International
Capital
Market
Association

COVERED BOND INVESTOR COUNCIL

To: Moody's Investors Service
One Canada Square
Canary Wharf
London
E14 5FA

21 October, 2013

Dear Sirs,

The International Capital Market Association (ICMA) represents participants of all types – issuers, institutional investors and intermediaries – in international fixed income bond markets. ICMA is one of the few European-focused trade associations having both buy-side and sell-side representation. The ICMA Asset Management and Investors Council ('AMIC' or 'the Council') was established in March 2008 to represent the buy-side members of the ICMA membership. AMIC is composed of a wide variety of investors and asset managers. The AMIC's composition embraces the diversification and the current dynamics of the industry – representing the full array of buy side interests both by type and geography. While ICMA's specific area of expertise on the sell-side is in the fixed income sector, the AMIC's focus is on a broader set of issues and sectors which are of concern to its membership, rather than having a specific product focus. AMIC's focus is on asset management in Europe, while recognising that asset management is a global business.

The Covered Bond Investor Council (CBIC) is a permanent working group of AMIC.

We welcome the latest step by Moody's to rethink the anchor point for covered bond ratings and would like to take the opportunity to briefly comment on the main aspects from investors' point of view.

- We welcome the idea of modifying the anchor point as a proxy for the probability of the issuer ceasing to make payments to the covered bondholders in the light of forthcoming regulation on bank resolution. As the TPI framework is not supposed to change, this step is appreciated, especially in keeping the comparability of ratings over time intact.

- We also welcome the temporary stop of covered bond downgrades until this modification is implemented, as already outlined in our letter to the rating agencies dated 7 August 2013.

- We acknowledge the difficulties in finding an appropriate and consistent approach to determine the anchor point. The approach outlined so far by either uplifting the adjusted Baseline Credit Assessment (BCA) or the senior unsecured rating (SUR) is based on quantitative factors, namely the amount of bail-in-able debt in proportion to the total liabilities. As support is already incorporated in the SUR, one might additionally think of some kind of minimum anchor points for highly relevant domestic covered bond issuers as there could be elements of support which are of more help in the covered bond market than in the senior unsecured market, for example market size in national mortgage market and / or index weights.

- As this new approach should become applicable throughout the EU and other countries closely following EU regulation, we nevertheless ask in advance for sufficient rating leeway / national discretion in terms of the final rating methodology to reflect possible differences in bank resolution regimes across various countries.

Looking at the three main questions being asked in the request for comment, the CBIC would like to reply as follows:

1. Are the proposed levels of bail-in-able debt appropriate to achieve 1-2 notches of uplift?

The proposed limits on bail-in-able debt are based on a universal bank business model. Hence, specialised lenders and / or covered bond subsidiaries might be unduly penalised by this methodology as there are covered bond issuers who have no deposits or senior unsecured debt to be bailed in on their balance sheets due to either domestic covered bond legislation or the management decisions of the issuer. So referring to the levels of bail-in-able debt to the whole banking group where appropriate instead of being focused strictly on the issuer of the covered bond itself may be preferable. Furthermore, the potential support may vary significantly where a covered bond issuer focuses exclusively on mortgage lending and refinances purely through covered bonds and equity. Such an issuer would also struggle to fit into the proposed framework while possibly benefitting from two support measures – support for the mortgage market as well as support for the covered bond product itself. Accordingly, the basis for uplifting the BCA as well as the SUR needs to be broadened in our view.

We have not performed a model calculation on the appropriateness of the 5% and 10% thresholds signalling the next step of uplifting. As absolute limits are always debatable per se, we nevertheless think that the ranges under discussion so far are meaningful. Furthermore, we note Moody’s statement that the results of their analysis will be refined over times so, from that perspective, we cannot come up with better threshold figures than those stated in the request for comment for the time being.

As a general remark, we would like to point out that, for measuring the amount of bail-in-able debt compared to total liabilities, the measurement is usually subject to accounting standards, e.g. accounting for derivatives. Therefore, the total liabilities may vary significantly after a change in accounting standards and in turn poses certain threats to the potential uplifting itself.

Secondly, this approach offers a certain weakness, as experience has shown that it is not purely the nature of the liability (deposit or bond) that is important but also the nature of the bondholder (retail vs. institutional). Admittedly, this experience dates back from the pre-bank resolution era, but it cannot be ruled out in the future that certain instruments will be spared from bail-in for political reasons. Therefore, a further specification of the term “senior unsecured” in the context of measuring bail-in-able debt seems appropriate. Within a future clarification of “senior unsecured debt”, the 5% and 10% threshold would have to be reconsidered as well in our view.

Thirdly, we would like to ask for a clarification of the term “total liabilities” as we believe it is used in the context of “sum of all outstanding liabilities”, but excluding equity. If this figure was to include equity, i.e. the size of the whole balance sheet, a capital increase would raise the probability of a covered bond downgrade. We assume also that Moody’s would accept lower boundaries than the 5% and 10% with regard to the levels of senior unsecured debt once the debt of an issuer has been bailed in.

Finally, the question arises whether the sum of all liabilities should include all maturities, namely also short term debt and money market transactions which would at least partly be inconsistent with current drafts of legislation on bank resolution.

2. **Should we consider uplift beyond +2 notches above the adjusted BCA and / or +1 notches above the SUR?**

   Yes, as we do not foresee a sufficient economic reasoning to ultimately limit the uplift at 2 notches for BCA or 1 notch for SUR. Within the upcoming bank resolution regime, it will also become possible to split up banks as well as bail-in. Accordingly, a rating agency would have to come up potentially with two adjusted BCA and SUR in cases where an entity is broken up into two. As in case of a good bank / bad bank split, the BCA would presumably be much higher for the good bank than for the previously troubled institution, so a higher anchor point ex ante beyond the +2 uplift is potentially justified to reflect this in the current methodology. It is obviously still up to the rating agency to make use of this leeway in accordance with its individual assessment.

3. **Should the number of notches for external support and loss absorbing capacity due to bail-in be strictly additive, or should we assume some tradeoff between the two: for example, limiting credit for bail-in-able debt when we have assumed a high degree of support in the SUR?**

   For the sake of reducing complexity, we would prefer that those two aspects should be additive. As the incorporation of support into ratings by definition involves a measure of discretion, introducing a tradeoff as suggested here would in our view not contribute to improved transparency.

To conclude; we would like to emphasise that we share Moody’s view that the proposals regarding bank resolution will be largely credit positive for covered bonds. Accordingly, we welcome the envisaged changes and are looking forward to further discussions regarding the clarifications suggested above.

Yours faithfully,

Annika Wahlberg

ICMA

Secretary, ICMA Asset Management and Investors Council

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MEAG

Acting Chair, Covered Bond Investor Council