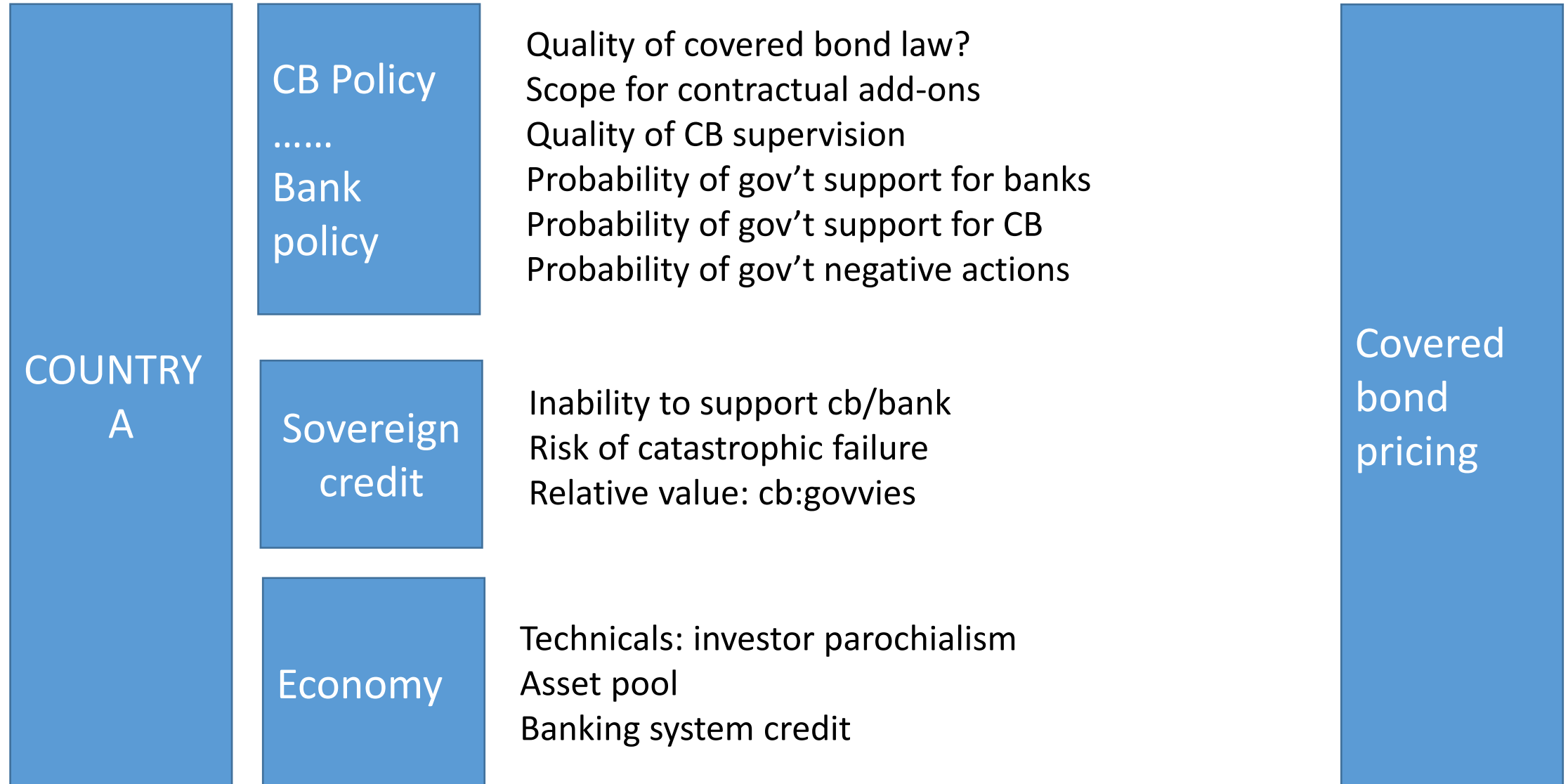


# Market fragmentation: evidence and reasons

“Covered bond....pricing should normally be driven by....

- (i) the credit quality of the cover assets;
- (ii) the repayment capacity of the issuer; and
- (iii) relevant country factors..
  - ..relative strength of the sovereign
  - ..robustness of the underpinning legal and supervisory framework”

# Welcome to country A. Where do the covered bonds price?



# Problems!

## **Beta pricing**

- Covered bonds pricing on a good-bad continuum
- What changed was the price of risk, not the relative price of different covered bonds
- Investors assume credit variables are more correlated than they are

## **Changing perceptions**

- EG, investors used to say: UK is periphery / covered bonds price over govies / asset pools reflect state of housing market
- Most of these happened DURING the crisis, not before or since

## **Evolution of market**

- EBA - convergence of supervisory practices
- BRRD – convergence of support probability?
- ECBC – convergence of transparency

## **Investors want to price risk**

- But they must do so rationally
- The risks must be legitimate (different commercial models) not due to fragmentation

**Which pricing differences are legitimate? / Which are evidence of market failure?**