

Thomas Jordan: Funding mortgages – securitisation and pfandbriefe in the light of the financial crisis

Summary of a speech by Mr Thomas Jordan, Member of the Governing Board of the Swiss National Bank, at the annual general meeting of the Pfandbriefbank Schweizerischer Hypothekarinstitute, Zofingen, 15 May 2008.

The complete speech can be found in German on the Swiss National Bank's website (www.snb.ch).

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The funding of mortgages is the focal point in discussions on the causes of the international financial crisis. The massive credit expansion in the US, particularly in the area of sub-prime mortgages, reinforced and prolonged the US real estate bubble. From mid-2007, the value of financial products backed by sub-prime mortgages declined substantially, leading to heavy losses on the part of banks and investors. The problems encountered with these financial products gave rise to discussions on the future of mortgage funding. The danger of such discussions is that the problems inherent in different instruments could be confused and their economic benefits overlooked.

Three different refinancing instruments can be differentiated: pfandbriefe, mortgage-backed securities (MBS) and structured securitized products. Common to all three is that they make it possible to refinance mortgages, and ease the process. However, they differ with respect to risk transfer. While the credit risk remains with the bank when refinancing via pfandbriefe, it is passed on to the investor in the case of MBSs and structured securitized products.

In mid-2007, serious problems with structured products backed by sub-prime mortgages put an abrupt stop to the boom in securitisation. False incentives, inadequate control mechanisms, shortcomings in the rating system and insufficient personal responsibility on the part of investors were the main criticisms aimed at securitisation practices. What is important now, is to correct these deficiencies, so that the trust of market participants in these products can be restored. It would be wrong to ban the securitisation of mortgages, since these refinancing instruments generate substantial economic benefit and are an indispensable part of our modern financial system.

The mortgage securitisation weaknesses revealed in the financial market crisis do not apply in the case of the Swiss mortgage bond. Consequently, it should definitely have the potential to play an even greater role in maturity-matched refinancing of mortgages in Switzerland in the future. In addition, banks can improve their liquidity by holding portfolios of Swiss mortgage bonds themselves. Mortgage bonds could be converted into liquidity quickly and simply, as required, by means of repo transactions – either in the Swiss franc interbank market or at the SNB.