

The ICMA Covered Bond Investor Council & The Covered Bond Report present:

## **The Covered Bond Investor Conference 2013**

Steigenberger Frankfurter Hof, Frankfurt, Thursday, 16 May 2013



# **The Covered Bond Report**

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## **The Covered Bond Report**

# Welcome remarks

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- **Martin Scheck**

Chief Executive, International Capital Market Association (ICMA)

The ICMA Covered Bond Investor Council & The Covered Bond Report present:

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# **The Covered Bond Report**

## **Keynote address**

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- **Ulrich Bindseil**

Director General, Market Operations, European Central Bank



EUROPEAN CENTRAL BANK

EUROSYSTEM

# Current covered bond issues from the ECB's perspective

ICMA Covered Bond Investor Conference

Frankfurt, 16 May 2013

Ulrich Bindseil

ECB

*The views expressed here may not reflect  
the views of the ECB or of the Eurosystem*

# Overview

**1** Relevance of covered bonds for ECB and Eurosystem

**2** State of the financial markets and euro area integration

**3** Covered bonds as a funding tool for SME loans?

**4** Information disclosure and asset encumbrance

**5** Current key topics

## Relevance of covered bonds for Eurosystem (I)

- Eurosystem balance sheet has currently a length of EUR 2.6 trillion. This includes **exposure to covered bonds of three kinds**:
  - Investment portfolios. Total euro securities investments of Eurosystem central banks are EUR 345 billion. A non-negligible part of this is invested in covered bonds. The Eurosystem is therefore amongst the large covered bond investors
  - Policy portfolios: in view of the importance of the banking system for monetary policy transmission in the euro area, and the importance of covered bonds as funding instrument, the Eurosystem undertook two CBPPs. Total purchases EUR 76 billion, current holdings around EUR 62 billion
  - Collateral in Eurosystem credit operation of currently EUR 850 billion (peak in 2012: 1282 billion; total eligible collateral: 14 trillion, of which CB: 1.7 trillion; total use: EUR 2.5 trillion; of which EUR 0.5 trillion covered bonds).

## Relevance of covered bonds for Eurosystem (II)

- Functioning capital markets, including covered bond markets are in any case a key interest of central banks (even without direct exposure) because of:
  - Efficiency of funding of the financial system, which is a precondition for realising the growth potential of the economy;
  - Predictability of transmission mechanism (absence of quantity constraints);
  - Avoiding that the central bank has to intermediate the financial system (money market impairment and capital market impairment have the same effects from the perspective of the central bank with this regard)

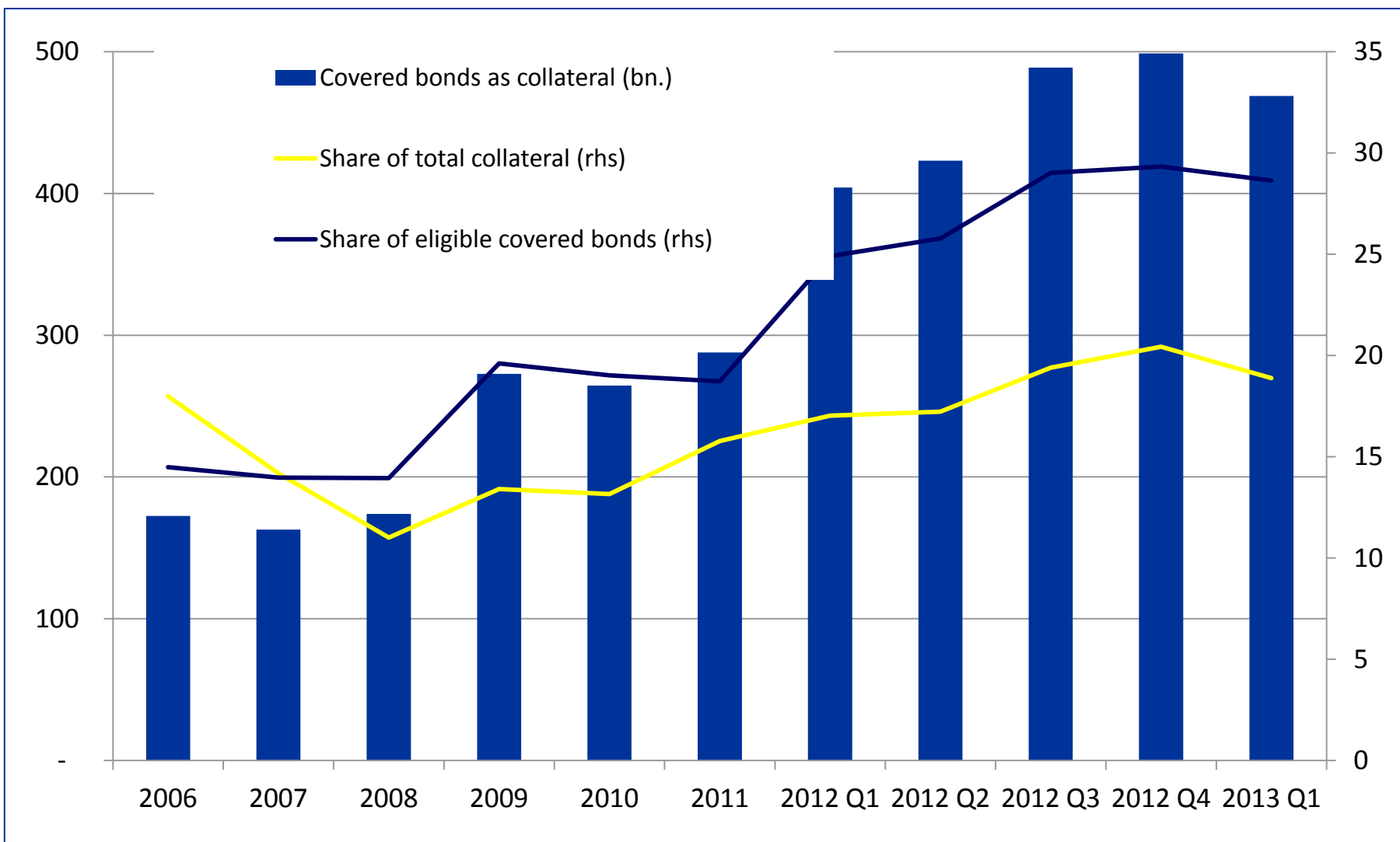
# Eurosystem collateral framework

- Article 18.1 of the Statute requires all credit operations carried out by the Eurosystem to be “**based on adequate collateral**”
- The concept of adequacy has **two notions**:
  - Collateral must be able to **protect** the Eurosystem from incurring losses in its credit operations;
  - There must be sufficient collateral potentially available to **ensure** that the Eurosystem can carry out its tasks.
- Central banks may also apply a “market neutrality” principle to avoid unintended “distortions” in the market (but two philosophies on what this means in practice!).
- The collateral framework of the Eurosystem responds to market developments, financial innovation and counterparties’ behaviour – nothing is static

# Eurosystem collateral framework: recent changes on covered bonds

- Communicated in November 2012 and that came into force on 3 January 2013:
- Introduction of a restriction on the inclusion of ABS in the cover pool of covered bonds. Covered bonds that do not fulfil the conditions are not eligible as of 31 March 2013, with a grandfathering period until 28 November 2014 for non-compliant covered bonds that were on the list of eligible assets on 28 November 2012. Aligns framework to CRD requirements and would also avoid possible arbitrage between ABS and covered bonds.
- Only CRD-compliant covered bonds should be eligible **for own-use**, or covered bonds with specific legal safeguards comparable to CRD compliant frameworks. Changes the reference from UCITS compliant to CRD compliant covered bonds.

# Covered bonds as Eurosystem collateral

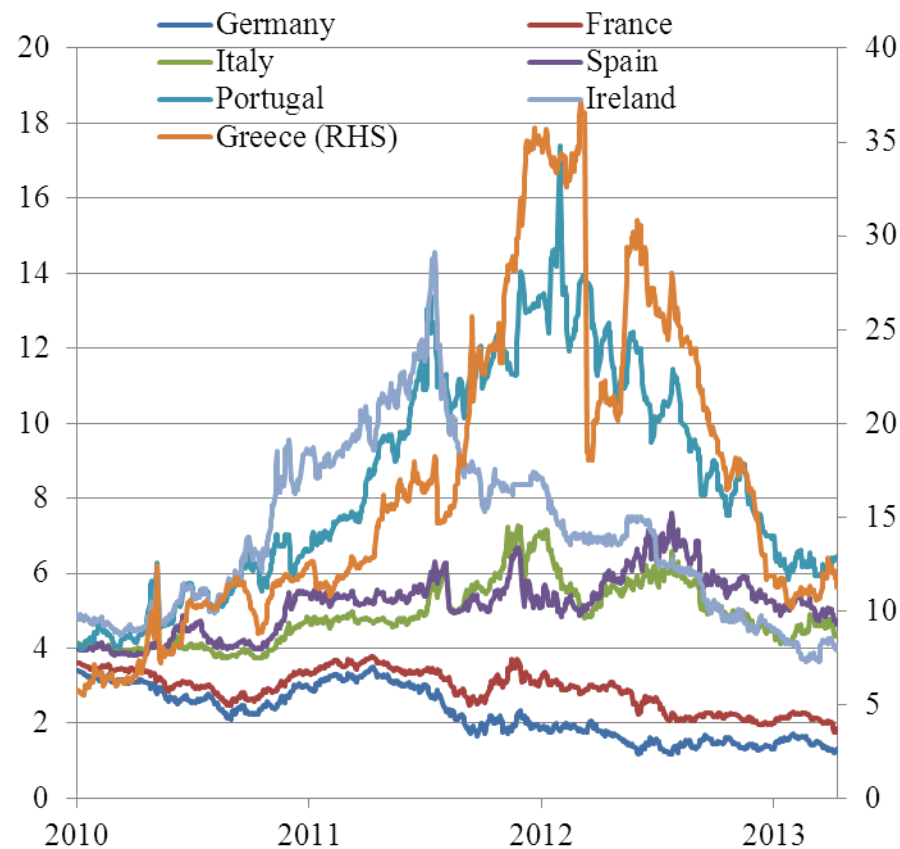
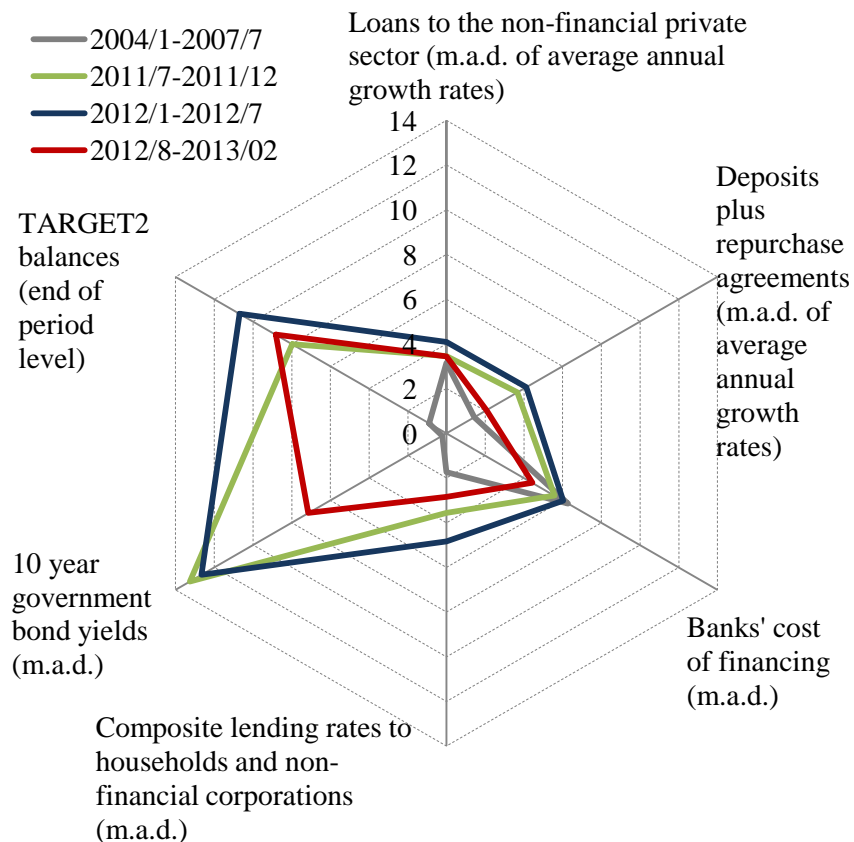


# Fragmentation receding (but still high)

## Policy measures benefited sovereign funding costs

**Financial indicators in the euro area** (Median absolute deviations (m.a.d.\*); end of period €100 bn for TARGET2 balances)

**Government bond yields in selected euro area countries**  
(Jan. 2010 – Apr. 2013, percentage, ten-year maturity)



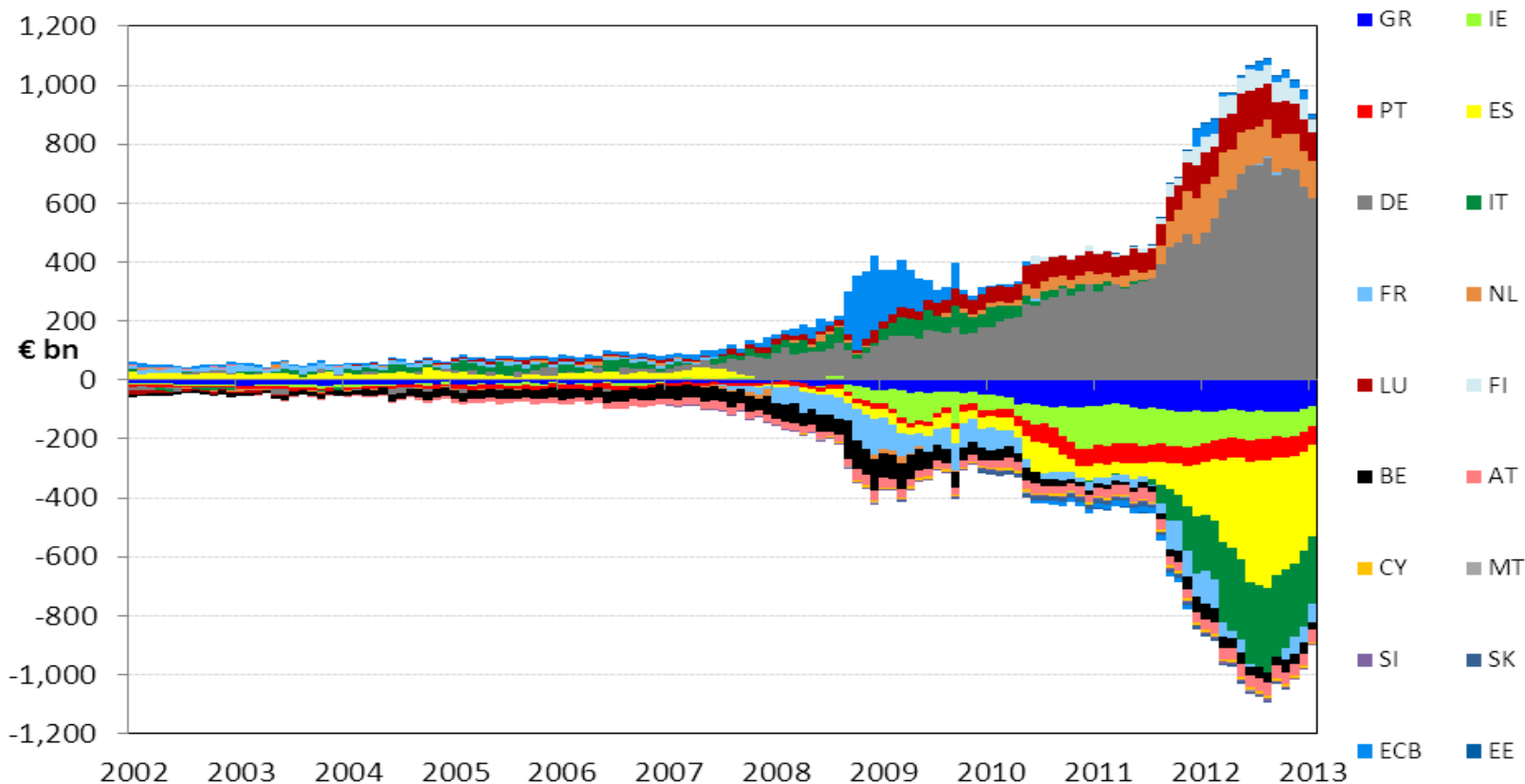
Sources: ECB, ECB calculations.

Notes: \*) m.a.d. = Median absolute deviation across selected euro area countries for which historical data are available. The 'm.a.d.' is computed as the cross-country dispersion of the time-averages for each of the four periods. The dispersion measure for 3-year government bond yields has been scaled by 10 for better visualisation.

Source: Bloomberg.

# Target balances indicate market revival

TARGET balances  
(EUR billion)



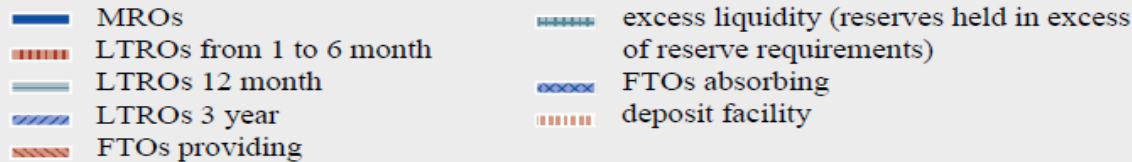
Sources: ECB, NCB and IMF data and author's calculations (P. Cour-Thimann, Target balances and the crisis in the euro area, mimeo).

Notes: Last observation is end-January 2013.

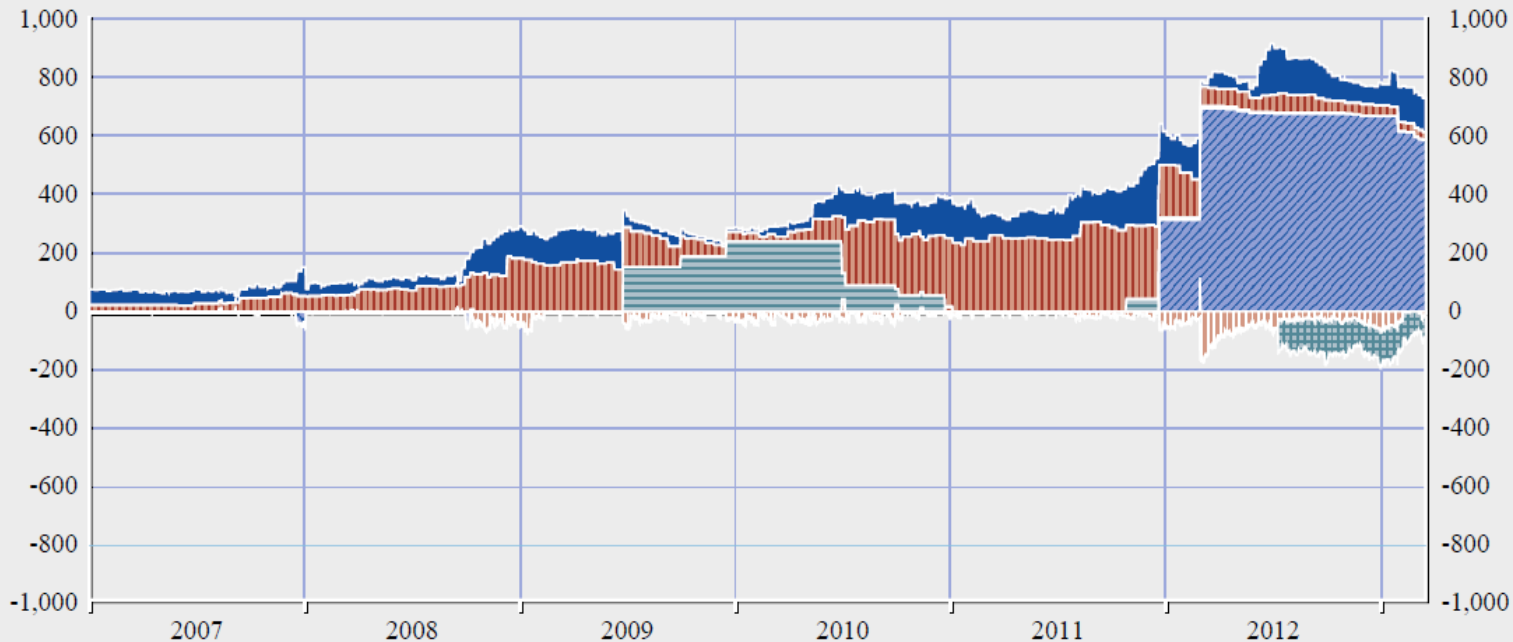
A positive (negative) sign reflects a net claim (liability) of the national central bank vis-à-vis the ECB in the TARGET2 payment system. Claims and liabilities (including that of the ECB) add up to zero.

# Remaining fragmentation as seen in Eurosystem operations

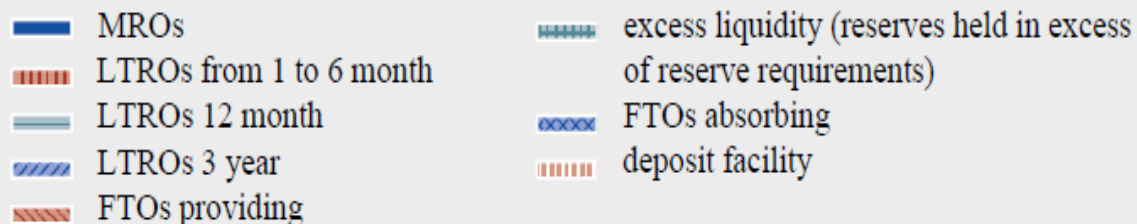
Recourse to the ECB's market operations and standing facilities  
(EUR billion)



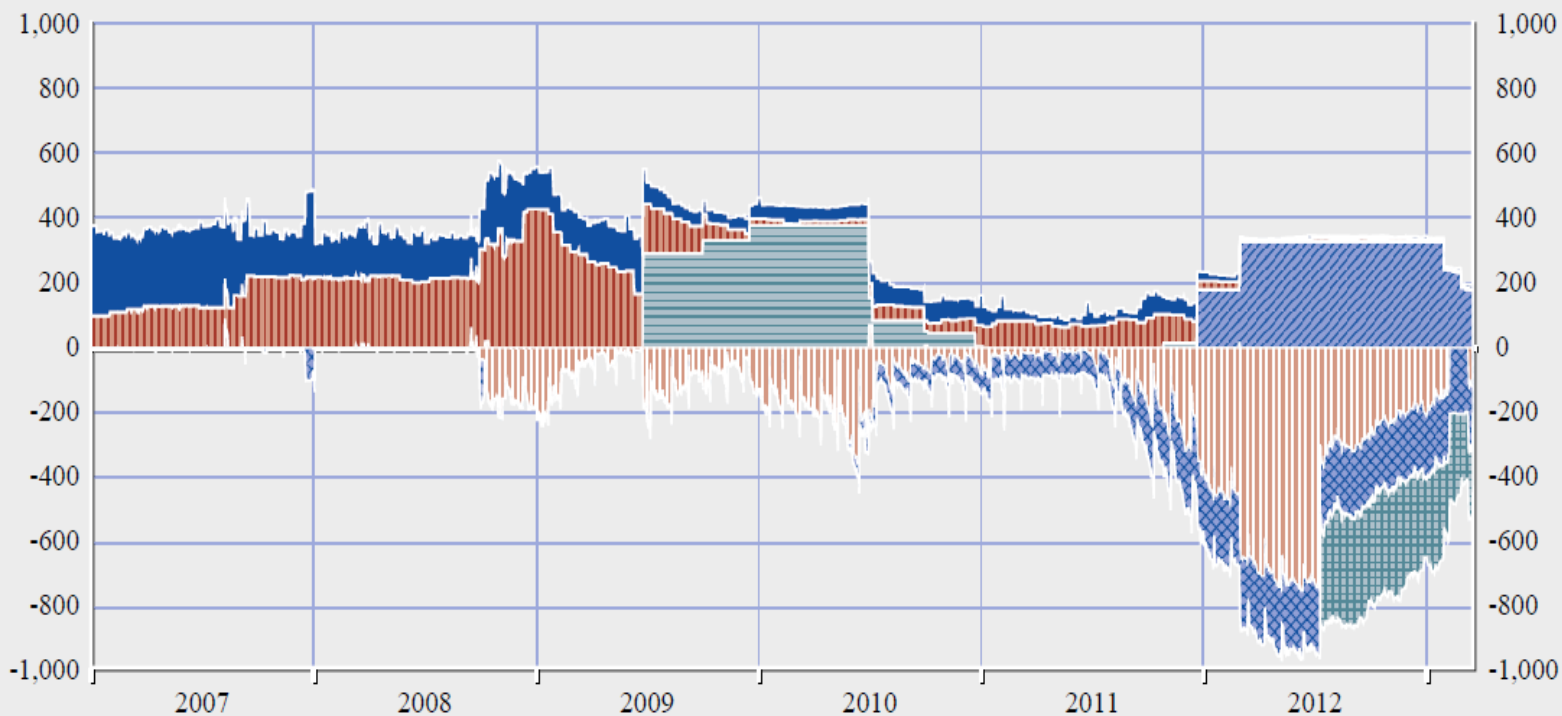
a) distressed countries



# Remaining fragmentation as seen in Eurosystem operations



b) non-distressed countries



## Recent decisions by ECB

- Financial markets have improved considerably, but are far from normalised
- Heterogeneous funding conditions across jurisdictions and instruments
- SME lending + real economy weak; price pressure over the medium term receding
- Weak growth presumably also a lagged result of state of financial system (if monetary policy is effective with lag of 1 or 2 years, financial conditions in general should be as well)
- **ECB's Governing Council decided on 2 May 2013 to:**
  - Lower the interest rate on the ECB's main refinancing operations by 25 basis points, to 0.50%.
  - Extend the ECB's fixed rate-full allotment policy for all refinancing operations for as long as necessary, and at least until July of next year.

Moreover, ECB decided to start consultations with other European institutions on strengthening efforts to promote the revival of the **market for asset-backed securities** that are collateralised by loans to non-financial corporations.

# SME loans in “covered bonds” or ABS?

## Some considerations:

### “Structured” covered bonds

- Currently covered bonds cheaper for issuers than ABS
- “Structured” covered bond as non-standard asset class - financial innovation
- Outside common covered bond legislation
- No tranching – one type of investors
- On-balance (no capital relief)
- Traditionally lower level of transparency
- Increase asset encumbrance
- Better regulatory and central bank haircut treatment

### ABS CLO

- Currently more expensive than SME CB, and almost no investors;
- Tranching – several types of investors
- Uses the versatility feature of ABS
- Capital relief
- High transparency requirements
- Established technique for SME loans
- Mitigate asset encumbrance
- Harsh regulatory treatment for regulated investors
- Central bank haircut 16%

## Ongoing Covered bond topics for study

- **Further improving disclosure** on covered bonds. Less information asymmetry means more efficiency and less uncertainty; Disclosure drives market discipline and competition, by enabling a more informed appraisal of prices and risks of a given asset.
- In respect of covered bonds, **asset encumbrance** per institution most likely lower compared to pre-crisis times. But in view of general trend to collateralized transactions, encumbrance also becomes more relevant for covered bonds
- The role of **banking union, the new resolution regime, and regulation in general**
- **None of them has been overlooked in today's agenda**



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**Thank you for your attention.**

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## **The Covered Bond Report**

# **ICMA CBIC transparency standards presentation**

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- **Andreas Denger**

Senior Portfolio Manager and Covered Bond Analyst, MEAG MUNICH ERGO  
Asset Management GmbH



ICMA

International  
Capital  
Market  
Association

# Covered Bond Investor Council (CBIC)

Covered Bond Transparency – it's better but still not good enough!

**Andreas Denger**, Senior Portfolio Manager, Covered Bond Analyst at MEAG (Munich) – Vice Chairman of the ICMA Covered Bond Investor Council (CBIC)

Frankfurt, May 2013

## Review of last year's presentation about CB Transparency standards

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- We showed that higher transparency was urgently needed, as the Covered Bond market has become more and more complex and diverse.
- We defined “Building Blocks” for a Covered Bond analysis to highlight where the CBIC transparency initiative kicks in.
  - Macro factors, Issuer, Cover Pool, Legal/Structural framework, RV
- We introduced the “7 C-List” for transparency data (key requirements), so investors can identify possible risks in cover pools and the remaining balance sheet of the issuer and can invest according to their respective risk profiles.
- We reported the latest amendments to the CBIC Transparency template and invited national associations to use it as a framework when creating their own national transparency template for Covered Bonds.

To obtain the updated template and/or get more information, please send your request to [cbic@icmagroup.org](mailto:cbic@icmagroup.org)

Or click on the following webpage: <http://www.icmagroup.org/About-ICMA/icma-councils-and-committees/Covered-Bond-Investor-Council-CBIC-/>

## This year's agenda

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### **Covered Bond Investor Council (CBIC)**

Covered Bond Transparency – It's better but still not good enough!

- Short review of last year's presentation
- Some thoughts about common comments people make when they talk about transparency for Covered Bonds.
- The Covered Bond Label – A good start but still a long way to go!
- The Covered Bond Label – Much more than just hope for better regulatory treatment!
- Some topics on the CBIC agenda
- Q&A

## Loan by loan data for covered bonds

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- Especially investors with a structured finance background still demand loan by loan data for Covered Bonds.
  - Main reasons: Lack of trust regarding aggregated issuer data
- ➔ The target should be to further enhance the quality and transparency of the aggregated, reported issuer data!
  - Examples: Describe how data is aggregated, eliminate blanks in data that often lead to wrong results, double-check if aggregated data is correct and easily understandable – or else give explanations.
  - The Covered Bond Label doesn't yet provide the quality to take all discussions regarding loan by loan data away from the table!
  - However, most investors who are asking for loan by loan data are only covering a very small part of the Covered Bond market.
    - Hardly any Investor has the capacity to even analyse half of the Covered Bond market on a regularly basis using loan by loan data.

## Covered Bond data needs to be more comparable

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- Ongoing harmonisation among the various national templates.
- Define a deadline when the reported data should be made available.
  - Reported data should be as up-to-date as possible.
- Create history of reported data (e.g. always end of quarter).
- Offer direct link to data, ideally downloadable to Excel.
- Reported data should be in the same order as in the national template.
  - Additional data should be reported at the end of the report and not somewhere in between.
- Use of “Key concepts explanations” as in the CBIC templates for calculations and certain reported data.

## LTVs and other figures are misleading for investors

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- Start / continue educating investors instead of not reporting important data only because it might be too hard to be properly understood!
  - Educating investors about the differences in LTV calculations and other reported / requested figures is a better solution than just saying that investors are not able to correctly understand them.
- Investors have to be able to understand the differences rather than not get the data to properly analyse the Covered Bonds.
- Making the differences transparent can attract new investors and increase confidence for existing investors.
  - Use the explanations as a further marketing tool!

## The CB Label – Good start but still a long way to go!

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- After not even six months since the official start of the Covered Bond Label, the first resumé is clearly positive.
  - Good acceptance among issuers even though some countries could do better!
- The control mechanisms for the Label are functioning!
  - Issuers who are not fulfilling the data requests are asked to make the respective changes, or else the Label is temporarily withdrawn
- However the current status should only be seen as a first step in a series of many more.
  - Increase amount and quality of requested/reported data for most national templates.
  - Harmonisation among the various national templates.

## The CB Label – Much more than just hope for better regulatory treatment !

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- The Covered Bond Label is also a tool to ringfence “old style / traditional” Covered Bonds from new types / other types of bonds which are also named Covered Bond but have, for example, “new” assets as collateral.
  - If there won't be any negative effects for European Covered Bonds (on regulatory treatment), it could be useful to make the Label achievable for “old style / traditional Covered Bonds” from all countries.
- The Covered Bond Label can provide investors with an easy accessible set of data to properly analyse Covered Bonds.
- Sell side analysts can use the reported data to provide better analyses and comparisons to investors.
- Issuers can use this as an additional marketing tool to attract new investors and increase confidence for existing investors.
- Investors can make sure that they buy what they really want to buy.

## Some topics on the CBIC's agenda

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- Do we need harmonised definitions / calculations for Covered Bond data? (LTV, Overcollateralization, NPLs,...)
- Asset encumbrance – What about possible negative effects for Covered Bonds (Rating, Collateral in an insolvency scenario,...)
- Covered Bond look-alikes!
- Effects of increased use of alternative / new repayment schemes (pass-through, very long soft bullets,...)
- Covered Bonds in a bail-in scenario (voluntary OC, dual recourse,..)
- Financial transaction tax
- Future developments regarding the Covered Bond Label

## AMIC future priorities - work programme

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- » Alternative Investment Fund Managers Directive (AIFMD)
- » **Asset Encumbrance & Bank financing**
- » Banking (Basel III and CRD IV)
- » Corporate Governance
- » Credit Rating Agency Regulation (CRAs)
- » Derivatives Central Clearing (EMIR)
- » Disintermediation by institutional investors
- » **Evolution of Insurance Regulation (Solvency II)**
- » Exchange Traded Funds
- » **Financial Transaction Tax**
- » **Long-term investments**
- » **ICMA Private Wealth Management Charter of Quality**
- » Institutions for Occupational Retirement Provision Directive (IORPD)
- » Investor Compensation Scheme Directive (ICSD)
- » Market Abuse Directive
- » MiFID (Market Structured, Investor Protection, 3rd Countries)
- » Packaged Retail Investment Products (PRIIPS)
- » Regular roundtable events (from September, 2013)
- » Remuneration (CRD IV, AIFMD, UCITS V)
- » Secondary Market Liquidity
- » Semi-annual conferences (April & November)
- » **“Shadow Banking”**
- » Short Selling Regulation
- » UCITS Review V & VI

# Q&A

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# **The Covered Bond Report**

# **Panel: Covered bonds in a world of macroprudential regulation and bank resolution schemes**

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Moderator: Neil Day, Managing Editor, The Covered Bond Report

Panellist: Georg Grodzki, Head of Pan-European Credit Research, Legal and General

Panellist: Christian Moor, Policy Advisor, Securitisation & Covered Bonds,  
European Banking Authority

Panellist: Claus Tofte Nielsen, Head of Position Management,  
Norges Bank Investment Management

Panellist: Mónica Trastoy, Senior Credit Analyst covering European Financials,  
Santander Asset Management Madrid

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## **The Covered Bond Report**

# **Panel: Primary and Secondary Markets: Where are the Landmines?**

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Moderator: Jozef Prokes, Vice President, Blackrock

Panellist: Gabriele Frediani, Head of Markets, MTS - EuroMTS

Panellist: Derry Hubbard, Head of FIG Syndicate, BNP Paribas

Panellist: Richard Kemmish, Head Covered Bond Origination, Credit Suisse

Panellist: Thorsten Jegodtka, Institutional Portfolio Management, Union Investment

Panellist: Matej Chytil, Trader, Credit Agricole

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# **The Covered Bond Report**

## **Panel: Ratings, Rules and Regulation**

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Moderator: John Serocold, Senior Director, Market Practice and Regulatory Policy, ICMA

Panellist: Florian Eichert, Credit Research - Senior Covered Bond Analyst, Credit Agricole

Panellist: Morten Bækmand, Head of Investor Relations, Nykredit

Panellist: Martin Rast, Vice President Structured Finance Group, Moody's

Panellist: Jens Tolckmitt, Executive Director of the Association of German Pfandbrief Banks

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# **The Covered Bond Report**

## **Panel: Evolving covered bond structures**

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Moderator: Ralf Burmeister, Senior Portfolio Manager, Deutsche Asset & Wealth Management

Panellist: Andreas Denger, Senior Portfolio Manager and Covered Bond Analyst,  
MEAG MUNICH ERGO Asset Management GmbH

Panellist: Helene Heberlein, Managing Director, Fitch Ratings

Panellist: Jan King, Senior Covered Bond Analyst, Royal Bank of Scotland

Panellist: Rainer Mastenbroek, Head of Covered Bond Funding, Commerzbank

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# **The Covered Bond Report**

## **Panel: Covering the Globe**

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Moderator: Tim Skeet, Member of the ICMA Board

Panellist: Luca Bertalot, Deputy Secretary General, European Mortgage Federation and Head of the European Covered Bond Council

Panellist: Karlo Fuchs, Senior Director Covered Bonds and Structured Finance, Standard and Poors

Panellist: Olivier Hassler, Housing Finance Adviser

Panellist: Lofti Sekkat, Chief Executive Officer, Crédit Immobilier et Hôtelier



# Covered Bond Investors Conference

*ICMA / The Covered Bond Report*

*May 16, 2013 Frankfurt*

## **COVERED BONDS in EMERGING MARKETS: DEVELOPMENTS & CHALLENGES**

Olivier Hassler

ohhfinance@gmail.com

# The number of emerging, or emerged, economies with a CB system is large and expanding

- **Countries with specific laws, or structured CB regulations/ guidelines by the banking regulators** (non-exhaustive list):
  - Europe: Baltic states, Bulgaria, Czech Rep., Hungary, Poland, Romania, Russia, Slovakia, Slovenia, Ukraine
  - LAC:
    - Chile, the pioneer : CBs developed in the 19 th century, a decisive support to the development of housing finance. The decline of the historic letter of credit model (86% market share in 1995, 11% in 2010) led to the creation of pool-based CBs in 2012
    - Colombia, Costa Rica, Panama, Paraguay
    - Recently: Uruguay (2009), Peru (2011)
  - Asia: Azerbaijan, Korea, Mongolia, Turkey
- **New frameworks being developed:** Morocco, Brazil, India, Mexico

# **The map of active markets is however much smaller than the legal map**

- **In each region, the actual use of covered bonds is still very limited but in a handful of countries**
- **Successfully introducing CBs require critical conditions that are not specific to, but not easily met by, young markets:**
  1. **Conducive background**
  2. **Value added by CBs to the market**
  3. **Credibility of CBs resilience to issuers' stressed situations**

# 1) Conducive background

## ■ Macro-economic conditions

High inflation, actual or expected, kills long term finance

## ■ Markets infrastructure

- Reliable titling systems
- Efficient mortgage transfer mechanisms ( loan replacement may be cumbersome and costly, a problem often in federal states)
- Efficient foreclosure
- Real estate market information, price indexes, independent / supervised appraising industry
- If public sector CBs: fiscal soundness of local bodies
- An already developed bond market, incl. a significant yield curve

## ■ Primary market critical mass

## ■ Institutional investors' universe critical mass

- Size and type of pension systems (positive examples: Chile , Mexico, Morocco, Romania's 2010 reform)
- Cross border placement hardly a remedy for small systems, save in the case of a monetary union or intragroup CBs

## ■ No crowding out by government bonds

## 2) Adding value to the market

### ■ Issuers' needs

- Factors: high loans-to-deposits ratios, awareness of long term liquidity risk, fixed rate lending, issuer's size and standing (unlike securitization)
- The issuance of CBs must be allowed to institutions that need them

### ■ Investor's needs

- Long term liabilities to match
- Little direct lending, portfolio diversification

### ■ Clear benefit of CBs relatively to other capital market instruments Ex:

- Colombia: Current CBs framework = pass through structure, very close to well developed MBS
- Brazil: several mortgage funding instruments already available, CBs will have to offer more

### ■ Pricing issues

- Risk is not always well valued, especially in young markets with few lenders and few investors (e.g. small premiums for subordinated debt)
  - Investors may not be ready to pay for higher security
  - Distorted pricing mechanisms (e.g. predominant lenders with little profitability constraints)
- Regulation must help recognize the heightened security (adjustment of investment rules, repo-ability of CBs held by banks)

### 3) Credible resilience to stressed situations

#### ■ Legal provisions

- Exemption to bankruptcy laws / or , if structured CBs, unquestionable true sale structure and complementing regulation
- Legal validity of overcollateralization above legal minimum, including on-going basis increases
- No bail - in risk
- Legal possibility to borrow against the cover pools after insolvency

#### ■ Market environment

- Availability of portfolios / CBs buyers and alternative servicers
- Strong supervisory capacities of the essence given the dynamic nature of cover pools
- Credible sovereign support

# Conclusion

## A large potential, but

- **Need to understand well the instrument**

Awareness creation and knowledge transfer generally needed

- **Need to identify and assess constraints linked to size and maturity of the mortgage and bond markets**

- **Need to foster a development dynamic**

There are interactions, and a need of coordination, between

- the legal/regulatory provisions,
- Lending growth and lenders' soundness,
- and the development of investment capacities

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# **The Covered Bond Report**

## **Closing remarks**

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- **Neil Day**

Managing Editor, The Covered Bond Report