

Preface

The long-lasting financial crisis at the end of the past decade—a period of severe market distress—has revealed that events that had been classified as rather improbable some years earlier can actually occur. Even German covered bonds (Pfandbriefe), which used to be considered as nearly risk-free and which had not incurred a single default in more than 200 years, were in some cases close to cover pool separation from the issuing bank, sometimes only avoided through bailouts of the corresponding issuers. Starting from there, we got interested in building a mathematical valuation model to assess the actual likelihood and severity of such events.

When starting our research we realized that there were almost no (academic) publications on this asset class: we could find very few detailed material on the Pfandbrief's cash flow mechanics, its risk profile or potential valuation methodologies. Furthermore, the majority of available information either came from lobbying and interest groups like vdp or ECBC, from rating agencies or from research departments of large investment banks, and was (assumably, at least to a certain degree) biased. This is when we decided that, before coming up with a proper mathematical valuation model, we have to lay the grounds for an in-depth understanding of the Pfandbrief mechanics.

Shortly after we had started our investigations into the Pfandbrief we were, by sheer coincidence, approached by a large insurance company, which was also looking for a detailed risk analysis of covered bonds. The risk managers there seemed to observe the same difficulties as we did in finding appropriate independent sources of information. Therefore, we suggested to provide a detailed introduction to Pfandbriefe, with a special emphasis on the legal framework together with a neutral risk analysis from the perspective of an investor.

While keeping our work up-to-date over the last three years, we have additionally collected a large amount of material covering different aspects of the Pfandbrief. This monograph now provides an extensive list of more than 200 references dealing with Pfandbriefe or covered bonds in general, which is why it is, to our opinion, an ideal starting point for further studies. Although focused on German legislation it can also provide valuable insights when dealing with other

legal or contractual frameworks. We believe that—especially in the light of the growing number of countries with covered bond legislations and discussions about SME-backed covered bond issues in Europe—it might provide additional benefits to some readers.

When writing this monograph, we had in mind the following target audience: risk managers at large financial institutions with significant investments in German Pfandbriefe (like insurance companies, pension funds and asset management companies), rating agencies and regulators. Although not in the main focus, it might be equally valuable for employees in the banking industry who are concerned with Pfandbrief-related duties such as issuance, pricing, reporting and risk management. We hope that the monograph will also be welcomed by students in banking and finance looking for concise and complete information on the German Pfandbrief, and that it might act as a starting point for fellow research colleagues in new pricing models for Pfandbriefe.

As we plan to continue our research in Pfandbriefe, we welcome any constructive feedback on this monograph, e.g. additional content to be included in a potential further edition, different opinions on some subjects or errors which need to be corrected.

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German Covered Bonds

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