

**Judith Hardt  
Secretary General  
European Mortgage Federation**

**(4 February 2003)**



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# European Mortgage Federation

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- Founded in 1967
- Groups national trade associations from all EU MS, Norway and Switzerland
- Accession countries membership: Czech Rep., Hungary, Malta, Poland and Romania
- Represents 70% of EU mortgage market
- Represents mortgage lenders' interests at European level



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# Understanding the Markets

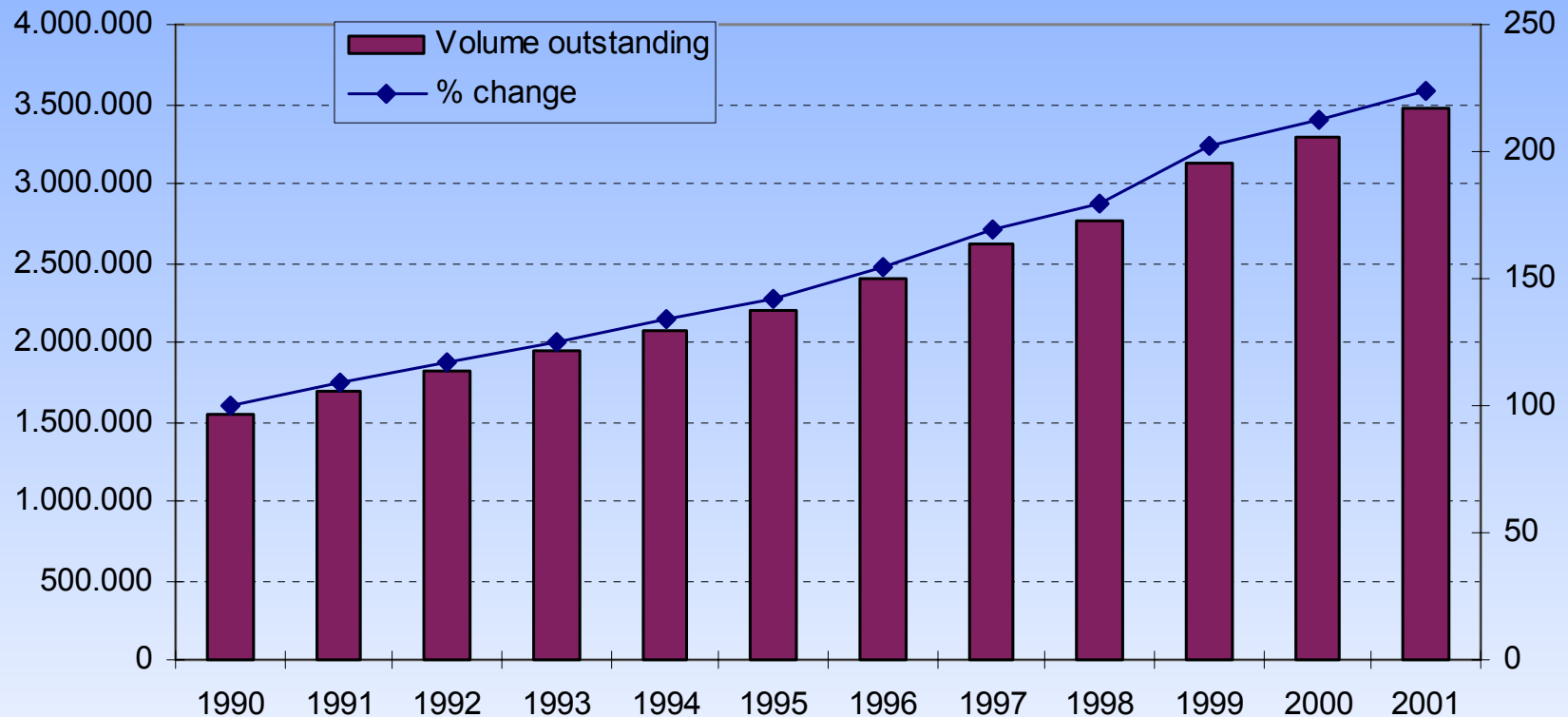
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- Outstanding volume of mortgage loans in 2001 exceeded EUR 3.9 trillion
- Twice the amount of 10 years ago
- Growing at approx. 8% per year over the last 10 years
- Around 40% of European GDP



# Growth of mortgage debt (10 years)

Period 1990 – 2001, Euro/million, volume outstanding, % change



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# What is a Mortgage Bond?

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***« Mortgage bonds are essentially debt securities issued by [mortgage] credit institutions and covered by certain types of assets, usually mortgage loans, which remain on the balance sheet of the issuer. »***

*Source: « Mortgage banks and the Mortgage Bond in Europe »*



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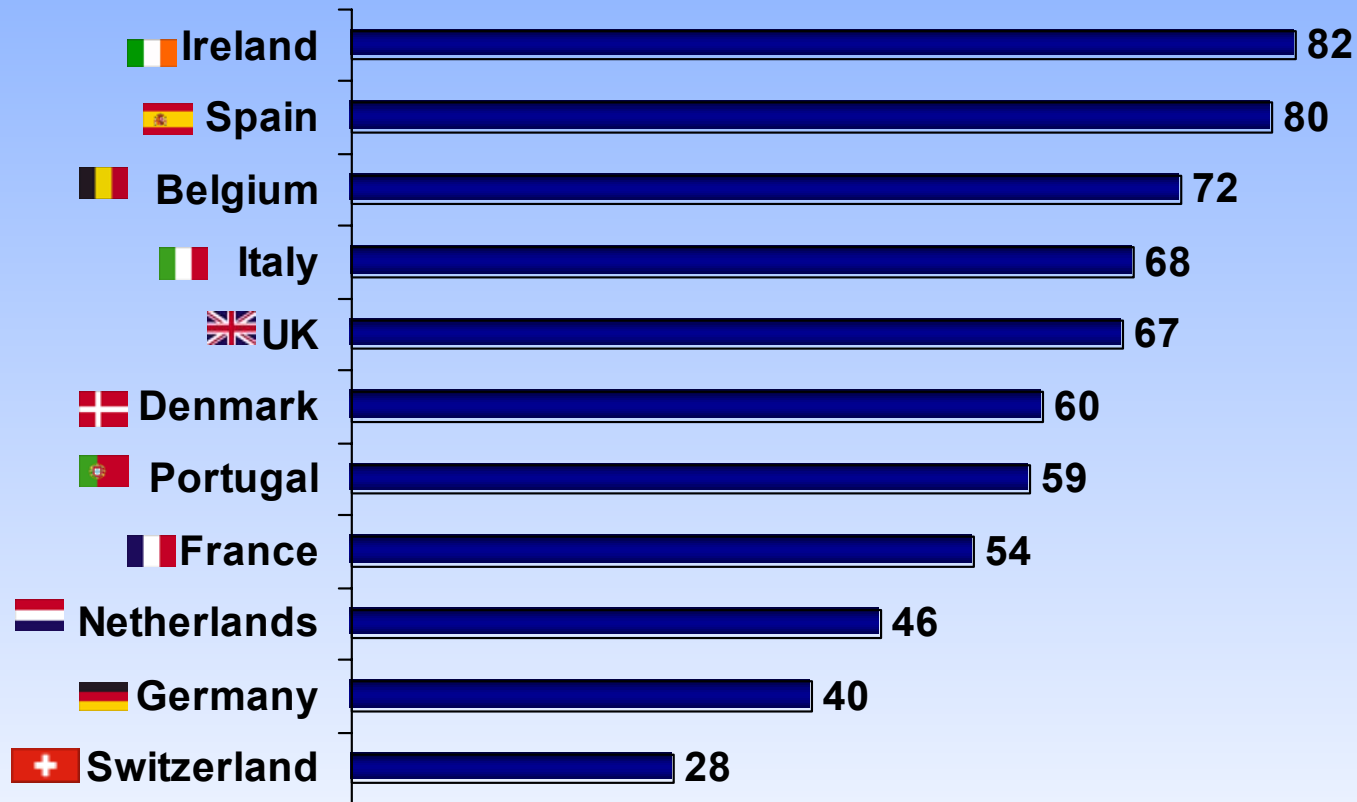
# Mortgage Bond Issuers in Europe

<b>Country</b>	<b>Type(s) of issuer</b>
Denmark	Mortgage banks
Germany	Mortgage banks & public sector credit institutions
Spain	Any credit institution
France	Specialised banks (sociétés de crédit foncier) & centralised issuing institution
Luxembourg	Mortgage banks
Austria	Mixed mortgage banks & Landeshypothekenbanken
Sweden	Mortgage companies
Finland	Mortgage credit banks
Switzerland	Centralised issuing institutions

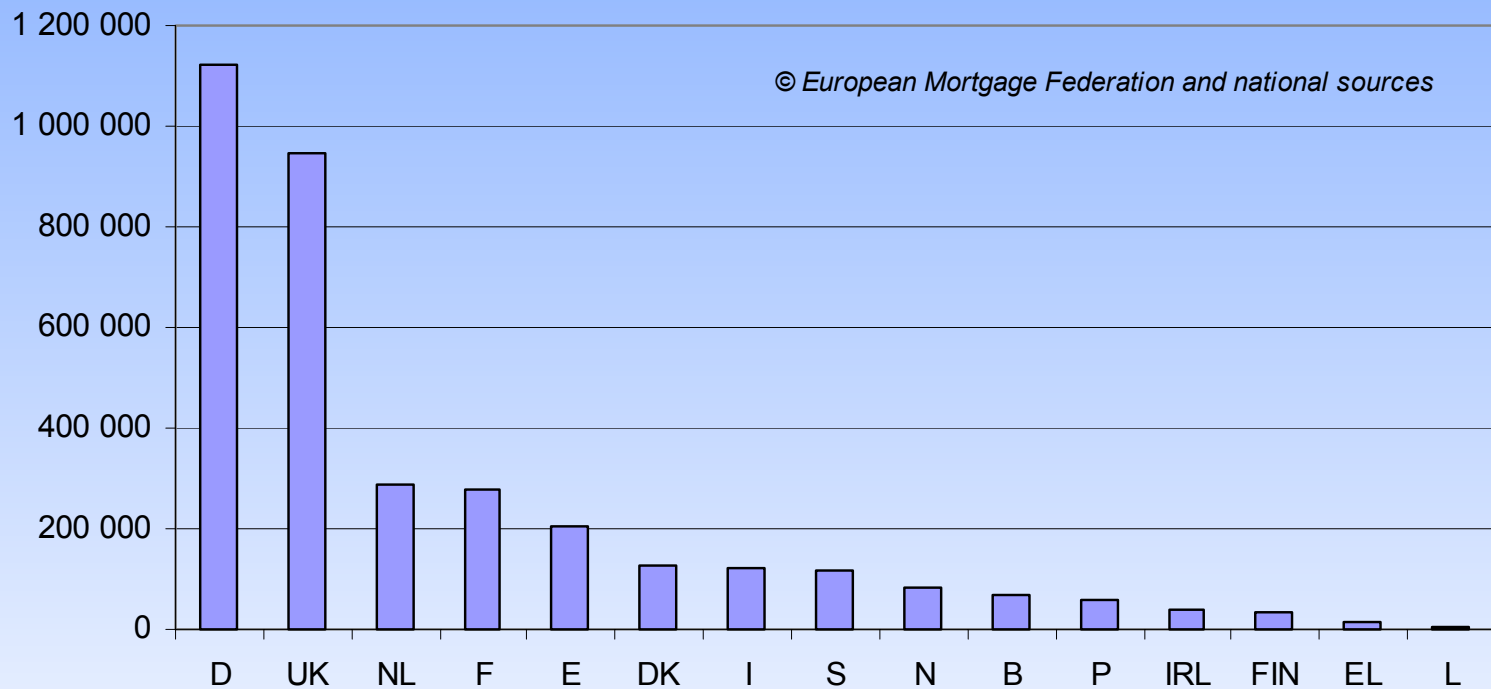


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# Home ownership rates across Europe



# Outstanding mortgage loans in Europe (year 2001)

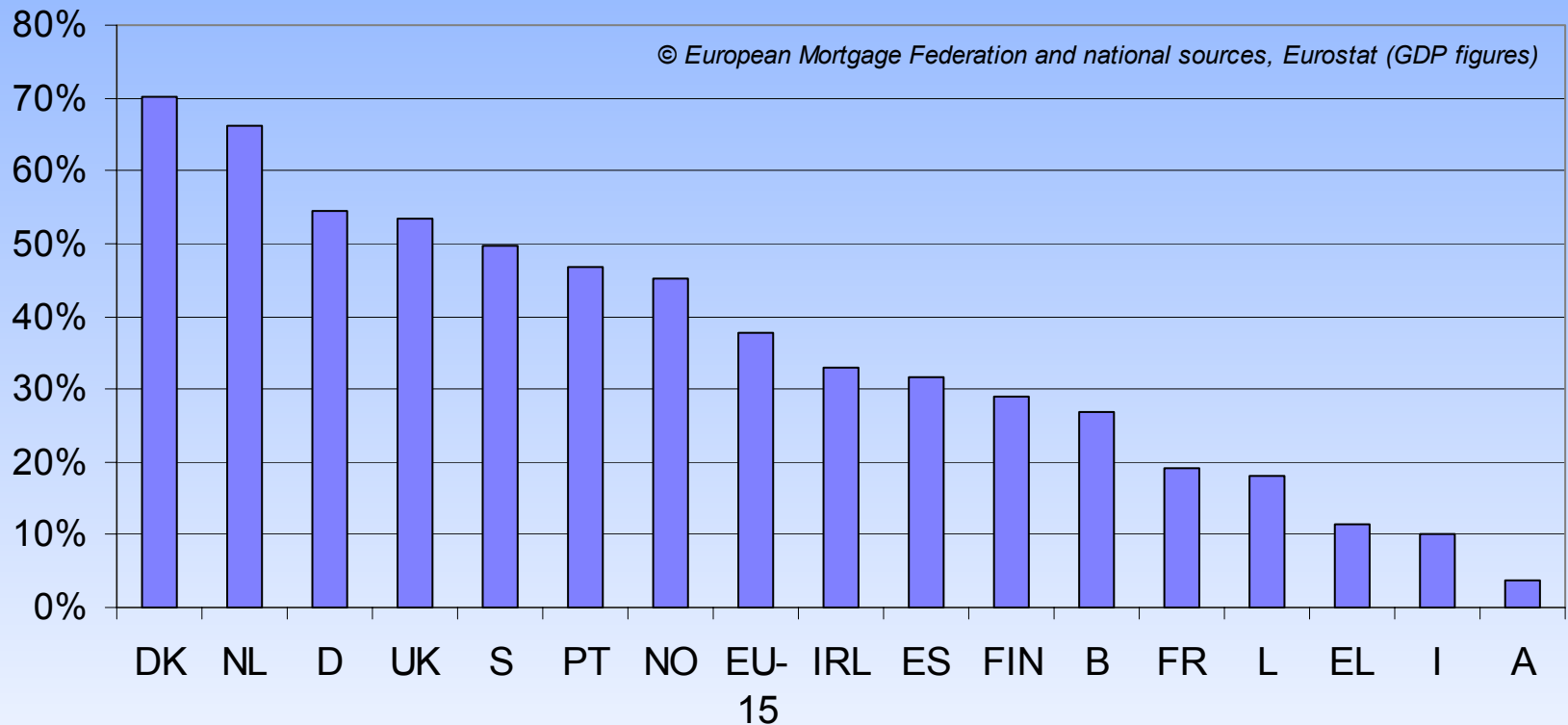


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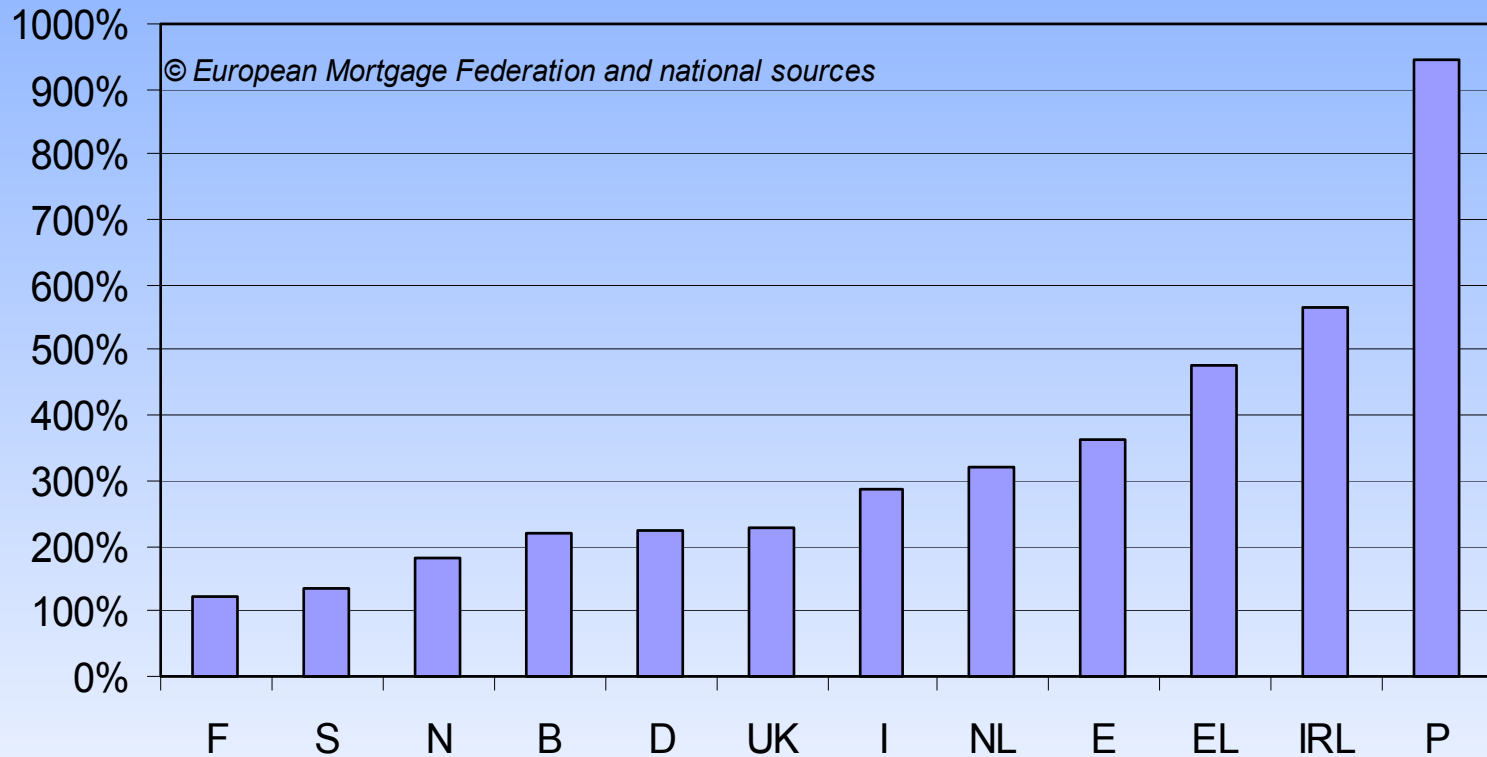
# Size of residential mortgage markets in the economy in 2001

(Volume outstanding as a % of GDP)



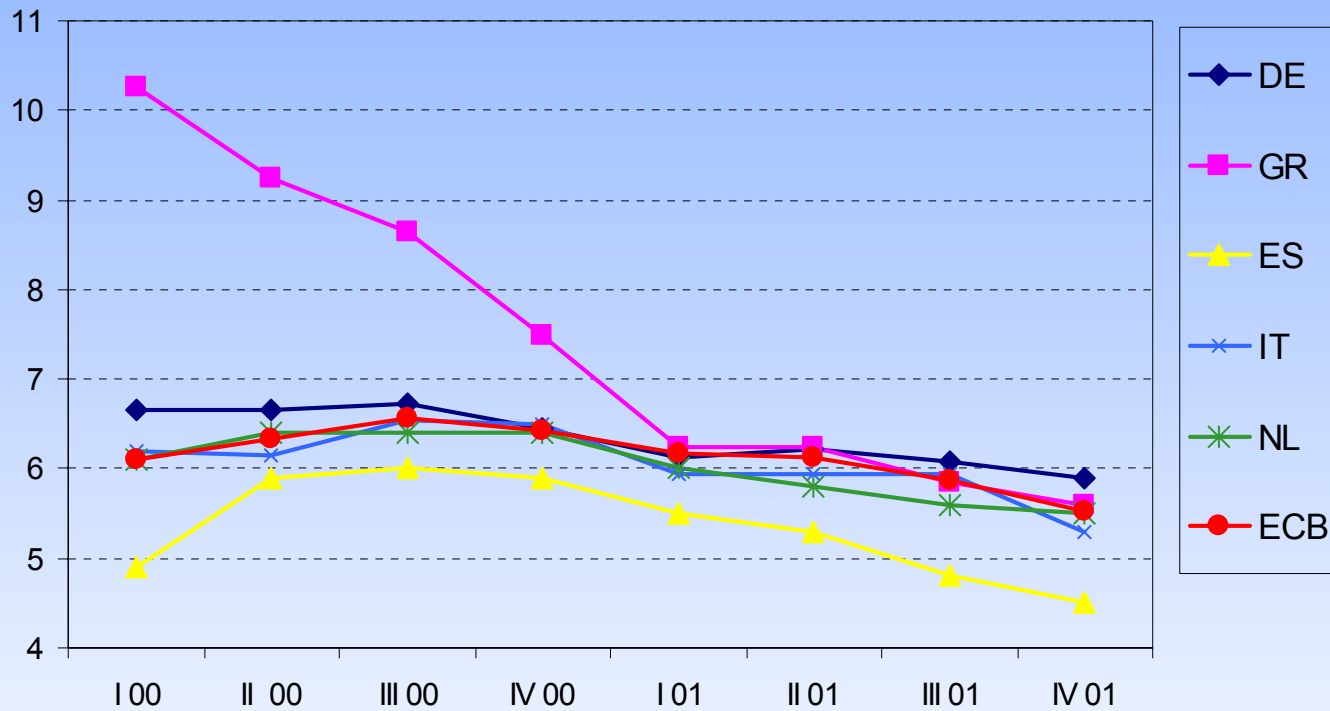
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# Fastest growing markets (1990 - 2001)



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# Mortgage interest rates in selected euro-zone countries



Source: European Mortgage Federation and national sources, ECB Monthly Bulletin



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# Market deregulation and consolidation

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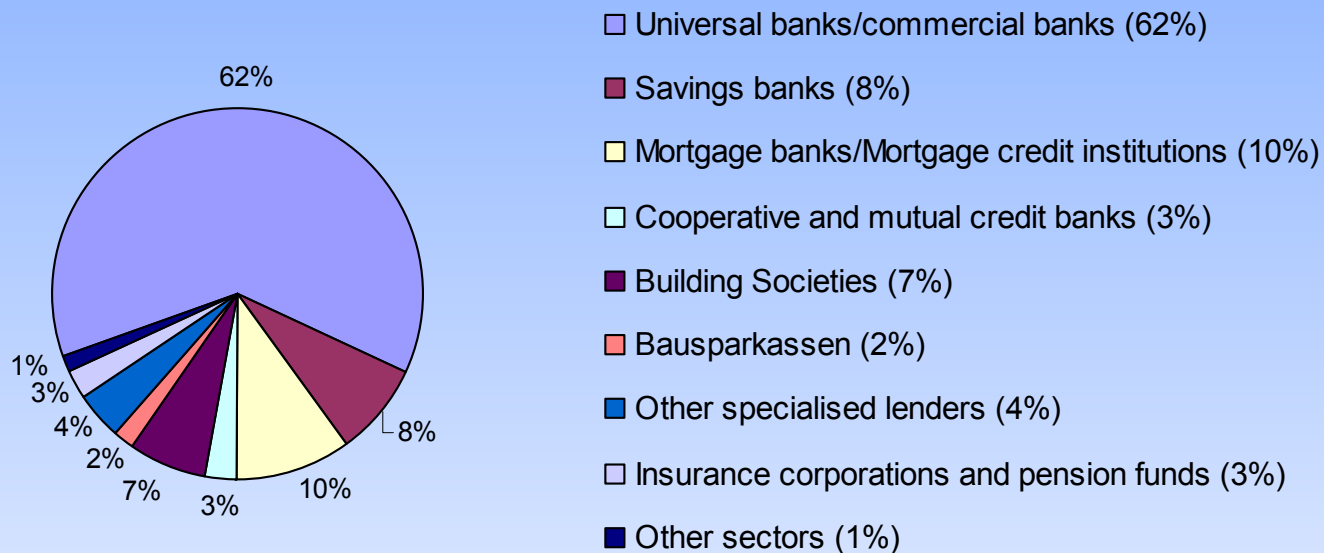
- Belgium, France, Netherlands and UK = most deregulated markets
- Mortgage bank countries cling to principle of specialisation
- Share of bank assets accounted for by the top 20 European banks had risen from 35% in 1997 to 41% in early 1999
- Consolidation and mergers to achieve economies of scale are only beginning



# Market shares by type of institution

(% based on volume outstanding, end-2001)

**In 2001, total outstanding volume exceeded EUR 3.9 trillions**



***Note:** The category "commercial banks" includes mortgage loans funded by the issuance of mortgage bonds that are granted by the largest "mixed" mortgage bank in Germany.*

*Source: European Mortgage Federation and national sources*



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# Internal Market, financial integration & consumer policy

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- 1992 internal market programme
- Liberalisation versus consumer protection? The concept of minimum and maximum harmonisation
- The role of national governments
- EU Commission is keen to accelerate the integration of financial markets
- Big players versus small players?



# Legal framework for mortgage loans

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- Mortgage credit is regulated at national level
- There is no European legislation but a European Code of Conduct
- Consumer regulations become increasingly important
- Common supervisory rules govern EU banks
- Capital adequacy rules will change the way mortgage lenders do business



# The new Basel capital requirements

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- **2002** - Quantitative impact study
- **2003** - Publication of the new Basel Accord
- **2004** - Adoption of Commission proposal
- **2005** - Adoption of Capital Adequacy Directive
- **2006** - Parallel running of Basel 2 with 1988 Accord
- **2006** - Deadline for full application of Basel 2





# Residential mortgage lending

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## Revised standardised

- Currently 50% weighting of residential loans
- Proposed 40% weighting

## Internal rating

- Results of QIS may mean less favourable treatment of residential loans than previously
- Nevertheless, potential to reduce capital requirements



# Weighting of funding instruments

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## Revised standardised

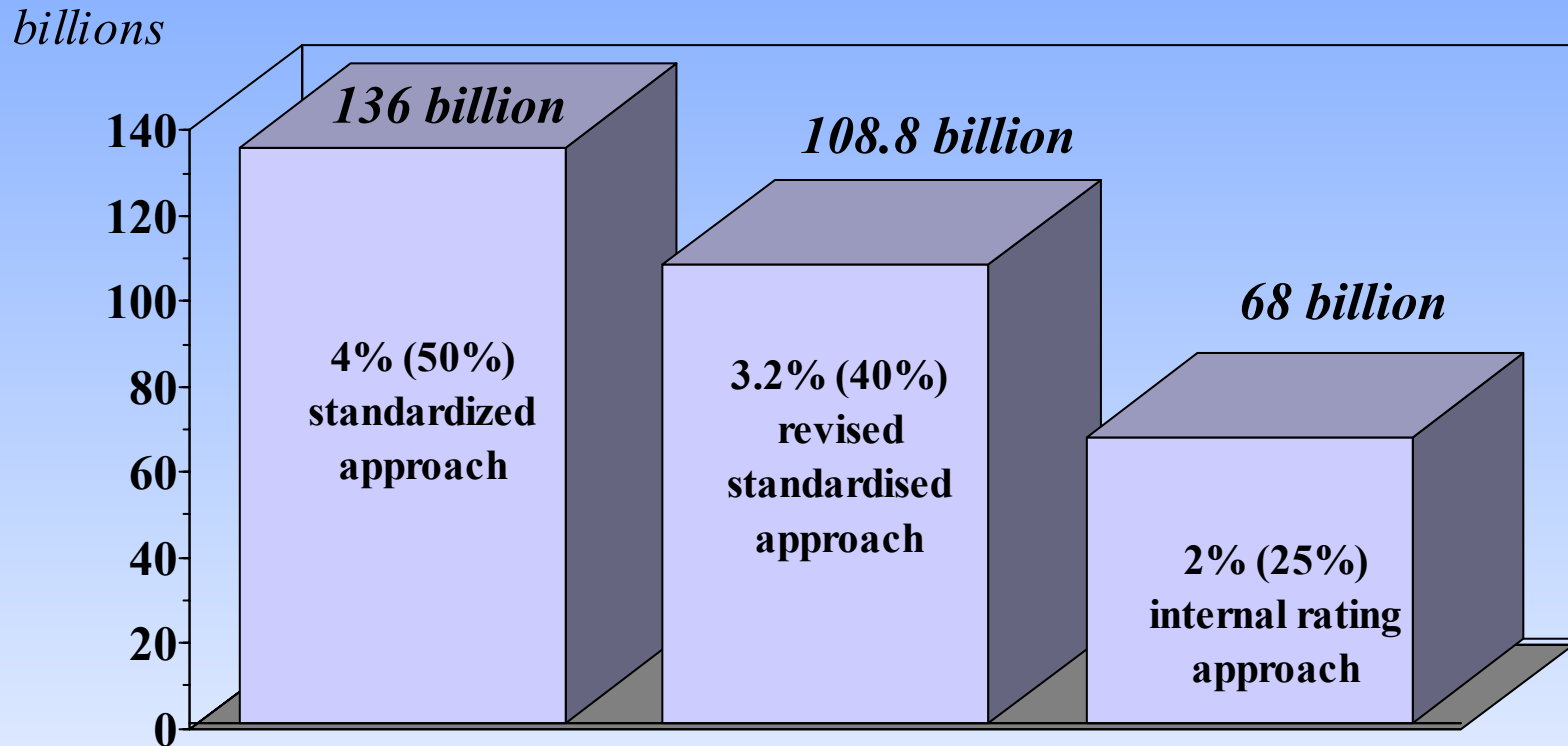
- Commission supports 10% weighting of mortgage bonds
- Increasing economic importance of mortgage bonds for European mortgage lenders

## Internal rating

- Commission to decide on internal rating of mortgage bonds and to examine risk profiles of different funding instruments
- Securitisation: lower capital requirements but more supervision



# Potential savings from Internal Rating



**Note: Outstanding Mortgage Loans in Europe = 3.4 trillion (end 2001)**

*All figures in Euros*



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# Winners and losers...

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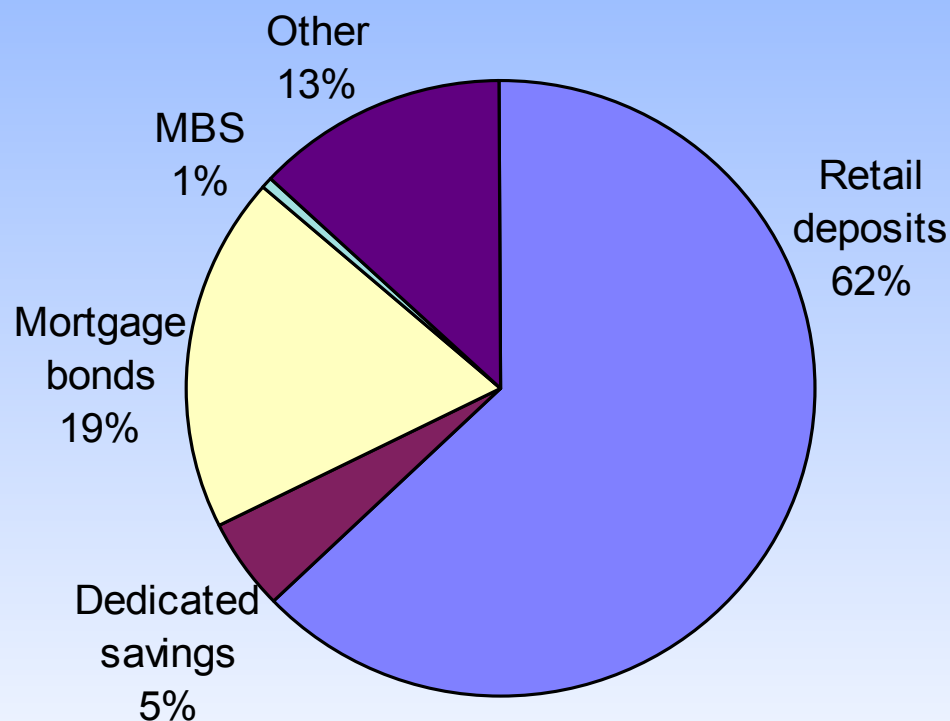
- Basel & mortgage loans: treatment of maturity, mortgages considered more risky than other types of lending, no future margin income to offset against future losses...
- Will Europe be disadvantaged compared to the US?
- Will the directive be adopted on time?



# Funding Europe's mortgage loans

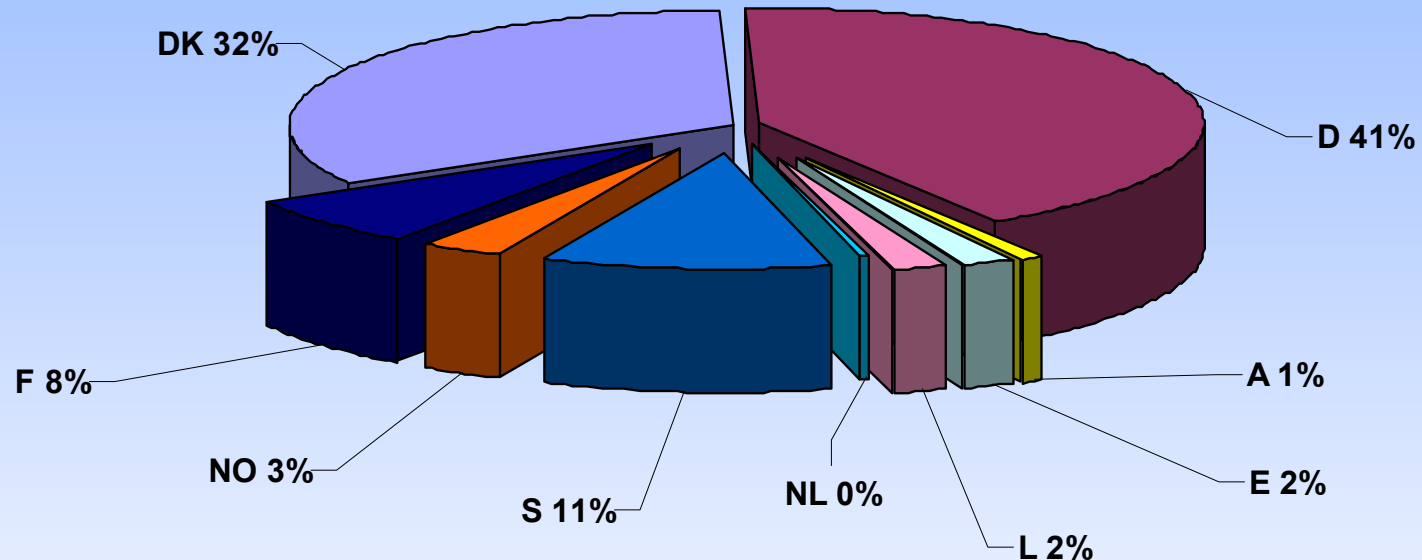
*(% based on volumes outstanding, end-1998)*

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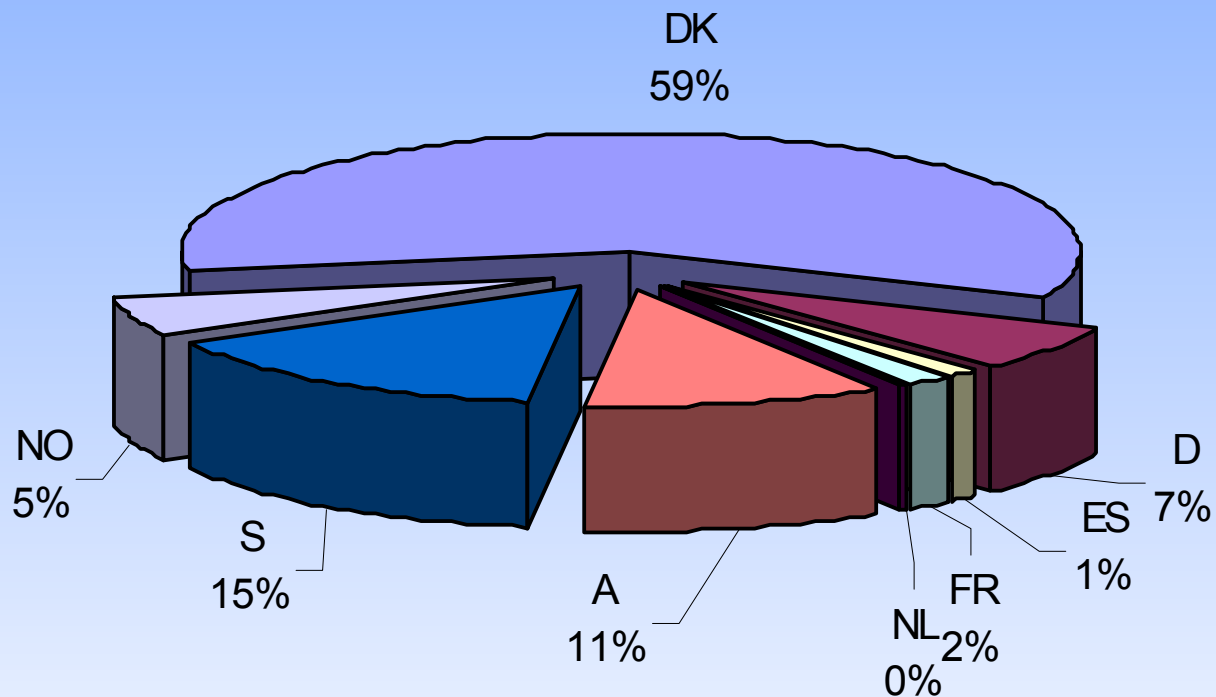
# Outstanding volume of mortgage bonds (year 2001)



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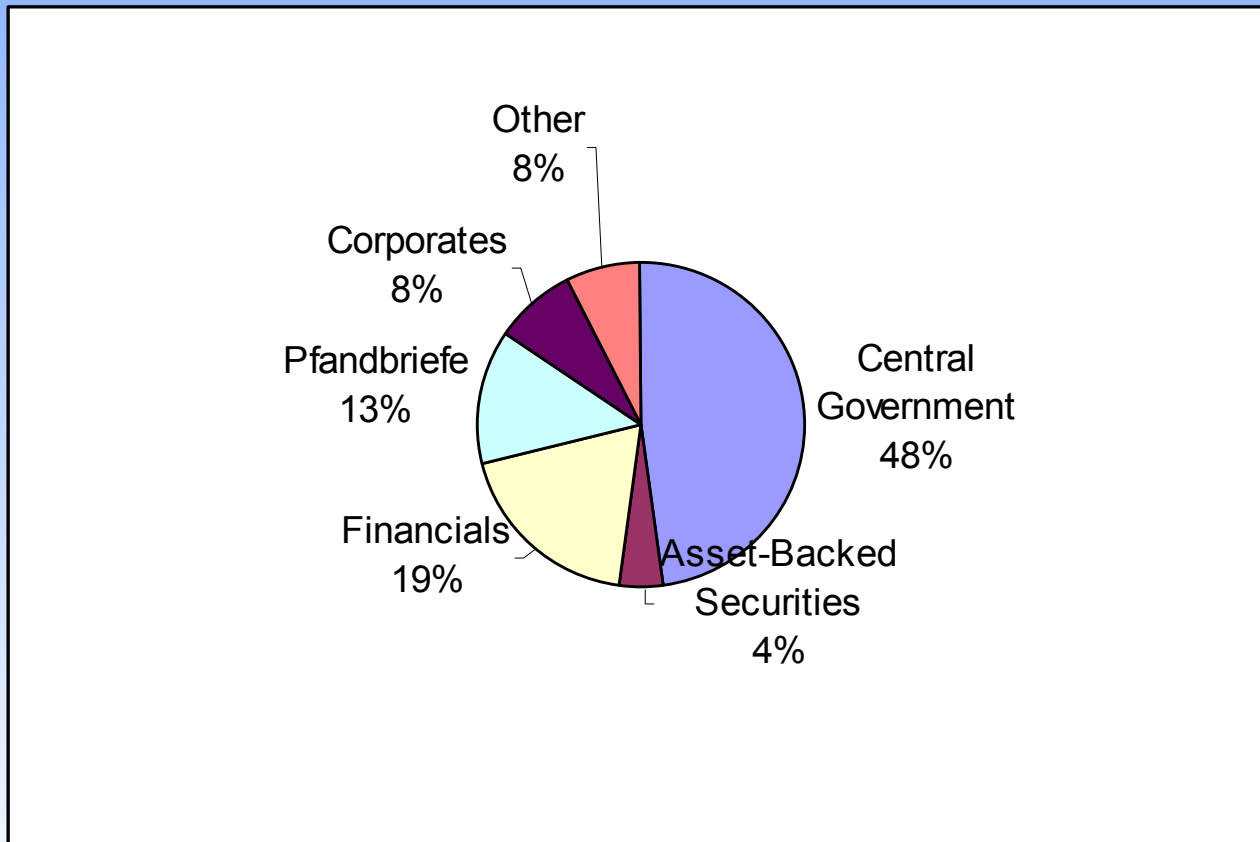
# MB outstanding as a % of national GDP (end 2000)

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# Mortgage bonds' share on EU's capital market (2002)



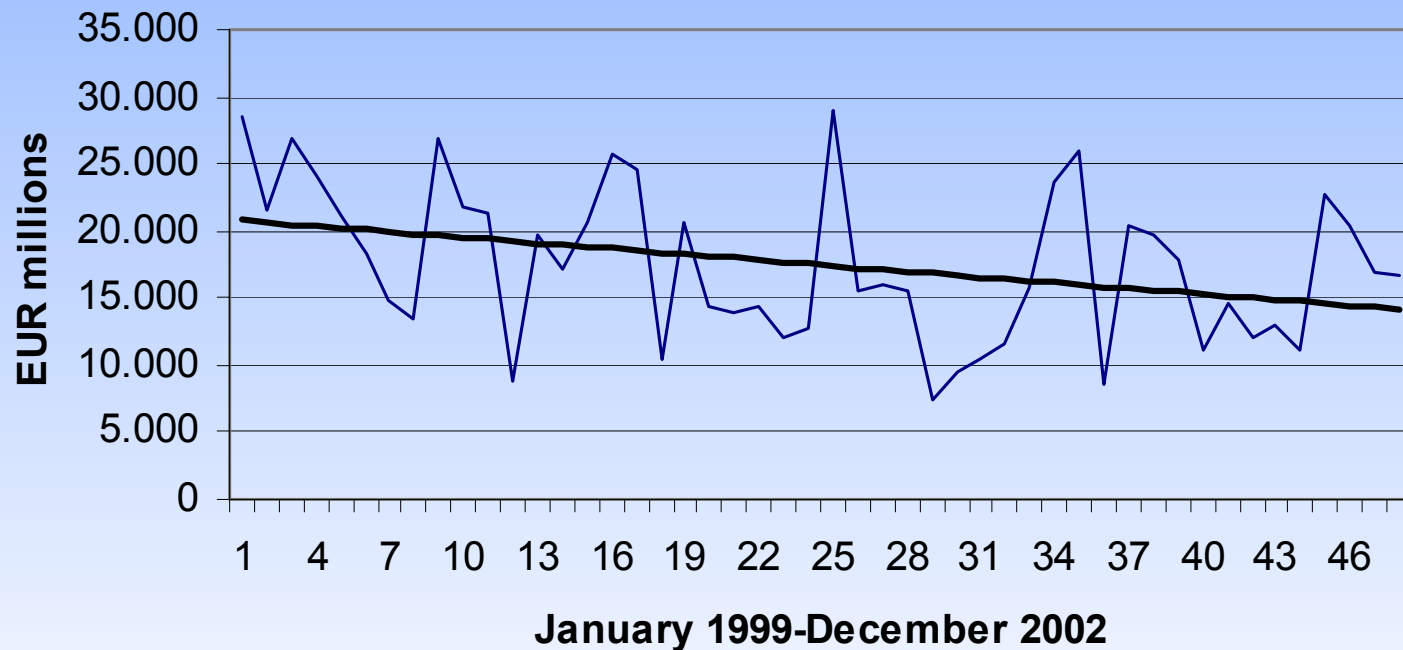
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# Pfandbriefe 1999-2002

(volume issued in EUR Million)

**Pfandbriefe (EUR millions)**

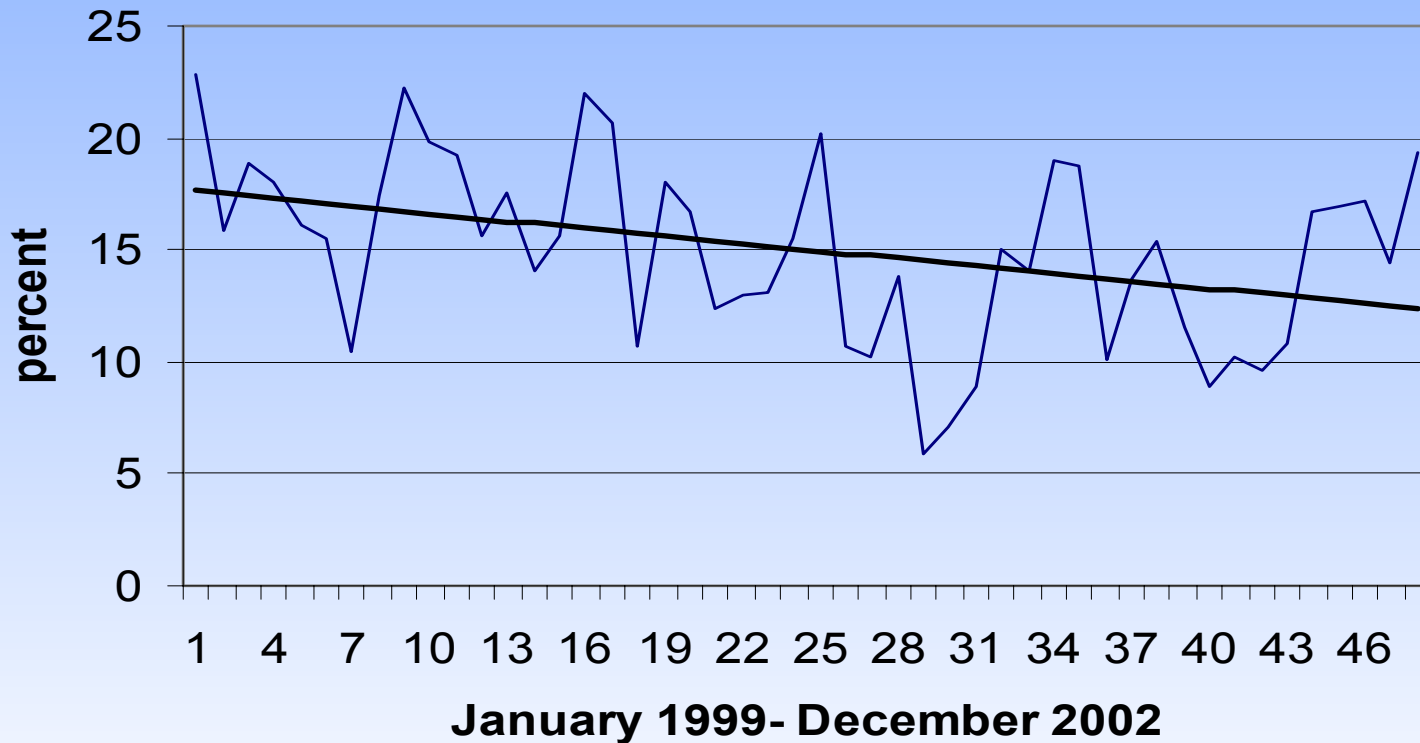


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# Pfandbriefe 1999-2002

(percent of gross issuance in euro denominated bonds)

## Pfandbriefe (as % of total bonds)



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# Competition and other worries...

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- No common asset class. Competition amongst issuers and regulation – good and bad?
- Competition from sovereign issuers and increasingly government sponsored enterprises such as US GSEs
- The role of the Rating Agencies - should they rate the issuers or should they rate the pool?
- Different countries have opted for different models. Is specialisation necessary or is over-collateralisation sufficient?
- How will new capital adequacy rules affect the covered bond market?



# Comparison of Mortgage Bonds and Mortgage-Backed Securities

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Mortgage loan production: bundled vs. unbundled process

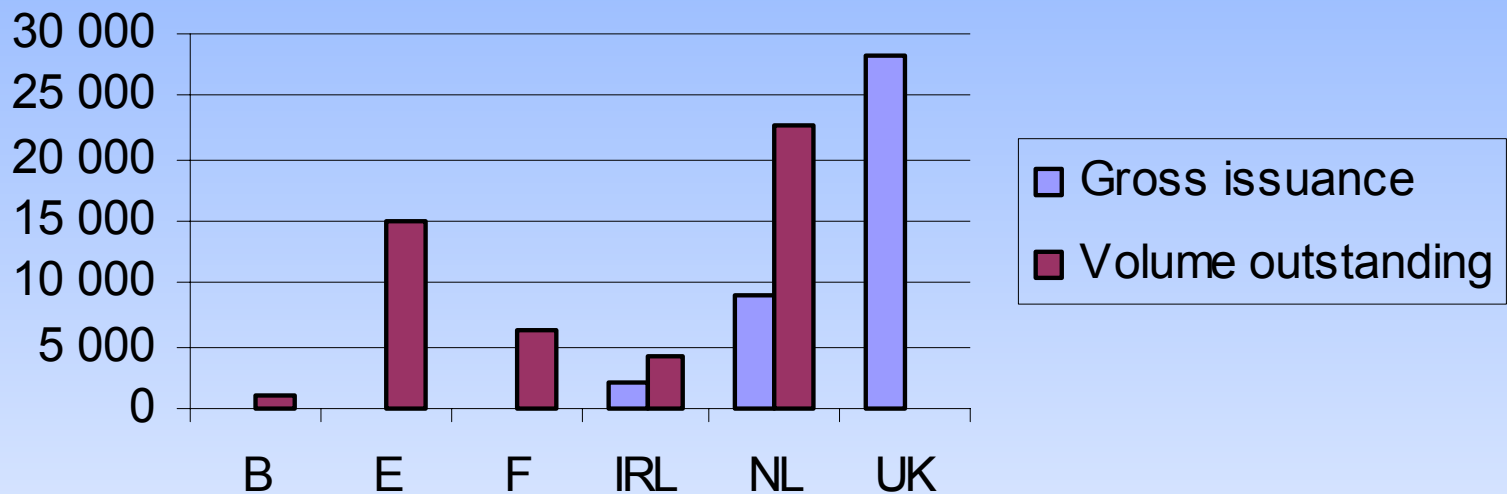
Type of securitisation: assets remain on the balance sheet of the originating institution (« On-balance sheet securitisation ») vs. assets are removed from the balance sheet of the originating institution (« Off-balance sheet securitisation »)

Source of principal and interest payments: Issuer cash flow vs. Collateral cash flow

Risk exposure- 1) *credit risk*: Issuer vs. Investor- 2) *prepayment risk*: Issuer vs. Investor - 3) *market risk*: Investor vs. Investor



# Mortgage Backed Securities in Europe



EUR Million, 2001



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# Why securitisation remains difficult

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- Securitisation has not emerged as a substantial funding instrument in Europe
- Securitisation remains difficult and costly because of differing contractual arrangements across Europe, lack of liquidity, small size of national market, lack of data, pricing of mortgage loans
- Competition from mortgage bonds which enjoy regulatory advantages over securitisation
- No common approach towards valuation & no common rules on loan-to-value ratios
- No collective European MBS market but merely a collection of MBS deals that sell well but trade infrequently



# Challenges & Opportunities

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- How profitable are mortgage loans?
- Building a European platform: common interests vs. national interests?
- Will integration of markets finally start?
- Is standardisation good for the industry? Is the US a model for Europe?
- Will specialised lenders survive or should they team up with larger players?
- Will banks restructure their balance sheet and will securitisation finally play a role?

