AMIC Covered Bond Investor Council

Statement regarding the ongoing usage of 'shadow / IOI' books

The Covered Bond Investor Council (CBIC) was established in March 2009 to represent the needs of investors in the covered bond market. The CBIC is an investor driven organisation, independent of both issuers and the market, for which the International Capital Market Association (ICMA) provides secretariat and administrative support services. ICMA is one of the few trade associations with a European focus having both buy-side and sell-side representation.

Covered bonds remain an important part of the financing of the mortgage and public sector in European markets and are an asset class with a significant public policy role. The covered bond market is also a significant source of bank financing beyond the current government guarantees and as such is part of any future solution to the current crisis.

The financial crisis and the high degree of uncertainty in the capital markets justified closer direct communication between issuers and investors. Investors fully understood their responsibility to support the Jumbo Covered Bond Market and gave very detailed guidance for successful deals in addition to the book-building process. A well-functioning primary market is in the interest of all market participants.

Various regulatory and market measures helped reduce gradually the high degree of uncertainty in the covered bond primary market. In the view of the CBIC, the primary market in Jumbo Covered Bonds is today in a much better shape than it has been in the last 2 years and has positively stabilised. Although liquidity in the secondary market can still be further improved, a clearer picture of a fair pricing level can now be drawn. Therefore, we question the advantages of the continued use of shadow books and 'price whispers'.

Better communication with investors is recognised as a key element to strengthen the covered bond market and establish its future and will be encouraged. The traditional official opening of a primary book and pricing the following day is not in fact different from the currently used shadow book building with screen announcements, official opening and pricing the subsequent day. However the use of the shadow book building process means that the opening of the book is limited to a few hours compared to a whole day in the traditional book building process. This restricted opening time limits the scope of investors to evaluate the information provided on new issues. This is also damaging in the case of smaller investors who may not be pre-sounded.

CBIC also want to draw attention to the increased risk of regulatory "inside information" concerns that arise from the current use of shadow book building.

The CBIC understands that issuers and their lead banks are concerned about the successful distribution of new issues, and the possible consequences of perceived failures on their overall reputation in the market. However investors believe that there is scope in the market for new issues to be distributed successfully via a conventional book building process, without the need for a 'price whisper' stage, provided that investment banks and issuers assess correctly the requirements of the market on the basis of sound preparatory work and reference to the improving secondary market.

In light of our observations, the CBIC urges issuers and their lead managers to return to using the traditional book-building process rather than the shadow book building process. The CBIC recommends the adoption of a longer fixed timeframe during which books would be open rather than the over hasty closing of books.

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