Covered Bond Update
A mixed picture when looking at returns

iBoxx performance indices by covered bond country

Source: Commerzbank Research
However, spreads have performed quite solidly

iBoxx swapspreads by covered bond country

Source: Commerzbank Research
Still trading below govies

… not only in peripheral markets

Source: Commerzbank Research
How about market access?

Market sentiment has shifted from a pure seller’s market towards a better equilibrium of supply and demand.

Source: Commerzbank Research
Case study: Spanish Cédulas Hipotecarias

After two waves of retained issuance, new volumes have fallen considerably

Source: AHE, Commerzbank Research

Single-Cédulas issuance
Multi-Cédulas issuance
€ benchmark issuance


(€bn)
The share of sub-Jumbo deals has never been higher

Source: Commerzbank Research
Plenty of reasons

For example…

- Surplus O/C already at relatively low levels
- Banks in deleveraging mode
- Downturn of public-sector financing business
- Pressure on several housing markets
- Asset quality issues
- Focus on deposit base, senior and sub debt
- Ample central bank liquidity
- Smaller newcomers
- Stricter ALM guidelines
Less newcomers but including some interesting new structures

How to… 1) overcome rating constraints, 2) use covered bonds for other core assets
NIBC‘s conditional pass-through structure

Some pros and cons

<table>
<thead>
<tr>
<th>Pros</th>
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<tbody>
<tr>
<td>+ Stable AAA/AAA ratings with the least possible ties to the bank’s credit quality.</td>
</tr>
<tr>
<td>+ Therefore, low risks of regulatory or internal rating limits being broken.</td>
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<tr>
<td>+ Lower loss risks compared to forced stress sale of pool assets. More flexibility for decision takers.</td>
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<table>
<thead>
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<th>But</th>
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<tr>
<td>- Higher complexity.</td>
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<tr>
<td>- The higher ratings do not mean better issuer or pool quality but are basically due to methodological reasons. This results in lower rating transparency in comparison to other programmes.</td>
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<tr>
<td>- Lower liquidity provision and over-collateralisation likely.</td>
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<tr>
<td>- Repayment may take longer than in the case of bullet structures. Long legal maturities may imply accounting difficulties for individual investors.</td>
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<td>- Smaller group of investors might be negative for liquidity.</td>
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<tr>
<td>• Legal registration, therefore also UCITS- and CRD-conform including all resulting advantages.</td>
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<td>• We expect no negative surprises in terms of index categorisation.</td>
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Moody’s reacting to bail-in proposals

Upgrades of 1-2 notches expected

<table>
<thead>
<tr>
<th>The current methodology</th>
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<tr>
<td>Step 1: anchor point</td>
<td>Senior unsecured rating</td>
<td>+ 0 notches</td>
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<td></td>
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<td>+ 1 notch</td>
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<td>Step 2: upnotching</td>
<td>based on TPI table</td>
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<table>
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<th>The proposed adjusted methodology</th>
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<td></td>
<td>if unsec. senior + sub.</td>
<td>&lt;5%</td>
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<tr>
<td></td>
<td>debt / total liabilities</td>
<td>&gt;5%</td>
</tr>
<tr>
<td>… and b)</td>
<td>Adjusted Baseline Credit</td>
<td>+0 notches</td>
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<tr>
<td></td>
<td>Assessment</td>
<td>+1 notch</td>
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<td></td>
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<td>+2 notches</td>
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<td>Step 2: upnotching</td>
<td>based on unchanged TPI table</td>
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Source: Moody's, Commerzbank Research
The ECBC Covered Bond Label

... is supposed to...

› … establish a clear **perimeter for the asset class** and highlight the core standards and quality of covered bonds

› … increase **transparency**

› … improve **access to information** for investors, regulators and other market participants

› … improve **liquidity** in covered bonds

› … position the covered bond asset class with respect to upcoming **regulatory challenges**
1) “Clear perimeter for the asset class”

Checklist

- Structured covered bonds, SME deals, Aircraft covered bonds etc. excluded
- Otherwise, however, UCITS criteria offer little protection against credit dilution
- Non-European covered bonds also excluded for the time being

Survey feedback

- Only a first step
- Minimum standards expected to increase over time
2) “Increasing transparency”

Checklist

› National reporting templates defined

› No international harmonisation yet, reporting standards can deviate substantially

› After some initial hiccups, frequent reporting seems to have been established by now

› Limited market penetration (e.g. in Germany, Austria, Belgium)

Survey feedback

› Further international standardisation of reporting templates and of underlying data desirable (LTVs, NPLs etc.)

› Loan-level data typically not required
3) “Access to information”

Checklist

› [www.coveredbondlabel.com](http://www.coveredbondlabel.com) website established featuring links to pool reports and bond details

› No pool reports on the Label website itself

› No programme docs etc.

› Limited market penetration

Survey feedback

› Increasing penetration required
4) “Improve liquidity”

Checklist

› No effect measurable so far

5) “Position covered bonds for regulatory challenges”

Checklist

› Under discussion
Issues for discussion

› A harmonisation of covered bond laws and practices across Europe?
  Shouldn’t we start with a standardisation of some ‘basics’ such as the form of special
  supervision, cover calculation practices, insolvency proceedings etc.?

› Transparency is a moving target!
  In addition to further harmonisation, new requirements will become relevant along the way
  (eg info on maturity structures, amount of bail-in-able debt etc.).

› Chicken and egg?
  The Label will only become truly relevant once it gains regulatory acceptance, which seems to
  depend on the Label’s market relevance though…
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