

Berlin, 11 July 2005

hyp-No 5

**VDH Pfandbrief Committee advocates an increase of Jumbo Pfandbriefe issued prior to 1 March 2001**

In order to fend off tax induced distortions in the Jumbo Pfandbrief market, the Pfandbrief Committee of the Association of German Pfandbrief Banks e.V (VDH) issued the following statement:

"The Pfandbrief committee of the Association of German Mortgage Banks (VDH) supports tapping of Jumbo-Pfandbriefe issued before March 1, 2001, in order to ensure the liquidity of these issues.

In recent days, some Jumbo Pfandbrief issues have risen significantly. This was in the context of tax-driven considerations, as Jumbo Pfandbriefe issued before March 1, 2001 that have not been tapped after February 28, 2002 do not fall under the EU directive on taxation of savings income which entered into force July 1, 2005. It was stated that this caused liquidity in these issues to dry up.

A unique feature of the Jumbo Pfandbrief market is its outstanding liquidity. In order to ensure this liquidity, the Minimum Standards for Jumbo Pfandbrief issuance demand a minimum volume of € 1 billion and market making provided by at least 3 Market Makers.

For the Mortgage Banks aligned to the Association of German Mortgage Banks, liquidity and a functioning market maker system are of crucial importance. This is why the Pfandbrief committee of the Association supports the tapping of a Jumbo Pfandbrief issue when liquidity becomes endangered because of the aforementioned tax considerations, even if the Jumbo Pfandbrief in question was issued before March 1, 2001 and would thus become "infected" (ie, fall under the EU directive).

Tapping such Jumbo Pfandbrief issues is in accordance with the EU directive. In 2002, the Association of German Mortgage banks commissioned a legal advice of a renowned law firm which affirms this view. German Mortgage Banks and other German Pfandbrief issuers have already tapped Jumbo Pfandbriefe issues in the past."

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## Clarifications

With this statement, the Pfandbrief Committee of the Association of German Mortgage Banks responded to distortions in the Jumbo Pfandbrief market which have materialized over the past few of days and which are directly related to the coming into force of the EU Directive on taxation of interest income on 1 July this year.

As of 1 July, interest income earned by natural persons who are EU residents in another EU Member State other than their home Member State shall be automatically disclosed to the financial authorities of the investor's home Member State. EU Member States Belgium, Luxembourg and Austria, however, decided to opt for a different approach instead introducing a tax levied at source. This move was accompanied by the simultaneous introduction of withholding tax also in Switzerland, Andorra, Liechtenstein, Monaco and San Marino. The initial rate for withholding tax will be 15 %, followed by 20 % as of the 1 July 2008 and 35% from 1 July 2011 onward.

Yet, the adoption of the EU Directive on taxation of interest rate income also came with a grandfathering clause: Bonds issued prior to 1 March 2001 which had not seen an increase after 28 February 2002, shall not fall under the scope of the EU Directive on taxation of interest income, i.e. interest income from such bonds shall not be subject to the home Member State disclosure obligation nor shall such income be eligible for withholding tax. Yet, if and when such bonds are increased at a later point in time, then this shall lead to an 'infection' of the entire bond, i.e. such bonds will no longer fall under the provisions of the grandfathering clause. When, on 17 June this year, the German administration announced the increase of all German Treasury Bonds issued prior to 1 March 2001, i.e. "infection" of said bonds, Jumbo Pfandbriefe issued prior to 1 March 2001 which had not seen any increase after 28 February 2002 underwent a sharp price rise. Obviously, investors driven by tax motivations sold the 'infected' German Treasury Bonds and bought 'non-infected' Jumbo Pfandbriefe. Subsequently, the 'non-infected' Jumbo Pfandbriefe were quoted at clearly higher prices than Jumbo Pfandbriefe covered by the scope of the EU Directive on taxation of interest income.

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