directives. On 23 July 2007, HM Treasury presented its proposal for a UCITS-compliant covered bond regime in the UK. The legislation, which came into force on 1 July 2008, provides a principles-based and outcomes-focussed framework. The law does not prescribe the complete design and contractual arrangements for the product. The covered bond regime is specifically supervised by the FSA's principles-based regulation, which is supported by guidance. Banks interested in issuing covered bonds have to apply to the FSA to be approved and the FSA keeps a register of approved issuers.

FSA registered issuing banks have to keep a cover register including cover assets, open hedge positions and covered bonds issued. 'Eligible properties' are broadly defined by HM Treasury in a way that captures high quality assets:

- Assets from the list at Annex VI to the CRD (the UK covered bond draft law considers ship mortgage loans as collateral for UK covered bonds
- Social housing and public private partnership loans
- Any other asset held in relation to a body which has a credit assessment equivalent to an AAA or AA rating
- The range of collateral by geography constitutes EEA member states, the US, the Channel Islands, Japan, Canada, New Zealand, Switzerland, Australia and the Isle of Man. For assets outside England and Wales the FSA requires an issuer to obtain a legal opinion on whether the law of respective jurisdiction affects the enforceability of security.

No LTV ratio limits are stipulated. However, to qualify for preferential risk weighting according to CRD the LTV ratio limits are 80% for residential properties and 60% for commercial properties.

The law stipulates that assets in the cover pool must be sufficient to pay claims of the bondholders as they fall due in a timely manner. No OC is stipulated. The law explicitly stipulates the preferential claim of covered bond holders and derivative counterparties on cover assets. Hence, derivative counterparties cannot rank senior to covered bond holders in case of a registered UK covered bond. The law does not explicitly define the mandatory procedures to be followed in case of issuer insolvency procedures to ensure timely payments. Under the UK Regulated Covered Bond Regulations, banks can apply with the FSA to have their outstanding programmes recognised as regulated programmes.In deciding whether an existing covered bond programme is recognised under the new legal framework, the FSA must be satisfied that the contractual arrangements ensure compliance with the stipulated rules. On 11 Nov 2008, the FSA announced the registration of covered bond programmes of ABBEY, ALLNCE, BACR, BOS, HSBC, NWIDE and YBS as 'Regulated Covered Bonds'. The main consequence is a lower risk weighting and higher investment limits.

CHARACTERISTICS OF UK COVERED BONDS

Issue structure

UK mortgage lenders have created an issue structure that establishes a bankruptcy remote cover pool but preserves the recourse to the issuer that is present in covered bond legislation, thereby replicating the concept of covered bonds.

In this structure, the originator sells a pool of mortgage loans to a SPV in the legal form of a limited liability partnership (LLP) via an equitable assignment (special Mortgage Sale Agreement). The UK covered bonds are issued by UK banks and therefore are direct, unconditional obligations of the issuing bank. In addition, these (unsecured) bonds are guaranteed by the LLP to become covered bonds. A security trustee holds the claim over the cover assets on behalf of the covered bond investors. The LLP is a consolidated subsidiary of the originator. Due to the fact that the issuer fully consolidates the LLP in its financial reports, the assets are still part of the originator's balance sheets. The LLP is the economic owner of the mortgages, but the transfer of the loans to the LLP will only be fully completed upon the occurrence of a certain trigger event, including the default of the issuer or breach of the asset coverage test (ACT), explained below. Hence, in case of insolvency of the issuer, the LLP does not form part of the bankruptcy estate. The mortgage lender and the covered bond issuer are not necessarily the same legal entity.

A third party acts as a GIC account provider for the transaction. On a daily basis, interest received from the portfolio will go into the GIC account, where it will be held for a maximum period of 30 days before being transferred to the transaction account in the name of the LLP. In the event of a default of the third party a GIC account provider as standby provider is already named.

The purchase of the mortgage loans by the LLP is funded by a subordinated intercompany loan. As the loan is repaid only after all covered bonds have been paid back, the subordination protects covered bondholders. There is no direct link between the mortgages and the covered bonds. Only when there is a call on the guarantee, are the mortgage cash flows used directly to pay the covered bond investors.

COVER POOL CREDIT QUALITY

Mortgage lending

The restrictions are mainly based on the issuer documentation. LTV ratios vary between 60% and 75%. In all but one programme for UK covered bonds the collateral consists of residential mortgages. Bank of Scotland has a separate programme backed by social housing loans.

Property valuation

A surveyor values the properties upon granting the loan. The properties are not re-valued by a surveyor, but marked-to-market via an indexed valuation with one of the broadly recognized house price indices, e.g. the Halifax or Nationwide House Price Index. Price increases are only taken into account by 85% whereas price decreases are fully taken into account. This protects investors in a broad downtrend in house prices (to the extent that the

mortgage bank can absorb the price decline), but also introduces correlation risk into the cover pool. Indexation also permits mortgages with higher initial LTVs to be included in the pool if a rise in the house price index increases the imputed property value.

Public sector lending
To date, no public sector assets have been refinanced with UK covered bonds.

Geographic scope
To date, no UK covered bond pool contains non-UK mortgage assets.

Substitute collateral
In the issuance programmes so far, substitute collateral are allowed up to 10%, 15% and 20%. Eligible substitute collateral are e.g. short-term investments in GBP, namely bank deposits and debt securities with a minimum rating of AA- or P-1/A-1/F1+, AAA rated RMBS and government debt.

Transparency requirement
There are no explicit transparency requirements regarding investors. Nevertheless, UK issuers typically publish monthly transparency reports with detailed cover pool data.

Cover pool monitor
The issuer/originator is responsible for the monthly pool monitoring, with the asset coverage test calculation being checked by an independent auditor on an annual basis. There are no stipulated requirements for the cover pool monitor. Generally, the auditor of the issuer performs the cover pool monitoring.

COVER POOL RISK MANAGEMENT

Prepayment risk
UK mortgage loans tend to be floating rate and prepayable. Prepayment risk is difficult to hedge because it is as much driven by special discounts offered by other banks as it is determined by interest rates. UK covered bond issuers generally retain prepayment risk. As prepayment risk (negative carry risk) is accounted for in the asset coverage test, the risk for investors is limited.

Matching requirements
In case of UK covered bonds, interest rate risk is mitigated through swaps. The asset coverage test (ACT) required according to the documentation of UK covered bonds ensures that the mortgage loans, cash and substitute assets in the LLP are sufficient as collateral for the outstanding covered bonds. The ACT only takes the mortgage loan up to its respective LTV limit into account. Non-performing loans are either substituted (e.g. Bank of Scotland) or taken into account only up to 40% (if the LTV of the loan is less than 75%) or up to 25% (if the LTV is higher than 75%) (E.g.Nationwide, Northern Rock and Abbey). The ACT is calculated on a monthly basis by the originator. In addition to that, an independent auditor (e.g. KPMG) controls the calculations regarding the ACT on a yearly basis.

Asset Coverage Test
Definition of the adjusted aggregated loan amount The adjusted aggregate loan amount of the portfolio is defined according to the following formula:

$$A + B + C + D - (X + Y + Z)$$

"A" corresponds to the lower of;

(a) The sum for each loan of the lower of;

(i) The actual outstanding current principal balance of the loan; and

(ii) 75% (BOS 60%) of the indexed valuation where loans are current or up to three months in arrears and 40% of the indexed valuation where loans are three months or more in arrears. This reflects the fact that only 75% (BOS 60%) LTV portion of each loan is effectively eligible for covered bond funding, regardless of the actual LTV ratio. For the purposes of determining this limit, original valuations at the time of origination of the loan or any subsequent valuation will be indexed using the appropriate price index; and

(b) The aggregate current principal balance of all loans in the portfolio multiplied by the asset percentage.

"A" would be reduced by:

(a) Any loan the seller has failed to repurchase due to a breach of warranty or any other obligation under the mortgage sale agreement; and

(b) Any loss caused by a material breach of a sale or servicing agreement. The asset percentage has been equal to 90.0%-93.5% (depending on the specific programme) since inception of the programme but may be adjusted downwards in certain circumstances. Multiplication by the asset percentage ensures that, regardless of the portfolio LTV ratio, credit enhancement will always be at least 6.5%-10.0% (depending on the specific programme).

"B" is equal to any cash held as a result of loan repayments since the end of the previous period held by the LLP. Such assets do not require over-collateralisation.

"C" is equal to any capital contributions made in cash by the members since the previous period;

"D" is the outstanding principal balance of substitution assets (being short-term, highly liquid, investment-grade investments).

"X" equates 2.25% of the outstanding current balance of the mortgage loans in the portfolio. This amount is intended to cover set-off from general deposit accounts.

"Y" is an amount intended to cover the set-off risk that could result from borrowers seeking to set off amounts in respect of increased funding costs, should the seller (for example, due to bankruptcy) fail to fund any redraws that borrowers were entitled to under flexible loan agreements (8% x undrawn redraw capacity x 3);

"Z" is an amount intended to address potential negative carry in the transaction caused by holding funds in the GIC (guaranteed investment contract) account that earn a sub-LIBOR (London Interbank Offered Rate) return. This is sized at 0.50% x the weighted average maturity of covered bonds outstanding x aggregate covered bond principal outstanding.

Liquidity risk

Liquidity risk is managed through covenants (e.g. a reserve fund) that require certain levels of cash in the LLP prior to large cash outflows on the covered bonds or by soft bullet maturities. Details depend on the individual issuer.

Except for Bank of Scotland and HSBC, all outstanding UK covered bonds have a soft bullet payment at maturity. The soft bullet structure gives the LLP time to liquidate assets in case of insolvency of the issuer and prevents insolvency of the LLP. The unpaid amount will automatically be deferred and shall be due and payable one year later. This maturity extension provides protection in case of insufficient cash at the LLP level.

In case of issuer insolvency, the LLP will receive the interest and principal on the mortgage loans and the amortization test ensures that there is enough cash flow out of the collateral assets in the LLP to pay interest and principal on covered bonds. The LLP can sell mortgage assets to attract funds to repay the principal on covered bonds.

Taking derivatives into cover

Derivatives are used and included in the LLP to hedge interest rate and currency risk. The documentation includes rating agency-determined language to mitigate counterparty risk. In case of covered bonds that are not yet registered as UK covered bonds under the legal framework, swap counterparties may rank senior to covered bond holders.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools

The cover assets of a UK covered bond are transferred from the issuer (or originator) to the guarantor LLP. There is no specific cover pool register as such, but the cover assets are all owned by the LLP. The Mortgage Sale Agreement specifies which assets are owned by the LLP and thus segregated from the bankruptcy estate of the issuer.

Preferential claim and bankruptcy remoteness

The holders of UK covered bonds are senior unsecured creditors of the issuer who benefit from a guarantee given by the LLP that is legally a separate entity. Therefore, they have a claim on the other assets of the issuer if the assets of the LLP should not be sufficient to repay the bonds. In this case, investors – via the bond trustee – submit an unsecured claim against the issuer and invoke the covered bond guarantee. All cash is collected in a GIC account for the benefit of investors. This includes cash generated by the mortgages, proceeds from monetization of the portfolio and the proceeds from liquidation of the issuer.

There are two types of default events: (a) Issuer event of default, which apart from standard default provisions includes a failure to maintain the asset coverage test (ACT). Usual grace periods apply. (b) LLP event of default, which includes the failure by the LLP to make a payment under the guarantee and a failure to pass the amortization test (AT). In the event of an issuer default, the equitable assignment of mortgage loans to the LLP will be fully completed. The issuer (or originator) will manage the collateral as long as it is solvent, but the trustee will take control on behalf of the investors should the issuer become insolvent. This structure is commonly used in RMBS transactions and there are legal opinions to the effect that this type of asset transfer indeed rules out recourse of unsecured creditors to the transferred mortgage assets.

In case of insolvency, the LLP will take over payments of capital and interest to the covered bondholders. Covered bonds remain due and payable as scheduled. Investors receive payments of interest and principal under the covered bond guarantee as and when they would otherwise have been paid had no issuer event of default occurred. The ACT will no longer be conducted and there is no longer a substitution of assets. The cover pool becomes static.

Instead of the ACT the so-called amortization test (AT) will determine the solvency of the pool. There is no deduction of an asset percentage; hence an OC requirement is not stipulated under the AT. Furthermore, the AT includes no

other ratios to cover set-off or redraw risks. If the AT is breached, meaning the loan amount in the LLP is lower than the amount of outstanding covered bonds, the assets in the LLP will be liquidated and the covered bonds become due.

Legal Protection for OC

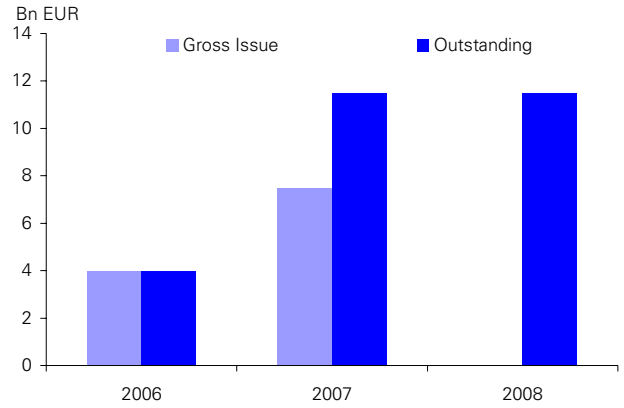
In UK covered bond programmes there is a minimum OC stipulated in the documentation via the ACT between 7% and 11%. A breach of the ACT would constitute an issuer event of default, not an LLP event of default. As the mortgage loans in the LLP are insolvency remote, any kind of OC is legally protected.

USA

MARKET OVERVIEW

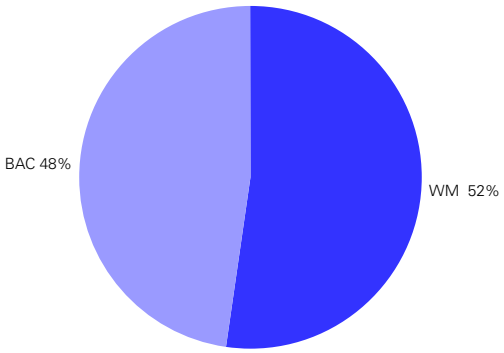
In 2006 Washington Mutual Bank (taken over by JP Morgan in 2008) became the first US issuer to tap the European covered bond market. The two-tranched inaugural transactions of Washington Mutual of EUR 2 bn each were priced at mid-swaps + 3 bp for the 5Y and +9 bp for the 10Y.

Supply and outstanding of US covered bonds



Source: Deutsche Bank

Only two issuers of US EUR Jumbo covered bonds so far



Source: Deutsche Bank

Overall, the US covered bond market is small so far. Total outstanding volume amounts to EUR 12.85 bn. The outstanding volume of EUR denominated US covered bonds amounts to EUR 11.5 bn, from two issuers, JP Morgan (formerly Washington Mutual, EUR 6 bn) and Bank of America (EUR 5.5 bn). There is only one USD denominated US covered bond outstanding, issued by Bank of America (USD 2 bn).

At the beginning of August 2008 the US Treasury published Best Practice rules for residential covered bonds. Citigroup, JP Morgan and Wells Fargo are working on covered bond programmes in line with the new guidelines.

Taking into account the mere size of the US residential mortgage market of around USD 11 tn (compared to USD 6.5 tn for the EU 25 mortgage market), the US covered bond market could become a multi-billion covered bond market, even if covered bonds were to play only a minor role in US mortgage refinancing.

Encouragement from the Treasury

The US Treasury highlighted that the Best Practices announced are building on the FDIC's Final Covered bond Policy Statement from 15 July 2008. Hence upcoming US covered bonds are likely to be based on the following guidelines:

- Issuance limit of 4% of an issuer's liabilities
- Issuance can either be made through a bankruptcy remote SPV or the originating bank (or a wholly owned subsidiary bank)
- Issuers must receive consent to issue covered bonds from their regulator
- Only 'well-capitalized' institutions will be allowed to issue covered bonds under the new regime.
- Eligible mortgages have been restricted to first lien performing mortgages with a maximum LTV of 80% only, at the time of cover pool inclusion. Mortgages that are 60 or more days delinquent must be replaced
- Jumbo, Alt-A and subprime mortgages are allowed in principle, but mortgages must be current when added to the pool, be based on documented income, and be underwritten on the assumption that the borrower pays the fully indexed rate with full amortisation (although the 'Best practices' rule out negative amortisation mortgages, IOs and ARMs are allowed)
- LTV updated on a quarterly basis using a house price index
- Geographic concentration in a metro statistical area is limited to 20%
- Minimum OC of 5% within the asset coverage test
- Asset coverage test on a monthly basis

- Monthly cover pool disclosure rules (including information disclosure requirements when a given amount of cover assets are substituted within a certain time frame)
- Specific supervision regarding an issuer's controls and risk management process
- Hedges are needed for interest rate and FX risks.
- Independent trustee and asset monitor

The Securities Industry & Financial Markets Association (SIFMA), the electronic trading platform Tradeweb and a few dealers intend to provide liquidity in the secondary market. According to the Fed, US covered bonds will be eligible as collateral against discount window borrowing, but not for open market operations. In addition, Treasury will update its own collateral acceptability policy to include covered bonds against Treasury tax and loan account deposits.

Under the Treasury/FDIC Best Practices, we calculate that a total of USD 1.1 tn in bank assets satisfies these conditions. Given a 5% OC requirement, this would imply about USD 1.05 tn in outstanding covered bonds. However, the more binding constraint to the size of the market seems to be the 4% liability limitation. This would suggest a maximum size to the US covered bond market of USD 400 bn.

Structural subordination addressed

The FDIC in its 'Final Covered bond Policy Statement' clarified the sequence of claims on the issuing bank's assets in the case of the issuer's default. The covered bond trustee would be able to claim the underlying assets, on the same level as the Federal Home Loan Banks and other secured creditors with a "perfected" interest on the bank's assets. Thus the covered bond would have early claim on the bank's assets, along with other secured creditors, ahead of the FDIC itself or the bank's depositors. (On the other hand, prior to an FDIC takeover, if collateral deterioration calls for substitution, it is unclear how to prioritize the needs of the covered bond vs. other secured creditors such as the FHLB.) However, if the liquidation value of the cover assets isn't enough to pay off the covered bond cash flows, then the covered bond trustee is treated as an unsecured creditor.

The reason for the 4% FDIC restriction of covered bonds which can be issued in relation to total liabilities is the subordination of deposits. The more covered bonds are outstanding, the less unencumbered assets remain to satisfy unsecured creditors. Because FDIC is guaranteeing the deposits, the potential liability for FDIC would increase if covered bonds increased too much in volume (technically speaking, the loss severity on the guarantee increases).

Central bank repo eligibility as supporting factor for covered bonds

An institutional factor supporting demand by banks is the ECB repo eligibility (with low haircuts). Bank participation in EUR Jumbo covered bonds has typically been high at around 35% already pre-crisis. Since then, bank demand even increased to almost 50% in H1 2008.

Covered bonds have a privileged role in ECB monetary policy operations. The ECB recognizes the high security of covered bonds, specifying that covered bonds that fulfil article 22 (4) of the UCITS directive are eligible as collateral for monetary operations. Jumbo covered bonds are in the same category as sub sovereign and agency debt. This is a strong signal indicating that the ECB is very comfortable with the credit quality of covered bonds.

For the development of the US covered bond market, a similar repo eligibility supporting bank demand would be helpful.

A standardized covered bond product would be helpful

In the absence of standard setting legislation, investors in US covered bonds may still need to examine the details of the legal structure of each bond that they purchase. The Best Practices introduce some meaningful restrictions on the structure of a covered bond programme relative to the FDIC statement but these restrictions are not legally binding and investors still need to confirm that any given programme will adhere to them.

Generally, one has to keep in mind that covered bonds issued by deposit taking banks in general have a rather short history. Traditional covered bonds in Germany, Denmark and Sweden were typically issued out of specialized banks. Current pricing in EUR covered bonds suggests that even the best structure, covered bond law or general institutional framework cannot remove investor concerns regarding the collateral.

In conclusion, we expect the US covered bond market will take some time to develop, given the current disadvantages relative to funding alternatives and now particularly given the competition of widely priced FDIC guaranteed bonds, and the lack of a more solid institutional framework. In the long term, we do see covered bonds as a viable alternative in addition to other funding sources. In the short-term, the obstacles to the formation of the covered bond market are already high, and the credit crisis with the accompanying avoidance of mortgage-related instruments only adds to the difficulties.

CHARACTERISTICS OF US COVERED BONDS

Issue structure

To explain the basic structure of outstanding US covered bonds we use JP Morgan (formerly Washington Mutual) as an example. Washington Mutual, the first issuer of US covered bonds did not issue the covered bonds directly but used a statutory trust named Washington Mutual Covered bond (WMCB) which buys mortgage bonds issued by Washington Mutual Bank (now JP Morgan). WMCB does not have bank status. Also Bank of America (BoA) uses a statutory trust (Bank of America Covered bond). The mortgage bonds are direct and unconditional obligations issued by the bank (JP, BoA) ranking pari passu among themselves. The mortgage bonds are secured pari passu and without priority to the assets of the cover pool. The assets of the cover pool backing the mortgage bonds remain on JPM's balance sheet. The cover pool is pledged in favour of WMCB by a perfected security interest via the Uniform Commercial Code (UCC).

The UCC was agreed to harmonise commercial transactions in the US and hence is said to be the legal basis for secured debt instruments issued by US banks. The UCC stipulates rules governing perfections and the priority of security interest. A mortgage bond indenture trustee gets a first priority perfected security interest in the cover pool. The cover register of the covered bonds is not in the statutory trust, but in the issuer of the mortgage bonds, the bank. If the collateral assets are not sufficient to pay the mortgage bond, the holders of the mortgage bonds rank pari passu with unsecured creditors of the bank. A single covered bond is not backed by all issued mortgage bonds, but only by one respective mortgage bond. The covered bond investors have a pro rata claim on the proceeds of the cover pool in case of bank insolvency. The covered bonds are limited recourse obligations of the bank.

COVER POOL CREDIT QUALITY

Mortgage lending

First lien residential mortgage lending is eligible as collateral for the mortgage bonds backing the covered bonds. Restrictions are self-imposed. E.g. JP's program has a 75% LTV limit. Similar to the German Pfandbriefe, higher LTV loans are included in the cover pool of mortgage bonds. However, the part of the loans exceeding the LTV limit is not taken into account in the asset coverage test (in Germany the part of the loan exceeding the LTV limit is not eligible as collateral for Pfandbriefe). Loans that are in arrears for more than 60 days are not eligible. The maximum single loan amount is USD 3 m.

Property valuation

The values of the pledged properties are indexed to the Office of Federal Housing Enterprise Oversight (OFHEO) house price index. The indexation is done on a monthly basis. Similar to the UK, house price increase are only taken into account to 85% whereas price decreases are fully taken into account.

Public sector lending

The covered bond program of JP Morgan (and also the one of BoA) does not foresee public sector backed covered bonds.

Geographic scope

As there is no legal framework for US covered bonds, restrictions are self-imposed. E.g. JP Morgan's mortgage bonds are backed by US residential mortgage loans only.

MBS/covered bonds

RMBS are eligible as substitute assets but not as ordinary collateral for mortgage bonds. Covered bonds are not eligible as collateral.

Substitute collateral

The total value of substitute assets is limited to 10% of the collateral assets. E.g. in case of JPM, substitute assets can consist of:

- Central, regional and local government debt, central bank debt, international organizations and public sector entity debt that are 0% risk-weighed
- Debt of institutions that are 20% risk weighted is not allowed to exceed 10% of the pool
- USD denominated AAA rated RMBS provided that the total exposure to such investments shall not exceed 10% of the (USD equivalent of the) aggregate principal amount outstanding of the covered bonds

Substitute assets must fulfil the criteria of Annex VI, Part 1 Section 12 of the EU Capital Requirement Directive.

Cover pool monitor

The Mortgage Bond Indenture Trustee is in charge of record keeping of the loan portfolio backing the mortgage bonds. Consequently, it is also the responsibility of the Mortgage Bond Indenture Trustee to calculate the Asset Coverage Test. It is also the responsibility of the Mortgage Bond Indenture Trustee to enforce the mortgage bond and exercise the liquidation of the cover pool.

The Covered Bond Indenture Trustee's activities are rather limited. Should, in a windup scenario, the amount of collateral turn out to be insufficient (i.e. an asset coverage test has been breached and not remedied or the asset

covered test itself failed) the Covered Bond Indenture Trustee – as would be the case in any other covered bond framework – safeguards the proper acceleration of payments of the covered bonds.

COVER POOL RISK MANAGEMENT

Prepayment risk

Dealing with prepayment risk in Germany is comparably easy, where fixed rate mortgage loans without penalty free prepayment rights in the first 10 years are the norm. On the other hand, matching bullet redemptions on the liability side of US banks with an uncertain payment date as a consequence of the penalty free repayment option in mortgage loans on the asset side is challenging.

While JPM or BoA are solvent, the banks simply replace assets in case of a prepayment. The biggest form of prepayment would be if the FDIC were to buy the cover pool in case of the bank's insolvency, a kind of total prepayment. The GIC where the money would be parked would yield below swaps. This post insolvency prepayment risk is covered by the covered bond swap. In case of insolvency, and if the amortization test is failed, covered bonds will be bought back at market value plus accrued interest. This is intended to cover prepayment risk.

Matching requirements

There is an asset coverage test (ACT) to ensure that there are enough mortgage loans as collateral in the cover pool of the mortgage bonds. The ACT is calculated monthly and designed to ensure a minimum level of OC. On each monthly calculation date, the mortgage bond issuer calculates the expected loss for the portfolio (probability of default multiplied with loss given default), consisting of mortgage loans. This will act as an input into a cash flow model to indicate the minimum OC needed to support the target rating of the covered bond. Regardless of this calculation, the ratio between covered bonds and cover assets in the ACT may not exceed 93% in case of JPM and 96% in BoA at any time. According to the ACT, the adjusted aggregated loan amount of the cover pool is defined as A + B + C.

A = the sum for each loan of the lower of (a) the actual outstanding current principle balance of the loan, (b) 75% of the indexed valuation of the loan (c) the aggregate current principle balance of all loans in the portfolio multiplied by the asset percentage

B = cash

C = substitution assets

Adjusted aggregate loan amount = 'lowest loan value' + cash + substitution assets. As indicated above, mortgage loans will only be taken into account as collateral for the mortgage bonds up to a LTV ratio of 75%. Moreover, mortgage loans which are in arrears for more than 60 days are not taken into account. If the ACT is breached and not remedied on the next calculation date, the outstanding mortgage bonds would become immediately due and repayable. A breach of the ACT will not result in an acceleration of the outstanding covered bonds, but it would prevent further new issues.

In case of US covered bonds denominated in EUR, there is an interest and currency mismatch between USD denominated floating rate mortgage bonds and EUR denominated fix rated rate covered bonds. This is hedged via the covered bond swap, swapping USD denominated floating rate income from mortgage loans into EUR denominated fixed rate payment on the covered bonds. In contrast to that, interest rate and prepayment risk between floating rate mortgage bonds and fixed rate mortgage bonds and the prepayment risk between the mortgage loans and mortgage bonds is managed by the bank as part of the general asset-liability management.

Liquidity risk

If the bank is insolvent, there may not be an immediate decision from the FDIC regarding the mortgage bonds. In this period, the trustee would not be allowed to meet interest payment on the covered bonds. According to the documentation of JPM's covered bonds, the swap provider will cover this risk up to 90 days.

US covered bonds have soft bullet maturity with an extension period of 60 days. In case of insolvency of the bank, the statutory trust may not have sufficient liquidity for a timely repayment of covered bonds. In this case, the maturity will be extended by 60 days.

Taking derivatives into cover

The bank receives floating rate payments in USD on its mortgage loans. The statutory trust has to pay fixed coupons in EUR on the EUR denominated covered bonds. Therefore, USD denominated floating coupons from the mortgage bonds issued by the bank are swapped into EUR fixed to pay interest and principal of covered bonds issued by the statutory trust through the so-called covered bond swap.

COVER POOL BANKRUPTCY RISK

Segregated assets or segregated asset pools
The assets in the cover pool backing the mortgage bonds are segregated by a pledge to a mortgage bond trustee.

Following the occurrence of a 'Segregation downgrade', JPM will (within 28 days) deposit on a daily basis within two business days of receipt all collections it receives on the eligible mortgage loans included in the cover pool to a segregated account maintained by JPM. JPM will not commingle any of its own funds and general assets with amounts on deposit in the Mortgage Bond Account.

Preferential claim and bankruptcy remoteness
As mentioned above, in case of a downgrade of the unsecured rating of JPM Bank NV below A3 at Moody's and its short-term rating below A1/F1 at S&P and Fitch, the cash flows from the mortgage loans will be segregated. JPM will open a mortgage bond account to collect all cash flows on the mortgage loans backing the mortgage bonds. In case of a more drastic downgrade of JPM Bank NV's unsecured rating to below investment grade by one of the three big rating agencies, the mortgage loan files and the mortgage bond account will be transferred to mortgage bond indenture or a third party custodian in the following 60 days. In case of JP Morgan Bank NV's default, the WMCB has a priority claim on the mortgage loans, which it will liquidate in order to continue interest and capital payments on outstanding covered bonds.

In case of insolvency of JPM, the OTS is authorized to appoint the Federal Deposit Insurance Corporation (FDIC) to resolve the obligations of JPM to the holders of covered bonds. The FDIC has three options:

- JP Morgan continues payments on the mortgage bonds
- FDIC makes direct compensatory payments equal to par plus accrued interest to WMCB
- FDIC allows the mortgage bonds to default. In the following, the Mortgage Bond Indenture Trustee would enforce its security interest on the cover assets of the mortgage bond

Legal protection for OC
The ACT requires a minimum OC of 7.5% (100/93) in case of JPM and 4.2% (100/96) in case of BoA. As pledging to a mortgage bond trustee segregates the assets in the cover pool, any OC is legally protected.

Risk Weighting
Because of the 'look through' approach, US covered bonds have the same risk weighting as the underlying mortgage bonds, i.e. 20%. US banks cannot make use of the European CRD. US covered bonds are not issued by a EU member state bank but a SPV. Hence, there is no privileged risk weighting under CRD.

Cover Pool Overview

Aareal Bank, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	**3.306**	
Total Outstanding Covered bonds	2.975	
Nominal Overcollateralisation	11.1	
Maximum Concentration	Germany (75.68%)	
Maturity (Years)	Assets	Liabilities
<1	0.241	0.224
>1 & <5	0.639	0.765
>5 & <10	0.649	0.974
>10	1.7777	1.012

Data as of 30 Sep 2008, Source: Fitch

Yorkshire Building Society, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	**4.618**
Total Outstanding Covered bonds	3.03
Nominal Over collateralisation (%)	54.97
Maximum Concentration	UK (100%)
Volume of residential assets	4.62
Stressed Recovery Rate (%)	82.81
Stressed Loss Severity (%)	28.08
Average residual maturity of assets	18.35
Average residual maturity of liabilities	3.21
Average residential current LTV (%)	56.22
Assets in GBP (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	40.13 Months

Data as of 30 Sep 2008, Source: Fitch

Wüstenrot Bank AG Pfandbriefbank, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	**.85**	
Total Outstanding Covered bonds	.79	
Nominal Over collateralisation (%)	6.85	
Maximum Concentration	Germany (88.97%)	
Maturity (Years)	Assets	Liabilities
<1	.65	.72
>1 to <5	.18	.03
>5 to <10	.02	.04
>10	.01	.01

Data as of 30 Jun 2008, Source: Fitch

Wüstenrot AG Pfandbriefbank, Mortgage Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	**5.25**	
Total Outstanding Covered bonds	4.55	
Nominal Overcollateralisation (%)	15.41	
Maximum Concentration	Germany (100%)	
Volume of residential assets	4.632	
Volume of commercial assets	0	
Variable rate assets (%)	3.83	
Variable rate liabilities (%)	17.89	
Assets in EUR (%)	100	
Liabilities in EUR (%)	100	
Arrears of more than 90 days (%)	.01	
Maturity (Years)	Assets	Liabilities
<1	.97	.67
>1 to <5	2.1	1.42
>5 to <10	2.14	2
>10	.05	.46

Data as of 30 Sep 2008, Source: Fitch

WM Covered Bond Program, Mortgage Cover Pool (USD bn)	
Total Cover Pool Volume	**11.59**
Total Outstanding Covered bonds	7.784
Nominal Overcollateralisation (%)	48.89
Volume of residential assets	12
Average residual maturity of assets	-
Average residual maturity of liabilities	5.29 Years
Assets in USD (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	41.09 Months
Average residential current LTV (%)	61.24
Maximum Concentration	USA (100%)

Data as of 31 Dec 2008, Source: Fitch

Unicredit S.p.A, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	6.83
Total Outstanding Covered bonds	4
Nominal Overcollateralisation (%)	70.75
Volume of residential assets	7
Stressed Recovery rate (%)	69.11
Stressed loss severity (%)	5.64
Average residual maturity of assets	24.25 years
Average residual maturity of liabilities	5 Years
Variable rate assets (%)	46.98
Variable rate liabilities (%)	0
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	23.04 Months
Average residential current LTV (%)	69.24
Arrears of more than 90 days (%)	0
Maximum Concentration	Italy (100%)

Data as of 31 Oct 2008, Source: Fitch

SpareBanken vest Boligkreditt AS, Mortgage Cover Pool (SEK bn)	
Total Cover Pool Volume	8.85
Total Outstanding Covered bonds	4.5
Nominal Overcollateralisation (%)	96.6
Volume of residential assets	9
Stressed Recovery rate (%)	87.76
Stressed loss severity (%)	21.5
Average residual maturity of assets	22.09 years
Average residual maturity of liabilities	3.5 Years
Variable rate assets (%)	100
Variable rate liabilities (%)	100
Assets in NOK (%)	100
Liabilities in NOK (%)	100
Average seasoning of residential assets	22.64 Months
Average residential current LTV (%)	56.52
Arrears of more than 90 days (%)	0
Maximum Concentration	Norway (100%)

Data as of 30 Nov 2008, Source: Fitch

Sparebank 1 Boligkreditt AS, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	4.05
Total Outstanding Covered bonds	3.8
Nominal Overcollateralisation (%)	6.44
Volume of residential assets	4
Stressed Recovery rate (%)	89.83
Stressed loss severity (%)	19.35
Average residual maturity of assets	20.17 years
Average residual maturity of liabilities	-
Variable rate assets (%)	100
Variable rate liabilities (%)	6.33
Assets in NOK (%)	99.8
Liabilities in EUR (%)	88.92
Average seasoning of residential assets	22.39 Months
Average residential current LTV (%)	47.34
Arrears of more than 90 days (%)	0.01

Data as of 30 Sep 2008, Source: Fitch

Societe Generale SCF, Public Sector Cover Pool (EUR bn)	
Total Cover Pool Volume	1.93
Total Outstanding Covered bonds	1
Nominal Overcollateralisation (%)	92.8
Average residual maturity of assets	7.1 Years
Average residual maturity of liabilities	4.8 Years
Variable rate assets (%)	22
Variable rate liabilities (%)	0
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Loan Performance (100%)	100
Concentration, Top 10 Borrower (%)	39
Maximum Concentration	France (100%)

Data as of 31 Aug 2008, Source: Fitch

SNS Bank N.V., Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	2.39
Total Outstanding Covered bonds	.74
Nominal Overcollateralisation (%)	225.17
Volume of residential assets	2.393
Average residual maturity of assets	25.1 years
Average residual maturity of liabilities	3.88 years
Assets in EUR (%)	100
Liabilities in EUR (%)	84.91
Average seasoning of residential assets	52.9 Months
Average residential current LTV (%)	82.6
Arrears of more than 90 days (%)	0.23
Maximum Concentration	Netherlands (100%)

Data as of 30 Nov 2008, Source: Fitch

Royal Bank of Canada, Mortgage Cover Pool (CAD bn)	
Total Cover Pool Volume	14.66
Total Outstanding Covered bonds	4.73
Nominal Overcollateralisation (%)	210.15
Volume of residential assets	15
Stressed Recovery rate (%)	
Stressed loss severity (%)	
Average residual maturity of assets	3.3 years
Average residual maturity of liabilities	6.18 years
Variable rate assets (%)	21.45
Variable rate liabilities (%)	0
Assets in CAD (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	21.75 Months
Average residential current LTV (%)	68.69
Maximum concentration	Canada (100%)

Data as of 30 Nov 2008, Source: Fitch

Northern Rock PLC, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	9.67
Total Outstanding Covered bonds	8.65
Nominal Overcollateralisation (%)	30.08
Volume of residential assets	10
Stressed Recovery rate (%)	-
Stressed loss severity (%)	-
Average residual maturity of assets	19.82 years
Average residual maturity of liabilities	6.04 Years
Assets in GBP (%)	100
Liabilities in EUR (%)	88.38
Average seasoning of residential assets	32.27 Months
Average residential current LTV (%)	74.49
Arrears of more than 90 days (%)	-
Maximum Concentration	UK (100%)

Data as of 30 Sep 2008, Source: Fitch

NIBC Bank N.V., Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	.48
Total Outstanding Covered bonds	.39
Nominal Overcollateralisation (%)	22.4
Volume of residential assets	.447
Stressed Recovery rate (%)	-
Stressed loss severity (%)	-
Average residual maturity of assets	8.54 years
Average residual maturity of liabilities	2.46 Years
Variable rate assets (%)	100
Variable rate liabilities (%)	100
Assets in EUR (%)	100
Liabilities in EUR (%)	88.38
Average seasoning of residential assets	43 Months
Average residential current LTV (%)	77.66
Maximum Concentration	Netherlands (100%)

Data as of 30 Sep 2008, Source: Fitch

Nationwide Building Society, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	26.62
Total Outstanding Covered bonds	18.01
Nominal Overcollateralisation (%)	56.47
Volume of residential assets	26.617
Stressed Recovery rate (%)	-
Stressed loss severity (%)	-
Average residual maturity of assets	18.08 years
Average residual maturity of liabilities	-
Assets in GBP (%)	100
Average seasoning of residential assets	49.93 Months
Average residential current LTV (%)	51.55
Arrears of more than 90 days (%)	0.05
Maximum Concentration	UK (100%)

Data as of 31 Aug 2008, Source: Fitch

Leeds Building Society, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	1.69
Total Outstanding Covered bonds	1.25
Nominal Overcollateralisation (%)	35.2
Volume of residential assets	1.69
Stressed Recovery rate (%)	77.3
Stressed loss severity (%)	33.02
Average residual maturity of assets	19.22 years
Average residual maturity of liabilities	4 Years
Variable rate assets (%)	33.85
Variable rate liabilities (%)	100
Assets in GBP (%)	100
Liabilities in GBP (%)	100
Average seasoning of residential assets	25.55 Months
Average residential current LTV (%)	64.02
Arrears of more than 90 days (%)	0
Maximum Concentration	UK (100%)

Data as of 31 Oct 2008, Source: Fitch

Landesbank Hessen Thueringe Girozentrale, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	21.46	
Total Outstanding Covered bonds	17.79	
Nominal Overcollateralisation (%)	20.62	
Maximum Concentration	Germany (93.6%)	
Arrears of more than 90 days	0	
Maturity (Years)	Assets	Liabilities
<1	1.67	1.76
>1 to <5	8.76	9.21
>5 to <10	8.77	4.53
>10	2.26	2.3

Data as of 30 Sep 2008, Source: Fitch

Landesbank Hessen Thueringen Girozentrale, Mortgage Cover Pool (EUR bn)		
Total Cover Pool Volume	**7.03**	
Total Outstanding Covered bonds	4.56	
Nominal Overcollateralisation (%)	54.24	
Maximum Concentration	Germany (100%)	
Arrears of more than 90 days	0	
Volume of residential assets	1.35	
Volume of commercial assets	4.85	
Maturity (Years)	Assets	Liabilities
<1	1.71	.14
>1 to <5	2.42	3.34
>5 to <10	2.84	.73
>10	.07	.35

Data as of 30 Sep 2008, Source: Fitch

Landesbank Berlin AG, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	**5.78**	
Total Outstanding Covered bonds	3.74	
Nominal Overcollateralisation (%)	54.86	
Maximum Concentration	Germany (94.54%)	
Total volume	5.78	
Average residual maturity of assets	-	
Average residual maturity of liabilities	-	
Variable rate assets (%)	-	
Variable rate liabilities (%)	-	
Assets in EUR (%)	100	
Liabilities in EUR (%)	100	
Maturity (Years)	Assets	Liabilities
<1	1.8	1.13
>1 to <5	1.91	2.26
>5 to <10	2.03	.35
>10	.04	0

Data as of 31 Dec 2008, Source: Fitch

Landesbank Baden-Württemberg, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	**91.18**	
Total Outstanding Covered bonds	78.42	
Nominal Overcollateralisation (%)	16.27	
Stressed recovery rate	-	
Average residual maturity of assets	4.5	
Average residual maturity of liabilities	3.35	
Variable rate assets (%)	22.27	
Variable rate liabilities (%)	7.43	
Assets in EUR (%)	96.64	
Liabilities in EUR (%)	97.7	
Concentration: Top 10 borrowers (%)	28.14	
Maximum Concentration	Germany (94.08%)	
Maturity (Years)	Assets	Liabilities
<1	20.64	18.49
>1 to <5	40.15	54.56
>5 to <10	24.7	12.32
>10	5.69	2.05

Data as of 30 Sep 2008, Source: Fitch

ING Bank NV, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	**7.48**
Total Outstanding Covered bonds	3.75
Nominal Overcollateralisation (%)	99.35
Volume of residential assets	7.482
Stressed Recovery rate (%)	-
Stressed loss severity (%)	-
Average residual maturity of assets	25.58 years
Average residual maturity of liabilities	8.66 Years
Variable rate assets (%)	100
Variable rate liabilities (%)	100
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	49.8 Months
Average residential current LTV (%)	79.96
Arrears of more than 90 days (%)	0.09
Maximum Concentration	Netherlands (100%)

Data as of 30 Sep 2008, Source: Fitch

Hypo Real Estate Bank AG, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	**15.36**	
Total Outstanding Covered bonds	14.81	
Nominal Overcollateralisation (%)	3.74	
Maximum Concentration	Germany (78.16%)	
Arrears of more than 90 days	.05	
Maturity (Years)	Assets	Liabilities
<1	8.2	3.99
>1 to <5	4.75	5.81
>5 to <10	1.29	2.07
>10	1.13	2.94

Data as of 30 Sep 2008, Source: Fitch

Hypo Real Estate Bank AG, Mortgage Cover Pool (EUR bn)

Total Cover Pool Volume	**16.93**	
Total Outstanding Covered bonds	15.99	
Nominal Overcollateralisation (%)	5.9	
Maximum Concentration	Germany (91.25%)	
Arrears of more than 90 days	.15	
Volume of residential assets	6.876	
Volume of commercial assets	9.558	
Maturity (Years)	Assets	Liabilities
<1	9.57	3.01
>1 to <5	4.29	8.44
>5 to <10	2.93	2.44
>10	.15	2.1

Data as of 30 Sep 2008, Source: Fitch

HSH Nordbank AG, Public Sector Cover Pool (EUR bn)

Total Cover Pool Volume	**10.72**	
Total Outstanding Covered bonds	9.75	
Nominal Overcollateralisation (%)	10.04	
Maximum Concentration	Germany (75.78%)	
Maturity (Years)	Assets	Liabilities
<1	.63	2.15
>1 to <5	1.9	2.77
>5 to <10	4.01	1.83
>10	4.19	3

Data as of 30 Sep 2008, Source: Fitch

HSH Nordbank AG, Mortgage Cover Pool (EUR bn)

Total Cover Pool Volume	**2.43**	
Total Outstanding Covered bonds	2.14	
Nominal Overcollateralisation (%)	13.54	
Maximum Concentration	Germany (68.08%)	
Volume of residential assets	.55	
Maturity (Years)	Assets	Liabilities
<1	.16	1.25
>1 to <5	1.08	.86
>5 to <10	.97	.03
>10	.22	0

Data as of 30 Sep 2008, Source: Fitch

HSBC Bank Plc, Mortgage Cover Pool (GBP bn)

Total Cover Pool Volume	**26.08**
Total Outstanding Covered bonds	11.57
Nominal Overcollateralisation (%)	125.45
Volume of residential assets	26.083
Average seasoning of residential assets	39.4 Months
Average residential current LTV (%)	61
Arrears of more than 90 days (%)	0.34
Maximum Concentration	UK (100%)

Data as of 31 Oct 2008, Source: Fitch

EUROHYPO Europäische Hypothekenbank SA, Public Sector Cover Pool (EUR bn)

Total Cover Pool Volume	**18.28**
Total Outstanding Covered bonds	17.01
Nominal Overcollateralisation (%)	7.48
Asset in EUR (%)	26.83
Asset in USD (%)	44.67
Liabilities in EUR (%)	31.09
Liabilities in USD (%)	41.28
Maximum Concentration	USA (12%)

Data as of 30 Sep 2008, Source: Fitch

EuroHypo AG, Public Sector (EUR bn)

Total Cover Pool Volume	**91.36**	
Total Outstanding Covered bonds	87.78	
Nominal Overcollateralisation (%)	4.08	
Maximum Concentration	Germany (71.34%)	
Maturity (Years)	Assets	Liabilities
<1	37.38	22.29
>1 to <5	28,23	45.87
>5 to <10	11.87	9.95
>10	13.89	9.67

Data as of 31 Oct 2008, Source: Fitch

EuroHypo AG, Mortgage Sector (EUR bn)

Total Cover Pool Volume	**50.31**	
Total Outstanding Covered bonds	45.67	
Nominal Overcollateralisation (%)	10.17	
Maximum Concentration	Germany (78.44%)	
Volume of residential assets	24.37	
Volume of commercial assets	24.87	
Arrears of mare than 90 days	.15	
Maturity (Years)	Assets	Liabilities
<1	21.38	9
>1 to <5	16.76	27.07
>5 to <10	10.57	8.44
>10	1.61	1.16

Data as of 31 Oct 2008,Source:Fitch

EBS Mortgage Finance, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	2.04
Total Outstanding Covered bonds	1.5
Nominal Overcollateralisation (%)	36
Volume of residential assets	2.04
Stressed Recovery rate (%)	67.3
Stressed loss severity (%)	48.1
Average residual maturity of assets	13.5 years
Average residual maturity of liabilities	2 Years
Variable rate assets (%)	100
Variable rate liabilities (%)	100
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	47 Months
Average residential current LTV (%)	57.3
Arrears of more than 90 days (%)	0
Maximum Concentration	Ireland (100%)

Data as of 31 Dec 2008, Source: Fitch

DZ Bank AG Deutsche Zentral-Genossenschaftsbank, Other Collateral Cover Pool (EUR bn)	
Total Cover Pool Volume	30.03
Total Outstanding Covered bonds	25.63
Nominal Overcollateralisation (%)	17.19
Variable rate assets (%)	27.65
Variable rate liabilities (%)	19.37
Assets in EUR (%)	97.12
Liabilities in EUR (%)	98.66
Maximum Concentration	Ireland (100%)

Data as of 31 Mar 2008, Source: Fitch

Düsseldorfer Hypothekenbank AG, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	14.54	
Total Outstanding Covered bonds	13.79	
Nominal Overcollateralisation (%)	5.46	
Maximum Concentration	Germany (55.62%)	
Arrears of mare than 90 days	0	
Maturity (Years)	Assets	Liabilities
<1	2.73	3.58
>1 to <5	3.82	5.44
>5 to <10	5.58	2.01
>10	2.41	2.76

Data as of 30 Sep 2008, Source: Fitch

DnB NOR Boligkreditt, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	17.75
Total Outstanding Covered bonds	13.04
Nominal Overcollateralisation (%)	36.13
Volume of residential assets	17.75
Stressed Recovery rate (%)	84.75
Stressed loss severity (%)	24.99
Variable rate assets (%)	96.73
Variable rate liabilities (%)	29.14
Assets in EUR (%)	100
Liabilities in EUR (%)	60.9
Liabilities in NOK (%)	35.47
Average seasoning of residential assets	13.24 Months
Average residential current LTV (%)	52.66
Arrears of more than 90 days (%)	0.01
Maximum Concentration	Norway (100%)

Data as of 30 Nov 2008, Source: Fitch

Dexia Municipal Agency, Public sector Cover Pool (EUR bn)	
Total Cover Pool Volume	73.4
Total Outstanding Covered bonds	66.15
Nominal Overcollateralisation (%)	10.96
Average residual maturity of assets	7.2
Average residual maturity of liabilities	4.76
Maximum Concentration	France (61.8%)

Data as of 30 Jun 2008, Source: Fitch

Deutsche Postbank AG, Mortgage Cover Pool (EUR bn)		
Total Cover Pool Volume	4.57	
Total Outstanding Covered bonds	3.55	
Nominal Overcollateralisation (%)	28.7	
Stressed recovery rate	-	
Average residual maturity of assets	8.5	
Average residual maturity of liabilities	4.26	
Variable rate assets (%)	.01	
Variable rate liabilities (%)	6.76	
Assets in EUR (%)	100	
Liabilities in EUR (%)	100	
Concentration: Top 10 borrowers (%)	28.14	
Maximum Concentration	Germany (100%)	
Average seasoning of residential assets	40.25 months	
Average residential current LTV	-	
Maturity (Years)	Assets	Liabilities
<1	.1	.55
>1 to <5	1.08	1.99
>5 to <10	1.92	1.01
>10	1.46	0

Data as of 30 Sep 2008, Source: Fitch

Deutsche Genossenschafts-Hypothekenbank AG, Public Sector Cover pool (EUR bn)		
Total Cover Pool Volume	42.34	
Total Outstanding Covered bonds	38.95	
Nominal Overcollateralisation (%)	8.71	
Maximum Concentration	Germany (65.63%)	
Maturity (Years)	Assets	Liabilities
<1	5.46	6.37
>1 to <5	17.15	13.97
>5 to <10	12.55	11.67
>10	7.19	6.94

Data as of 30 Sep 2008,Source:Fitch

Deutsche Genossenschafts-Hypothekenbank AG, Mortgage Cover Pool (EUR bn)		
Total Cover Pool Volume	16.02	
Total Outstanding Covered bonds	13.07	
Nominal Overcollateralisation (%)	22.6	
Maximum Concentration	Germany (96.5%)	
Volume of residential assets	11.6	
Volume of commercial assets	4.22	
Arrears of more than 90 days	.33	
Maturity (Years)	Assets	Liabilities
<1	2.43	1.64
>1 to <5	6.68	8.24
>5 to <10	5.88	3.16
>10	1.04	.04

Data as of 30 Sep 2008,Source:Fitch

DEPFA Deutsche Pfandbriefbank, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	44.48	
Total Outstanding Covered bonds	42.54	
Nominal Overcollateralisation (%)	4.57	
Maximum Concentration	Germany (32.86%)	
Arrears of more than 90 days (%)	0	
Maturity (Years)	Assets	Liabilities
<1	19.57	8.01
>1 to <5	8.93	21.35
>5 to <10	5.1	6.67
>10	8.93	8.45

Data as of 30 Sep 2008, Source: Fitch

DEPFA ACS Bank, Public Sector Cover Pool (EUR bn)	
Total Cover Pool Volume	49.12
Total Outstanding Covered bonds	42.61
Nominal Overcollateralisation (%)	15.29
Maximum Concentration	USA (24.48%)
Variable rate assets (%)	46.69
Variable rate liabilities (%)	17.28
Assets in EUR (%)	64.40
Liabilities in EUR (%)	63.10
Assets in USD (%)	27.58
Liabilities in USD (%)	23.98

Data as of 30 Jun 2008, Source: Fitch

Danske Bank, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	4.76
Total Outstanding Covered bonds	4.34
Nominal Overcollateralisation (%)	9.83
Volume of residential assets	4.54
Stressed Recovery rate (%)	62.86
Average residual maturity of assets	20.31 years
Average residual maturity of liabilities	3.89 Years
Assets in NOK (%)	100
Liabilities in EUR (%)	62.91
Liabilities in DKK (%)	36.57
Average seasoning of residential assets	25.21 Months
Average residential current LTV (%)	72.78
Maximum Concentration	Norway (100%)

Data as of 30 Sep 2008, Source: Fitch

Danske Bank, Mortgage Cover Pool Domestic (EUR bn)	
Total Cover Pool Volume	3.75
Total Outstanding Covered bonds	3.53
Nominal Overcollateralisation (%)	6.35
Volume of residential assets	3.75
Stressed Recovery rate (%)	-
Average residual maturity of assets	27.64 years
Average residual maturity of liabilities	6.02 Years
Assets in DKK (%)	100
Liabilities in EUR (%)	22.67
Liabilities in DKK (%)	70.37
Average seasoning of residential assets	26.58 Months
Average residential current LTV (%)	55.13
Maximum Concentration	Denmark (100%)

Data as of 30 Sep 2008, Source: Fitch

Coventry Building Society, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	2.87
Total Outstanding Covered bonds	2
Nominal Over collateralisation (%)	43.4
Volume of residential assets	2.87
Stressed recovery rate	69.08
Average residual maturity of assets	19.77
Average residual maturity of liabilities	4.8
Variable rate assets (%)	47.56
Variable rate liabilities (%)	100
Assets in GBP (%)	100
Liabilities in GBP (%)	100
Maximum Concentration	UK (100%)
Average seasoning of residential assets	24.31 months
Arrears of more than 90 days (%)	.02
Average residential current LTV	67.9

Data as of 30 Nov 2008, Source: Fitch

COREALCREDIT BANK AG, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume	**5.94**	
Total Outstanding Covered bonds	5.49	
Nominal Overcollateralisation (%)	8.22	
Maximum Concentration	Germany (80.62%)	
Arrears of more than 90 days (%)	0.08	
Maturity (Years)	Assets	Liabilities
<1	2.01	2.79
>1 to <5	1.85	1.69
>5 to <10	1.81	.75
>10	.26	.25

Data as of 30 Sep 2008, Source: Fitch

CREALCREDIT BANK AG, Mortgage Cover Pool (EUR bn)		
Total Cover Pool Volume	**4.25**	
Total Outstanding Covered bonds	3.49	
Nominal Overcollateralisation (%)	21.76	
Maximum Concentration	Germany (99.99%)	
Arrears of more than 90 days (%)	0.96	
Volume of residential assets	1.73	
Volume of commercial assets	1.94	
Maturity (Years)	Assets	Liabilities
<1	.71	.99
>1 to <5	1.12	2.44
>5 to <10	1.35	.07
>10	.07	0

Data as of 30 Sep 2008,Source:Fitch

Co-Operative Bank, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	**2.42**
Total Outstanding Covered bonds	1
Nominal Over collateralisation (%)	142.36
Volume of residential assets	2.42
Stressed recovery rate	76.76
Average residual maturity of assets	16.79
Average residual maturity of liabilities	3
Variable rate assets (%)	56.54
Variable rate liabilities (%)	100
Assets in GBP (%)	100
Liabilities in GBP (%)	100
Maximum Concentration	UK (100%)
Average seasoning of residential assets	38.09 months
Arrears of more than 90 days (%)	0
Average residential current LTV	56.84

Data as of 30 Sep 2008, Source: Fitch

Aareal Bank AG, Mortgage Cover Pool (EUR bn)		
Total Cover Pool Volume	**6.941**	
Total Outstanding Covered bonds	6.134	
Nominal Overcollateralisation	13.17	
Maximum Concentration	Germany (18.25%)	
Volume of residential assets	0.84	
Volume of commercial assets	5.852	
Arrears of more than 90 days	0	
Maturity (Years)	Assets	Liabilities
<1	1.033	1.089
>1 to <5	3.762	3.839
>5 to <10	2.03	1.07
>10	0.116	0.135

Data as of 30 Sep 2008, Source :Fitch

ABN Amro N.V, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	16.153
Total Outstanding Covered bonds	11.159
Nominal Overcollateralisation (%)	44.76
Maximum Concentration	Netherlands (100%)
Average residual maturity of assets	25.55 years
Arrears of more than 1 month	1.69
Average residual maturity of liabilities	7.24 years
Average seasoning of residential assets	56.16 months
Average residential current LTV (%)	87.75
Assets in EUR (%)	100
Liabilities in EUR (%)	88.91

Data as of 30 Sep 2008, Source: Fitch

Banca Popolare di Milano, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	1.221
Total Outstanding Covered bonds	1
Nominal Overcollateralisation (%)	22.1
Maximum Concentration	Italy (100%)
Volume of residential assets	1.221
Stressed Recovery Rate (%)	85.57
Average residual maturity of assets	18.13 years
Average residual maturity of liabilities	3 years
Variable rate assets	88.21
Variable rate liabilities	0
Assets in EUR	100
Liabilities in EUR	100
Average residential current LTV	48.81
Arrears of more than 90 days	0

Data as of 31 July 2008, Source: Fitch

Banco BPI, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	1.693
Total Outstanding Covered bonds	1
Maximum Concentration	Portugal (100%)
Volume of residential assets	1.693
Stressed Recovery Rate (%)	97.56
Average residual maturity of assets	24.8 years
Average residual maturity of liabilities	2 years
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	50.6 months
Average residential current LTV (%)	56.33

Data as of 31 Aug 2008, Source: Fitch

Banco Commercial Portugues, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	3.752
Total Outstanding Covered bonds	3.5
Nominal Overcollateralisation (%)	9.47
Volume of residential assets	3.673
Average residual maturity of assets	18.14 years
Average residual maturity of liabilities	5.93 years
Average residential current LTV (%)	57.7
Arrears of more than 90 days	0.24

Data as of 30 Sep 2008, Source: Fitch

Banco Espanol Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	36.051
Total Outstanding Covered bonds	25.844
Nominal Overcollateralisation (%)	131.84

Data as of 30 Nov 2008, Source: Fitch

Banco Espirito Santo, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	3.052
Total Outstanding Covered bonds	2.5
Nominal Overcollateralisation (%)	22.08
Maximum Concentration	Portugal (100%)
Volume of residential assets	3.052
Stressed Recovery Rate (%)	94.57
Average seasoning of residential assets	40.1 months
Average residual maturity of assets	15.15 years
Average residual maturity of liabilities	2.3 years
Variable rate assets (% of assets)	99.5
Variable rate liabilities (% of liabilities)	0
Average residential current LTV (%)	58.78
Arrears of more than 90 days	0

Data as of 31 Jul 2008, Source :Fitch

Banco Guipuzcoano, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	3.093
Total Outstanding Covered bonds	1
Nominal Overcollateralisation (%)	209.34
Maximum Concentration	Spain (100%)
Volume of commercial assets	0.207
Volume of residential assets	1.492
Stressed Recovery Rate (%)	22.18
Average residual maturity of assets	13.43 years
Average residual maturity of liabilities	10.12 years
Variable rate assets	97.52
Variable rate liabilities	28.57
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	26.27 months
Average residential current LTV (%)	68.11
Average seasoning of commcerial assets	27.5 months
Arrears of more than 90 days	0.49

Data as of 31 Mar 2008, Source: Fitch

Banco Popular Espanol, Mortgage Cover pool (EUR bn)	
Total Cover Pool Volume	22.554
Total eligible book volume	15.113
Nominal Overcollateralisation (%)	333.31
Maximum Concentration	Spain (100%)
Volume of commercial assets	5.015
Volume of residential assets	9.771
Stressed Recovery Rate (%)	-
Average residual maturity of assets	-
Average residual maturity of liabilities	-
Variable rate assets	98.44
Variable rate liabilities	0
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	25.19 months
Average residential current LTV (%)	-
Average commercial current LTV (%)	-
Arrears of more than 90 days	0.01

Data as of 31 Nov 2008,Source:Fitch

Banco Santander Totta SA, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	1.069
Total outstanding covered bonds volume	1
Maximum Concentration	Portugal (100%)
Volume of residential assets	1.069
Stressed Recovery Rate (%)	93.3
Average residual maturity of assets	27 years
Average residual maturity of liabilities	4 years
Variable rate assets	86.2
Variable rate liabilities	0
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	38.2 months
Average residential current LTV (%)	57.84
Arrears of more than 90 days	0

Data as of 31 May 2008, Source: Fitch

Banco Santander, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	54.025
Total eligible book volume	35.823
Nominal Overcollateralisation (%)	106.36
Maximum Concentration	Spain (100%)

Data as of 30 Sep 2008, Source: Fitch

Bank of Ireland, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	5.717
Total outstanding covered bonds volume	4
Nominal Overcollateralisation (%)	42.92
Maximum Concentration	United Kingdom (100%)
Volume of residential assets	5.717
Stressed Recovery Rate (%)	74.61
Average residual maturity of assets	16.08 years
Average residual maturity of liabilities	5 years
Variable rate assets	44.09
Variable rate liabilities	100
Assets in GBP (%)	100
Liabilities in GBP (%)	100
Average seasoning of residential assets	32.91 months
Average residential current LTV (%)	62.81
Arrears of more than 90 days	0

Data as of 30 Sep 2008, Source: Fitch

Bank of Montreal Mortgage Cover Pool (CAD bn)	
Total Cover Pool Volume	5.742
Total outstanding covered bonds volume	1.5
Nominal Overcollateralisation (%)	282.86
Maximum Concentration	Canada (100%)
Volume of residential assets	5.742
Stressed Loss Severity (%)	-
Average residual maturity of assets	2.34 years
Average residual maturity of liabilities	4.31 years
Variable rate assets	42.76
Variable rate liabilities	0
Assets in CAD (%)	100
Liabilities in EUR (%)	100
Average seasoning of residential assets	30.17 months
Average residential current LTV (%)	65.58

Data as of 30 Sep 2008, Source: Fitch

Barclays Bank PLC, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	7.121
Total outstanding covered bonds volume	5
Nominal Overcollateralisation (%)	42.41
Maximum Concentration	United Kingdom (100%)
Volume of residential assets	7.121
Stressed Recovery Rate (%)	-
Average residual maturity of assets	-
Average residual maturity of liabilities	3.31 years
Variable rate assets	-
Variable rate liabilities	-
Assets in GBP (%)	100
Liabilities in GBP (%)	100
Average seasoning of residential assets	15.95 months
Average residential current LTV (%)	55.95
Arrears of more than 90 days	0.14

Data as of 30 Sep 2008, Source: Fitch

Bayerische Hypo- und Vereinsbank AG, Mortgage Cover pool (EUR bn)		
Total Cover Pool Volume		38.807
Total outstanding covered bonds volume		31.032
Nominal Overcollateralisation (%)		25.06
Maximum Concentration		Germany (99.96%)
Volume of residential assets		28.141
Volume of commercial assets		9.354
Arrears of more than 90 days		0.04
Maturity (Years)	Assets	Liabilities
<1	12.476	1.707
>1 to <5	16.305	17.764
>5 to <10	8.609	9.096
>10	1.418	2.464

Data as of 30 Sep 2008, Source: Fitch

Bayerische Hypo- und Vereinsbank AG, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume		10.974
Total outstanding covered bonds volume		7.099
Nominal Overcollateralisation (%)		54.57
Maximum Concentration		Germany (95.44%)
Arrears of more than 90 days		0.02
Maturity (Years)	Assets	Liabilities
<1	3.854	1.518
>1 to <5	4.133	2.046
>5 to <10	2.208	2.075
>10	0.779	1.461

Data as of 30 Sep 2008,Source: Fitch

Bayerische Landesbank, Mortgage Cover Pool (EUR bn)		
Total Cover Pool Volume		8.809
Total outstanding covered bonds volume		5.337
Nominal Overcollateralisation (%)		65.06
Maximum Concentration		Germany (77.95%)
Volume of residential assets		3.077
Volume of commercial assets		5.251
Average seasoning of Mortgage assets		72.1 months
Average residual maturity of assets		4.8 years
Stressed Recovery Rate (%)		-
Assets in EUR (%)		83.89
Liabilities in EUR (%)		91.69
Average seasoning of residential assets		101.54 months
Average seasoning of commcerial assets		54.85 months
Average residential current LTV (%)		55.95
Arrears of more than 90 days		0.02
Maturity (Years)	Assets	Liabilities
<1	12.476	1.707
>1 to <5	16.305	17.764
>5 to <10	8.609	9.096
>10	1.418	2.464

Data as of 30 Sep 2008, Source: Fitch

Bayerische Landesbank, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume		58.743
Total outstanding covered bonds volume		51.137
Nominal Over collateralisation (%)		14.87
Maximum Concentration		Germany (88.96%)
Stressed Recovery Rate (%)		-
Average residual maturity of assets		5.5 years
Average residual maturity of liabilities		3.6 years
Variable rate assets (% of assets)		31.86
Variable rate liabilities (% of liabilities)		9.17
Assets in EUR (%)		92.92
Liabilities in EUR (%)		93.04
Concentration: Top 10 borrowers (% of assets)		39.52
Maturity (Years)	Assets	Liabilities
<1	6.274	4.043
>1 to <5	22.022	33.506
>5 to <10	26.085	10.197
>10	4.362	3.391

Data as of 30 Sep 2008, Source: Fitch

Berlin-Hannoversche Hypothekenbank AG, Mortgage Cover Pool (EUR bn)		
Total Cover Pool Volume		9.672
Total outstanding covered bonds volume		9.012
Nominal Overcollateralisation (%)		7.32
Maximum Concentration		Germany (93.55%)
Volume of residential assets		-
Volume of commercial assets		8.055
Stressed Recovery Rate (%)		-
Average residual maturity of assets		3.5 years
Average residual maturity of liabilities		3.74 years
Variable rate assets (% of assets)		20.96
Variable rate liabilities (% of liabilities)		1.61
Assets in EUR (%)		95.86
Liabilities in EUR (%)		100
Average residential current LTV (%)		57
Average seasoning of commcerial assets		90.41 months
Average commercial current LTV (%)		77.33
Arrears of more than 90 days (% of assets)		0.26
Maturity (Years)	Assets	Liabilities
<1	3.398	1.378
>1 to <5	3.294	6.334
>5 to <10	2.854	1.004
>10	0.126	0.297

Data as of 30 Sep 2008, Source: Fitch

Berlin-Hannoversche Hypothekenbank AG, Public Sector Cover Pool (EUR bn)		
Total Cover Pool Volume		18.421
Total outstanding covered bonds volume		17.233
Nominal Overcollateralisation (%)		6.9
Maximum Concentration		Germany (87.30%)
Total volume		18.421
Average residual maturity of assets		4 years
Average residual maturity of liabilities		4.49 years
Variable rate assets (% of assets)		19.41
Variable rate liabilities (% of liabilities)		13.36
Assets in EUR (%)		99.83
Liabilities in EUR (%)		100
Concentration: Top 10 borrowers (% of assets)		-
Arrears of more than 90 days (% of assets)		0
Maturity (Years)	Assets	Liabilities
<1	6.633	4.442
>1 to <5	4.938	7.175
>5 to <10	6.284	3.526
>10	0.665	2.09

Data as of 30 Sep 2008, Source: Fitch

BNP Paribas Covered Bonds, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	17.001
Total outstanding covered bonds volume	12.678
Nominal Over collateralisation (%)	34.1
Maximum Concentration	France (100%)
Stressed Recovery Rate (%)	-
Average residual maturity of assets	15.49 years
Average residual maturity of liabilities	3.1 years
Variable rate assets	14.44
Variable rate liabilities	1.25
Assets in EUR (%)	100
Liabilities in EUR (%)	99.22
Average seasoning of residential assets	-
Average residential current LTV (%)	70.48

Data as of 30 Sep 2008, Source: Fitch

Bradford & Bingley, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	11.123
Total outstanding covered bonds volume	6.996
Nominal Overcollateralisation (%)	63.56
Maximum Concentration	United Kingdom (100%
Stressed Recovery Rate (%)	-
Average residual maturity of assets	-
Average residual maturity of liabilities	-
Variable rate assets	-
Variable rate liabilities	-
Assets in GBP (%)	100
Liabilities in GBP (%)	-
Average seasoning of residential assets	-
Average residential current LTV (%)	60.1
Arrears of more than 90 days (% of assets)	0.87

Data as of 30 Sep 2008, Source: Fitch

Caisse de Refinancement de l'Habitat, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	54.8
Total outstanding covered bonds volume	38
Nominal Overcollateralisation (%)	44.21
Average residual maturity of assets	5.2 years
Average residual maturity of liabilities	5.2 years
Variable rate assets	0
Variable rate liabilities	0
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Arrears of more than 90 days (% of assets)	0

Data as of 31 Mar 2008, Source: Fitch

Caixa d'Estalvis de Catalunya, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	23.978
Total eligible book volume	14.082
Nominal Overcollateralisation (%)	225.35
Maximum Concentration	Spain (100%)
Stressed Recovery Rate (%)	-
Average seasoning of mortgage assets	36.31 months
Volume of residential assets	15.935
Volume of commercial assets	1.663
Average residual maturity of assets	20.79 years
Average residual maturity of liabilities	5.31 years
Variable rate assets (% of assets)	99.58
Variable rate liabilities (% of liabilities)	18.32
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average residential current LTV (%)	-
Average commercial current LTV (%)	-
Arrears of more than 90 days (% of assets)	6.07

Data as of 30 Sep 2008, Source: Fitch

Caixa de Aforros de Vigo, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	8.125
Total eligible book volume	4.461
Nominal Overcollateralisation (%)	187.41
Maximum Concentration	Spain (100%)
Average seasoning of residential assets	38.05 months
Volume of residential assets	3.856
Volume of commercial assets	0.662
Average residual maturity of assets	21.52 years
Average residual maturity of liabilities	9.17 years
Variable rate assets (% of assets)	95.75
Variable rate liabilities (% of liabilities)	22.38
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average residential current LTV (%)	58.61
Average commercial current LTV (%)	54.03
Arrears of more than 90 days (% of assets)	0.21

Data as of 31 Mar 2008, Source: Fitch

Caixa Geral de Depositos, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	7.081
Total outstanding covered bonds volume	5.55
Nominal Overcollateralisation (%)	27.59
Maximum Concentration	Portugal (100%)
Stressed Recovery Rate (%)	99.53
Stressed Loss Severity (%)	16.74
Average seasoning of residential assets	53.1 months
Volume of residential assets	7.081
Average residual maturity of assets	-
Average residual maturity of liabilities	7.33 years
Variable rate assets (% of assets)	100
Variable rate liabilities (% of liabilities)	27.9
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average residential current LTV (%)	53.94
Arrears of more than 90 days (% of assets)	0

Data as of 31 Mar 2008, Source: Fitch

Caja de Ahorros de Murcia, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	11.345
Total outstanding covered bonds volume	4.625
Nominal Overcollateralisation (%)	145.29
Maximum Concentration	Spain (100%)
Stressed Recovery Rate (%)	31.15
Average seasoning of residential assets	38.03 months
Volume of residential assets	6.545
Volume of commercial assets	0.947
Average residual maturity of assets	13.66 years
Average residual maturity of liabilities	6.14 years
Variable rate assets (% of assets)	99.53
Variable rate liabilities (% of liabilities)	99.48
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average residential current LTV (%)	61.99
Average commercial current LTV (%)	49.15
Arrears of more than 90 days (% of assets)	1.23

Data as of 30 Sep 2008, Source: Fitch

Cajamar Caja Rural, Mortgage Cover Pool (EUR bn)	
Total Cover Pool Volume	10.781
Total outstanding covered bonds volume	2
Nominal Overcollateralisation (%)	439.04
Maximum Concentration	Spain (100%)
Stressed Recovery Rate (%)	34.63
Average seasoning of residential assets	23.81 months
Volume of residential assets	4.506
Volume of commercial assets	2.33
Average residual maturity of assets	18.39 years
Average residual maturity of liabilities	6.85 years
Variable rate assets (% of assets)	96.92
Variable rate liabilities (% of liabilities)	43.33
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average residential current LTV (%)	59.42
Average commercial current LTV (%)	55.9
Arrears of more than 90 days (% of assets)	2.08

Data as of 30 Apr 2008, Source :Fitch

Canadian Imperial Bank of Commerce, Cover Pool (CAD bn)	
Total Cover Pool Volume	5.549
Total outstanding covered bonds volume	3.599
Nominal Overcollateralisation (%)	54.18
Maximum Concentration	Canada (100%)
Stressed Recovery Rate (%)	-
Average seasoning of residential assets	19.63 months
Volume of residential assets	5.549
Average residual maturity of assets	3.36 years
Average residual maturity of liabilities	1.96 years
Variable rate assets (% of assets)	100
Variable rate liabilities (% of liabilities)	13.86
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average residential current LTV (%)	55.76
Arrears of more than 90 days (% of assets)	-

Data as of 30 Sep 2008, Source: Fitch

Cassa Depositi e Prestiti, Public Sector Cover Pool (EUR bn)	
Total Cover Pool Volume	17.618
Total outstanding covered bonds volume	8.064
Nominal Overcollateralisation (%)	118.49
Maximum Concentration	Italy (100%)
Average residual maturity of assets	10.31 years
Average residual maturity of liabilities	3.19 years
Loan Performance: Performing (% of cover assets)	100
Concentration: Top 10 borrowers (% of assets)	8.54
Assets in EUR (%)	100
Liabilities in EUR (%)	99.21

Data as of 30 Jun 2008, Source: Fitch

Chelsea Building Society, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	1.773
Total outstanding covered bonds volume	1.25
Nominal Overcollateralisation (%)	41.84
Maximum Concentration	United Kingdom (100%)
Stressed Recovery Rate (%)	87.27
Stressed Loss Severity (%)	23.84
Average seasoning of residential assets	40.16 months
Volume of residential assets	1.773
Average residual maturity of assets	16.69 years
Average residual maturity of liabilities	3 years
Variable rate assets (% of assets)	13.3
Variable rate liabilities (% of liabilities)	100
Assets in EUR (%)	100
Liabilities in EUR (%)	100
Average residential current LTV (%)	52.53
Arrears of more than 90 days (% of assets)	0

Data as of 31 Oct 2008, Source: Fitch

Clydesdale Bank PLC, Mortgage Cover Pool (GBP bn)	
Total Cover Pool Volume	2.418
Total outstanding covered bonds volume	1.85
Nominal Overcollateralisation (%)	30.69
Maximum Concentration	United Kingdom (100%)
Stressed Recovery Rate (%)	71.27
Stressed Loss Severity (%)	41.35
Average seasoning of residential assets	17.95 months
Volume of residential assets	2.418
Average residual maturity of assets	17.94 years
Average residual maturity of liabilities	3.26 years
Variable rate assets (% of assets)	63.82
Variable rate liabilities (% of liabilities)	100
Assets in GBP (%)	100
Liabilities in GBP (%)	100
Average residential current LTV (%)	67.08
Arrears of more than 90 days (% of assets)	0

Data as of 31 Oct 2008, Source: Fitch

CM-CIC Covered Bonds, Mortgage Cover Pool (EUR Bn)	
Total Cover Pool Volume	10.033
Total outstanding covered bonds volume	6
Nominal Overcollateralisation (%)	67.22
Maximum Concentration	France (100%)
Stressed Recovery Rate (%)	-
Average seasoning of residential assets	45 months
Volume of residential assets	10.033
Average residual maturity of assets	15.42 years
Average residual maturity of liabilities	2.66 years
Variable rate assets (% of assets)	22.04
Variable rate liabilities (% of liabilities)	0
Assets in GBP (%)	100
Liabilities in GBP (%)	100
Average residential current LTV (%)	67
Arrears of more than 90 days (% of assets)	0

Data as of 30 Sep 2008, Source: Fitch

Appendix 1

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