Learn with ETMarkets: How are covered bonds different from other bonds?

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At a time when more than $10 trillion worth of bonds are yielding less than zero meaning that you lose some of your capital if you hold on to maturity, investors globally seek safety of capital.

Covered bonds are one such category where people gain in terms of security as they are bonds backed by assets, cash flows from mortgages or public sector loans.

1. What are covered bonds?
Covered bonds, a hybrid between asset-backed se curitiesmortgage backed securities. These are treated as normal secured corporate bonds.

Mortgage lenders issue such bonds as an instrument of refinancing.

Covered bonds do not transfer prepayment risk to investors. It repays cash to investors on pre-fixed dates, not entirely dependent on the cash-flow structure of the collateral pool.

2. What is so special about it?
Unlike secured corporate bonds which provide recourse against the issuer, covered bonds give a dual recourse. First, recourse against the issuer, and bankruptcy protected recourse against the assets of the issuer (Cover Pool) too.

Covered bonds are expected to provide a rating uplift, over and above the normal rating of the issuer.

3. What are these called globally?
Covered bonds have existed in Europe for over 200 years, ac cording to a report by Moody's.They are essentially a continental European instrument, known by variety of names such as pfandbriefe, a mostly triple-A rated German bank debenture, in Germany; realkreditobligationer in Denmark, obligations fonciers in France, pantbrev in Spain.

4. Are they becoming popular now?
The sub-prime crisis and the as sociated aversion for mortgage backed securities gave a new wave of popularity to covered bonds, spreading it to many new destinations such as USA, Australia, New Zealand, Canada, Korea, Malaysia, etc., Moody's said in a report.

Asian markets seem to be looking up with Singapore banks taking covered bonds.

5. Are there new innovations in the structure of securities?
The basic structure of covered bonds evolved over time in two variants: legislative covered bonds, and structured covered bonds.

Legislative covered bonds are those that are backed by a specific legislation that provides bankruptcy protection. This includes ones from continental European countries mostly.

The other form is structured covered bonds that use the features of common law to provide bankruptcy protection. UK has had several transactions using the structured covered bonds route.