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ICMA

COVERED BOND INVESTOR COUNCIL

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ICMA Covered Bond Investor Council Supports the Inclusion of Covered Bonds in LCR Level 1

The ICMA Covered Bond Investor Council (CBIC) supports the inclusion of covered bonds as extremely high liquid assets under the Liquidity Coverage Ratio (LCR) within the new liquidity provisions for the European banking sector.

We would like to highlight 3 main points to support this position:

1) The covered bond market did function throughout the crisis and offered banks a useful and reliable funding tool even in extremely difficult market conditions back in 2008. The Scandinavian experience is very insightful in that respect. The study by Dick-Nielsen, Gyntelberg and Sangill (2012), as quoted in the EBA Discussion paper on 'defining liquid assets in the LCR under the draft CRR'[1] examined the secondary market liquidity of government and covered bonds in Denmark before, during and after the 2008 financial crisis. The study found that the liquidity of both government and covered bonds declined during the crisis period. Whilst government bonds outperformed covered bonds before the crisis, the liquidity of the two instruments was broadly similar during the crisis. Therefore the liquidity of covered bonds declined less than that of government bonds during the crisis, although overall liquidity conditions were similar across the two markets. This positive historical experience and real stress test results confirm the high liquidity status that should be assigned to covered bonds.

2) The empirical study undertaken by the European Banking Authority (EBA) itself which was presented at the EBA public hearing on Liquidity Reports, which took place in London on the 23rd of October 2013 highlighted that there was only a very small quantitative difference in terms of liquidity between government bonds and covered bonds while the other asset classes considered showed a significant difference in terms of liquidity. CBIC members believe the EBA technical conclusions to be coherent with the empirical studies and their experience of the covered bond market, before, during and after the crisis. On the basis of these official documents and academic studies the CBIC supports the inclusion of covered bonds in extremely high liquid assets under the LCRs.

3) Finally one of the recently announced aims of European leaders was 'to break the vicious circle between banks and sovereigns'[2] through the EU's rescue fund, the European Stability Mechanism (ESM). The aim is to reduce the interdependence of sovereign and bank creditworthiness and in doing so preventing the effect of weak banks on sovereigns - that are themselves trying to bail out failing banks . On the basis of the EBA's own technical findings, covered bonds would also help support this aim and diversify banks' LCRs.

We therefore believe that the recognition of covered bonds as extremely high liquid assets is fully justified in the context of technical findings and empirical evidence and in light of recent regulatory announcements.

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[1] Published on 21 February 2013

[2] Euro Area Summit Statement, published on 29 June 2012