EMF ECBC

Market Insights & Updates

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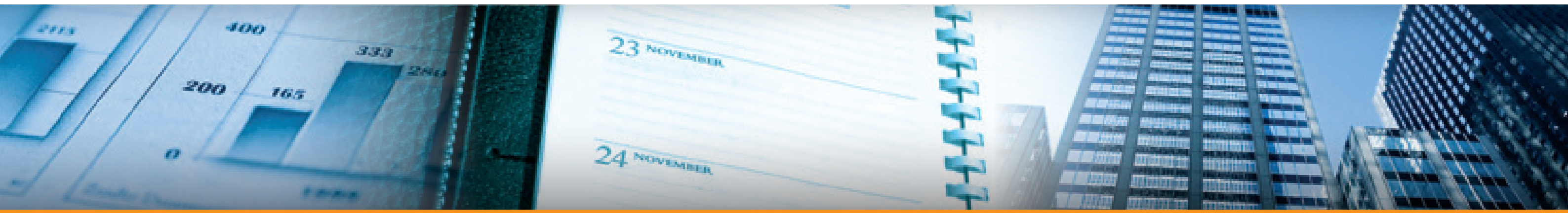

Summary

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European Mortgage Federation

ECBC European Covered Bond Council

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New Industry Communication Platform: Introducing the EMF-ECBC Blog...

By Luca Bertalot, Secretary General, EMF-ECBC

The EMF-ECBC strongly believes that communication amongst its members as well as between them and the other stakeholders in our sector plays – and will continue to play – a pivotal role in building a common market infrastructure which helps to enhance the exchange of market best practices and governance. We live in a very complex and dynamic financial and regulatory environment, and for this reason we believe that it is only by facilitating communication that we can build an effective market platform which will help pave the way for conscious market responses to the challenges in front of us. As such, today the EMF-ECBC launches a new communication tool – the EMF-ECBC Blog – which will allow our members and stakeholders in our industry to exchange their views, ideas, concerns and questions with a broad readership. This is intended to help all of us to better understand the views of market participants from the four corners of the Old Continent and beyond.

"Therefore I say to you, let Europe arise!"

With the intention of being somewhat provocative based on the events of recent days in Brussels, I start with a quote from Winston Churchill in his famous speech at the University of Zurich on the 19th of September 1946 *(full speech available here)*. As his speech made abundantly clear, 70 years ago Churchill captured with a pioneer's vision the strength and potential of the European dream: *"The structure of the United States of Europe, if well and truly built, will be such as to make the material strength of a single state less important. Small nations will count as much as large ones and gain their honour by their contribution to the common cause."* Today, more than ever, these words are a challenge to those of us who believe in the European dream just as much as for those who oppose it.

In the context of the current political debate on the future shape of the European Union, we believe that the call of Churchill's words also applies to the day-to-day activities of European trade organisations such as the EMF-ECBC, raising the crucial question as to what is the role to be played by a European market participant's platform? Being part of the first real "European generation" which grew-up with and was educated through the Erasmus programme, and with "Europe" ever-present as an entity not just a geographic term, we feel a responsibility to act as scouts, seeking out a new path in uncharted territory; territory characterised not only by revolutionary macro-financial developments but also, and more importantly, with uncertain social and political implications.

Consequently, we believe that the activities of the EMF-ECBC play an essential role in steering market-led solutions and highlighting potential market/legislative pitfalls by facilitating communication at a European level. In parallel, over recent years our organisation has also developed a broader scope of action with a view to reinforcing European perspectives in the debates of the Basel Committee on Banking Supervision, which have a global impact. In this work, communication is a crucial means by which we are able to seek to prevent market disruption and enhance market consensus and confidence.

Like most issues these days, everything is interconnected and linked to a greater or lesser degree, and it is no different with regards to the activities of an industry think-tank, the products of which can have deep political and social implications. Decisions taken by market participants acting and implemented at a European level can have a significant impact on the creation of a single market. Market-led initiatives can also help to ensure European financial stability in line with the spirit of the better regulation approach sought by Commissioner Hill.

As such, one of the cornerstones of a market-based platform like ours is structuring the organisational governance in a way which ensures the proper representation of every market and of all participants active in those markets. This was the objective – and we believe the result – of the review of the EMF-ECBC governance structure undertaken in 2014, resulting in the establishment of a new common legal entity, the Covered Bond & Mortgage Council (CBMC). In the CBMC, every member stands on an equal footing, thereby guaranteeing fairness and market representation in the *modus operandi* of our activities.

A second crucial element is to act as a market discussion forum and catalyst for market-led initiatives, i.e. to become the "hub" for market-specific information, where questions can be raised and constructive answers found, and through which good decisions can be taken and implemented. It is with this aim in mind that the EMF-ECBC has sought to realign its communication tools over recent years in order to provide its members and our industry's wider stakeholders with the information and input they need at the right time, in the right format and through the right channel. For example, we have moved towards holding regular and participant targeted roundtable/panel events focusing on very specific questions of current debate. These roundtables/panels are also intended not just to be a window onto our sector, but very much to result in concrete proposals as to how we can move the debate and market forward, and actively inform the future activities of our organisation. It is in this spirit that we launch the EMF-ECBC Blog.

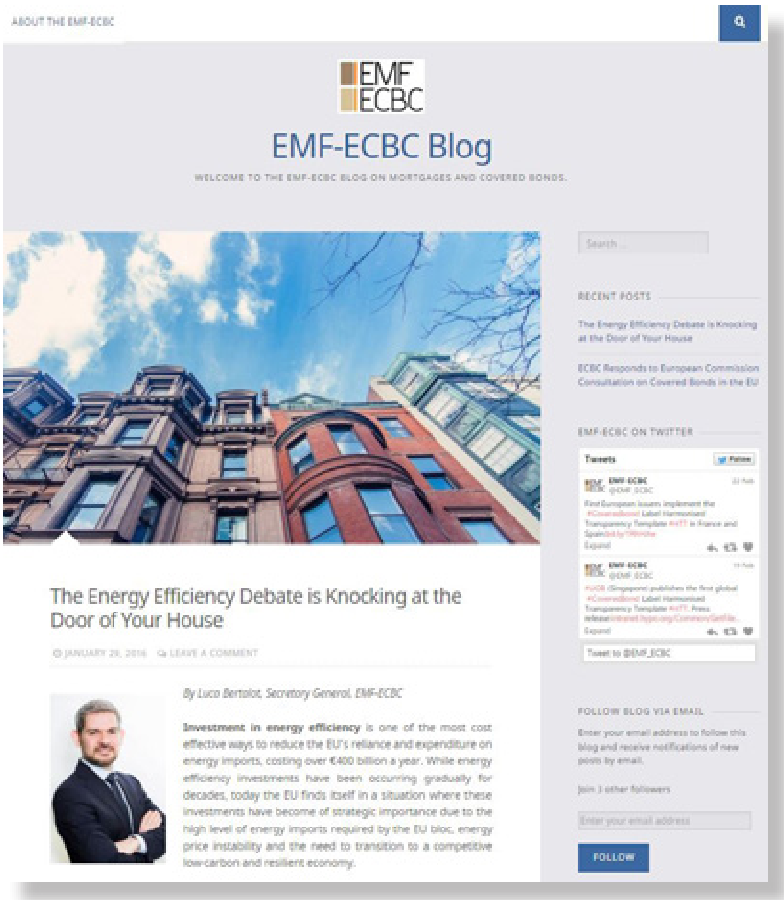
As mentioned above, today, Europe is not so much a geographical place but an idea which thrives based on the innovative ideas that it stimulates. This is why it is so important for us to have a market platform where ideas can be launched, exchanged and discussed. In this context, we warmly invite all market participants to subscribe to and follow the EMF-ECBC Blog, and to use it to share with us their views and ideas on the current and future state of our industry.

We would like to invite all EMF-ECBC members and market participants to comment on our new blog and to share ideas together. We also welcome contributions from potential guest authors from the Industry. If you would like to know more about the EMF-ECBC Blog or to ask about a potential blog post, please contact the Secretariat at emfinfo@hypo.org.

The aim of the EMF-ECBC is to support the European economy and facilitate access to capital markets by harmonising and promoting market best practices and, in particular, long-term funding and mortgage origination techniques, through:

1) *an intelligence platform where initiatives are debated, legislative proposals are discussed and best practice is exchanged in order to adopt common positions; and*
2) *providing unique, unrivalled and timely legal, economic, statistical and research information, as well as other funding and market information.*

The EMF-ECBC brings together mortgage lenders and covered bond market participants. The EMF-ECBC has a core European focus whilst representing views and sharing technical knowledge and networking at a global level.



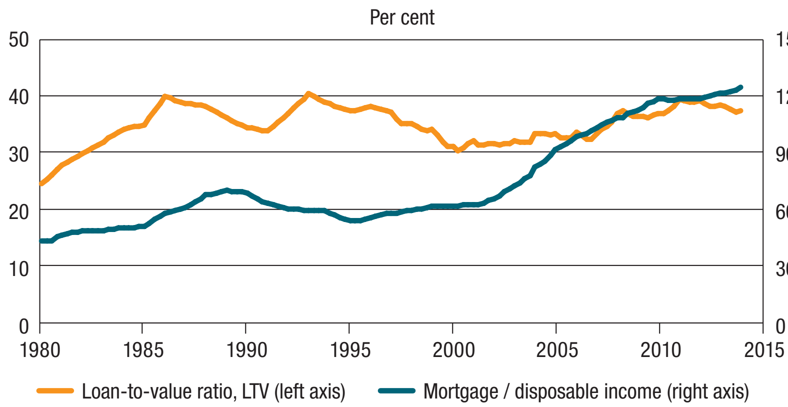
Amortisation – A Long Journey

By Magnus Karlsson, Analyst, Swedish Bankers' Association

Sweden experienced a quite severe banking crisis in the early 1990s, with substantial drops in house prices. However, since the recovery from the crisis, we have seen a steady increase in household indebtedness and continuously rising house prices. Over the last five or six years the debate about households' indebtedness and mortgage credit has been intense and measures have been taken. And after a very long journey – the first initiative from the Swedish Financial Supervisory Authority, FSA, was at the end of 2014 – an amortisation requirement is now on its way to being introduced. The government will introduce a law on the 1st of May this year that makes it possible for the FSA (the authority that is responsible for macro prudential policy in Sweden) to implement an amortisation requirement that will enter into force on the 1st of June 2016.

The Swedish Bankers' Association and its members welcome the proposed amortisation requirements and believe that it is well balanced on a general basis. The proposed requirement will only include new mortgages and will necessitate higher amortisation for households with higher loan-to-value (LTV) ratios. The Swedish Bankers' Association, together with the banks, have worked hard during the last five years to improve the amortisation culture. This work has proven successful and today an amortisation behaviour that is very close to the upcoming requirement has been established. Therefore, the transition to the requirement will probably be relatively smooth.

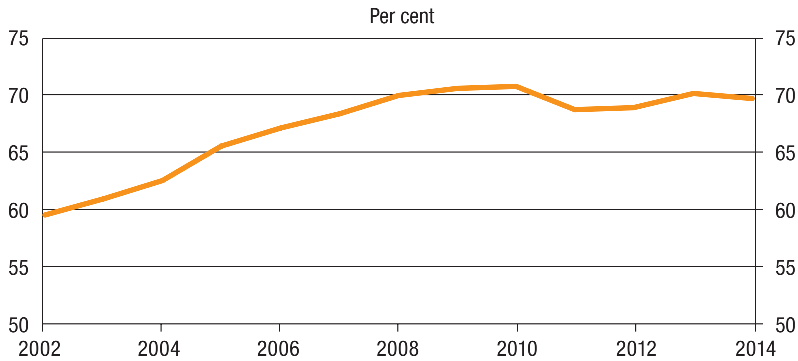
Diagram 1 ▶ Total loan-to-value ratio and mortgages in relation to disposable income in Sweden



Source: Statistics Sweden, the Swedish Tax Agency and FI's own calculations

Note. The diagram refers to aggregate values for the entire Swedish household sector and is not based on data from the mortgage survey.

Diagram 2 ▶ Loan-to-value ratio, new loans in mortgage stock



Source: The banks' calculations

Note. The loan-to-value ratio refers to a volume-weighted average, i.e. it is calculated taking account of loan size, such that large loans have a greater impact on the average.

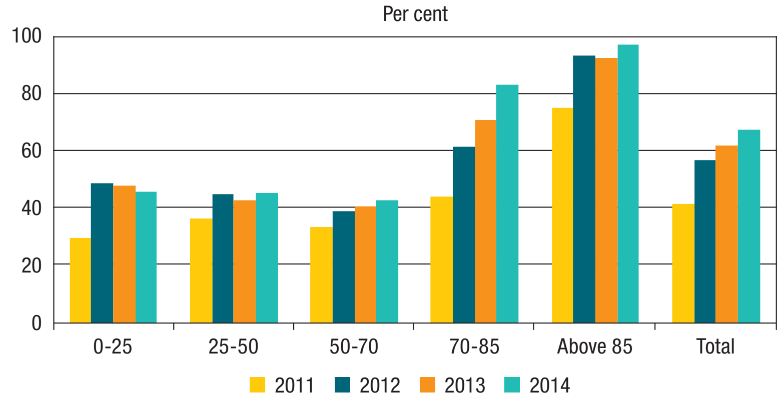
BACKGROUND

Sweden experienced a very deep banking crisis in the early 1990s and had a few years of recession. During this period of three to four years, house prices fell in real terms up to 30% and, in some regions, it took up to eight years for them to return to the same price level as before the crisis. Many households experienced a very tough time. In the years before the crisis, in the 1980s, credit markets had been deregulated and mortgage lending had increased. During and after the crisis the growth rate in mortgage lending was low and, as mentioned, house prices were fell and only recovered slowly.

In the late 1990s and early 2000s, house prices increased and mortgage lending took off. The increase in the growth rate of mortgage lending went up by double-digit numbers on an annual basis. The Swedish housing market didn't see a downturn during the last financial crisis, whilst most other countries in Europe did; rather, there was more a dent in the curve. The same is true for the mortgage market. We have not seen a dip in lending to households as has been the case for most other countries in Europe, although the growth rate did decrease from the really high rates seen, but has once again started to increase. After the crisis in the early 1990s and up until today, credit losses stemming from mortgages has been very low. The forecasts from the Swedish authorities are that this trend will continue and that there will be very low credit losses from mortgages into the future.

What has happened though is that the volume of new housing construction has remained very low since the crisis in the 1990s. This, combined with other constraints in the Swedish housing market (especially the ill-functioning rental market), has led to supply side shortages in the market. At the same

Diagram 3 ▶ Share of amortising households



Source: FI's sample

Note. Amortisation according to loan agreement.

time, the demand side has continued to grow. This combined with, for example, the exceptional low and steadily decreasing interest rates during the period from 1995 to now, has led to increased house prices. Also, during this period floating interest rates and interest only loans became more and more common. This combination led to a situation with high LTVs and very low amortisation for households.

CONSUMER PROTECTION, FINANCIAL STABILITY AND MACRO PRUDENTIAL POLICY – MEASURES INTRODUCED SINCE 2010

There have been several measures or tools implemented to dampen the increase in household indebtedness in Sweden whilst the debate has been ongoing. Both Swedish authorities and international organisations highlight the Swedish mortgage market as a major risk for Swedish macro-economic development.

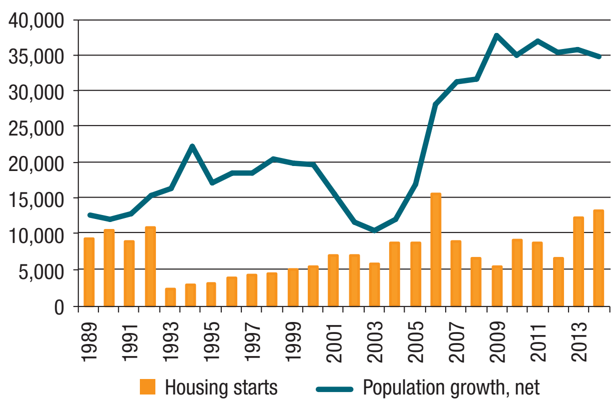
The FSA introduced an LTV-cap in 2010 which states that households need at least 15% in capital investment, or, put the other way around, you are only allowed to borrow up to 85% of the value of the home with the home as security (there is a possibility to use unsecured lending above 85%). Around the same time, in early 2011, the Swedish Bankers' Association issued a recommendation regarding amortisation – that new mortgages should be amortised down to 75% of the market value of the home. This was later modified (at the beginning of 2014) to 70% in 10-15 years and, at the same time, the Association introduced individual amortisation plans for all households that took out a new mortgage (the initial draft came from the FSA, but it needed legal support to implement it).

Beyond this, the FSA has increased risk weights for mortgages for banks using internal models. First, up to 15% (motivated by future credit losses) and then, later, up to 25% (motivated by macro prudential concerns). The four largest Swedish banks also have a 5% systemic risk buffer and the counter cyclical capital buffer will soon be introduced at 2%.

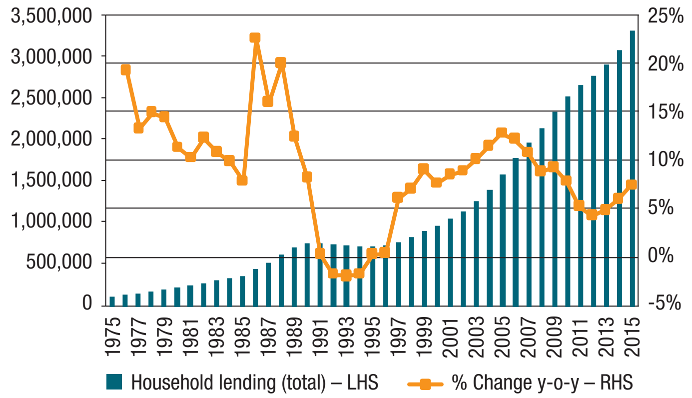
The Swedish Bankers' Association had its own recommendation for amortisation and planned to make it even stricter – amortisation of new mortgages down to an LTV of 50%. But, the Competition Authority argued that this could be anticompetitive (although it did not make a full investigation). The Association therefore withdrew its proposed new recommendation and also the existing one, in late 2014. After this, there were no rules regarding amortisation and the Swedish authorities and international organisations pushed for measures to be taken to stabilise the housing market. In the absence of any political decisions to make the housing market function more efficiently, focus turned to the FSA and an amortisation requirement. When the recommendation was in place, between 2011 until late 2014, amortisation behaviour strengthened dramatically. Today, amortisation behaviour is close to the upcoming requirement, especially for households with high LTVs (above 70%).

In early 2015, the FSA published its first proposal for a future amortisation requirement as a macro prudential tool. Nonetheless, the FSA encountered some legal issues regarding what was in its mandate as a macro prudential authority. As a result, it had to withdraw its proposal in April 2015 and then the government had to deal with the issue of how to implement an amortisation requirement and what mandate the FSA should have. It proposed, later in 2015, to introduce, or change, the legislation in a way that gives the FSA the mandate to introduce a requirement. This updated law will enter into force on the 1st of May 2016. The FSA has circulated its second proposal for an upcoming amortisation requirement and it is planning to introduce the requirement from the 1st of June 2016. This gives the banks and their customers little time to prepare and implement the new rules. Households which sign up for a new mortgage with an LTV above 70% will amortise 2% of the loan and households with an LTV between 50-70% will amortise 1%. The proposal also states that the market value can only be used or updated every five years. This makes the regulation rather difficult, both for banks and for households. It would have been easier, and still with almost the same utility, to use market value.

Therefore, two years after the removal of the Bankers' Association recommendation there will "most likely" be an amortisation requirement in place in Sweden from the 1st of June 2016. The introduction of the requirement will probably not be that dramatic because most households taking out a new loan already amortise, almost, up to the incoming requirement. If that is the case, the effect on household indebtedness will be rather small. The discussion of further measures, such as debt-to-income ratios or debt-service-to-income ratios, will continue. However, the measures to make a difference to the housing market in the long run are owned by the politicians – changes in the tax system to increase mobility, increased building etc. We have seen house prices level out during recent months, but the growth rate in lending is still high. The debate regarding the housing market and household indebtedness remains ongoing, and more measures or tools may come in the future.



Lending Growth



"La Caution" or the Guaranteed Loan: a specific feature of the French home financing market

By Éric Veyrent, Deputy Chief Executive Officer, Head of Administration and Finance, Crédit Logement

The French mortgage market or the French home financing market is the third largest European market in terms of new origination. The peculiarity of this market is the guaranteed loan or, more specifically, the *"caution"* as the main guarantee. This guarantee, delivered by an insurance company or a financial institution, is an alternative to the classic mortgage *"hypothèque"* registration. In 2014, guaranteed loans represented 61% of new home loans in France with a constant growth over the last decade. In comparison, the registration of mortgages, or loans guaranteed by a *"hypothèque"* represented only 37% of new home loans in France.

In the case of a guaranteed loan, the borrower has a choice between either a guaranteed loan or a mortgage. The full amount of a guaranteed loan is covered by the guarantee and not just the high loan-to-value (LTV) tranches. No additional guarantee is needed. A large range of home loans (bridging loan, long-term loan – up to 30 years, etc.) or borrowers (first time borrower, buy to let borrower, etc.) are eligible for the guaranteed loan.

For borrowers, it's interesting to note the price competitiveness of the guaranteed loan. On average the up-front premium or fee amounts to 1%, allowing the avoidance of mortgage registration. This guarantee is more flexible: quick to obtain and with no extra cost in the case of early repayment. For borrowers, the guaranteed loan is the easiest way to obtain a rapid and competitive loan offer from a lender.

For banks, the key benefits of the guarantee are as follows: an automated and secured process to obtain the guarantee approval, full and rapid compensation when a guaranteed loan is in default, and a recovery process fully managed by the guarantor.

The main added values of the guaranteed loan are:

- The guarantor provides an independent and second risk analysis.
- The robustness of the guarantee does not depend on the value of the real estate at the time of default.
- The guarantor provides a global risk mutualisation relying on a high level of risk division.

The main guarantors of guaranteed loans in the French market are Crédit Logement (the market leader), CEGC (a subsidiary of BPCE), CAMA (a subsidiary of Crédit Agricole) and CMH (a subsidiary of Crédit Mutuel).

La Banque de France stated in its December 2015 French financial system risks evaluation that regarding the home financing market, the guaranteed loan system was "robust". The guarantees are recognised as risk mitigation according to Art. 201 of the Capital Requirements Regulation (CRR). Guaranteed home loans are eligible for refinancing through SCF, SFH and securitisation transactions, and guaranteed covered bonds are eligible for low risk weights according to Art. 129.1.e of the CRR.

A SOLID GUARANTOR WITH A PROVEN BUSINESS MODEL

Crédit Logement has been licensed in France since 1975 and has the status of a financial institution *(société de financement)* regulated by the French banking law (23/12/2013 decree) and the French financial regulator ACPR. The company has a solid financial structure, being owned by highly respectful French banks such as BNP Paribas, Société Générale, Crédit Agricole, Crédit Lyonnais, Crédit Mutuel and the French Post bank.

Crédit Logement's core business is to guarantee home loans to individuals. The loans are presented by partner banks, most of whom are also Crédit Logement's shareholders. Crédit Logement currently has more than 100 active banking partnerships. The Crédit Logement financial guarantee is based on the principle of risk pooling, with each borrower contributing to a Mutual Guarantee Fund.

Crédit Logement has a 33% share of the French residential market (mortgages and guaranteed loans) and a 60% share of the French guaranteed loan market. Crédit Logement has also recently developed specific cross-border guarantee activities with regional banks located near the French border.

As of the 31st of December 2015, Crédit Logement's outstanding guarantees amounted to €283 billion and its annual guaranteed production reached €80 billion. More than 7 million borrowers have already benefited from the Crédit Logement guarantee.

Crédit Logement is rated AA low by DBRS and Aa3 by Moody's, both with a stable outlook.

A HIGHLY SECURED AND AUTOMATED APPROVAL PROCESS

No approval delegation is given to the lender. All guarantee applications are transmitted automatically by the banks through two channels: via an exchange of computerised data or via an extranet. Each guarantee application is analysed by a scoring system in addition to an expert system (a set of limits and professional rules: LTV; debt-to-income ratio; etc.) with two main axis of analysis: the borrower's ability to repay the loan and the margin on the property or on the borrower's entire possessions. Crédit Logement's guaranteed borrowers base is also checked automatically. 50% of all files are approved and cleared through the automated approval process. The remaining 50% are reviewed by experts because they are not compliant with the pre-defined set of criteria or have a low score.

FULLY IN CHARGE OF THE COLLECTION PROCESS

Regarding the default claim, Crédit Logement takes over the recovery of loans in default from the first payment claimed by the bank through to the recovery completion (final losses paid or loan put back on track). The bank has to contact Crédit Logement after three monthly repayments are overdue. Crédit Logement covers the current overdue repayments and the subsequent overdue repayments.

The key objective of Crédit Logement is to quickly assess the client's solvability:

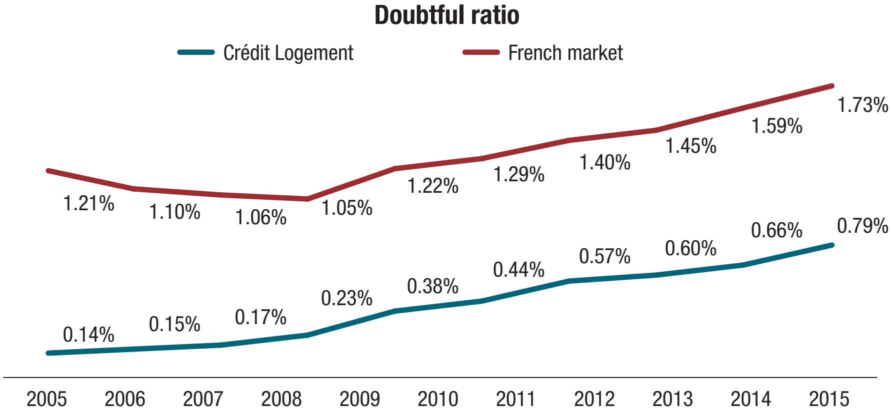
- If the borrower manages to repay late instalments, the file comes back to the normal situation in the book of the lender (50% of cases are put back on track within six months).
- Otherwise, Crédit Logement requests the bank officially to declare the file as a defaulted loan and at that point in time repays the lender the full amount outstanding.

Crédit Logement takes all of the actions necessary to secure its position: register a judicial mortgage; sell the property on the market to obtain the highest recovery rate; or proceed to an auction to sell the property.

ROBUST RISK SERVICING
In 2015, for Crédit Logement:

- 810,000 new guarantee applications were processed (14% were refused).
- 11,500 claims for payment were received from lenders. €337 million euros were paid out to lenders. €115 million euros were recovered.

GUARANTEE PERFORMANCE
Crédit Logement has the lowest doubtful ratio of the French market. The ratio stands at 0.79% compared to the French market average of 1.73%. Crédit Logement forecasts its ratio will stabilize in 2015.



Ethics Standards for the Real Estate Sector – Have Your Say!

By Sander Scheurwater, Head of External Affairs & EU Liaison Europe, RICS

Today, both the banking and real estate sector are under increased scrutiny from the public and regulators. Our image has seen better days. By showing that we operate ethically, we can change this. The International Ethics Standards (IES) Coalition, comprising over 60 national and international organisations, has developed a draft global ethics standard for the real estate (finance) and construction sector, which is now open for consultation. The European Mortgage Federation – European Covered Bond Council (EMF-ECBC) and its members can help by responding to the current consultation and helping to ensure that we end up with a standard that will have a positive effect on our sector.

WHY DO WE NEED A GLOBAL ETHICS STANDARD FOR OUR SECTOR?

This question can be split in two:

- Why do we need ethics standards?
- Why do we need them to be global?

Why do we need ethics standards?

We need an ethical framework to complement legal obligations. For example, look at the way some high profile companies have set up their tax structure. They have done so perfectly within the law, yet they have come under increased scrutiny from media and the public as it does not appear to be in line with their image and what could be considered as fair, or ethical, behaviour.

Every working day we are faced with dilemmas, options and choices. How we make our choices is not always as straightforward as we would like, and partially determined by our ethical principles. There are three basic factors that could lead to unethical decision-making, together forming the "Fraud Triangle". These are:

1. **Pressure**: the need to commit fraud (e.g. for money)
2. **Rationalisation**: personal justification for dishonest action
3. **Opportunity**: the ability to commit fraud without being caught

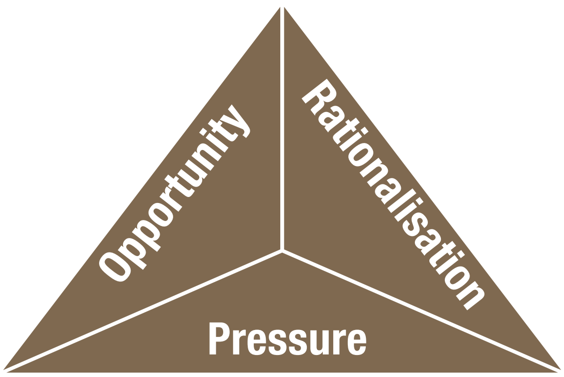
By having a clear set of ethical standards and actively making use of them, it will become harder to rationalise certain choices.

Why do we need ethics standards to be global?

Codes of conduct are a key feature of our profession. Many of us have them, either through our associations or directly from the company we work for. Whilst the intentions of these codes are likely to overlap, they differ; because there are differences they are hard to compare, making it difficult for clients and public to understand exactly what it is we mean with "ethics".

Other professions have come before us. Both lawyers and accountants already have a global set of ethics standards. The best known, and oldest, example is the Hippocratic Oath, a Greek medical text that has provided an ethical foundation to the Western medical profession for over 2,500 years.

The Fraud Triangle



The benefits of creating one universal set of ethics principles for real estate and related professions are clear:

- **Consistency** by outlining what is expected as a minimum standard for ethical conduct;
- **Transparency** as clearly stated ethical values which are promoted and used to enable better compliance; and
- **Clarity** by creating one universal set of principles and a stronger foundation for public trust.

THE CREATION OF THESE ETHICS STANDARDS IS AN OPEN AND INCLUSIVE PROCESS

The International Ethics Standards (IES) Coalition was established in October 2014 at a meeting in New York hosted by the United Nations. The participating organisations agreed that in many parts of the world, there is a real and perceived problem with an inconsistent approach to ethics in real estate which must be addressed. The Coalition currently consists of over 60 national and international organisations, working together to develop a standard that they all aim to follow.

Participating in the coalition, as well as accessing and using the IES will be free of charge. Coalition organisations will provide advice and guidance about implementing the standard.

WHAT DOES THE DRAFT LOOK LIKE?

The International Ethics Standards will outline principles, not rules. Principles help guide professional judgement when individuals and organisations need to decide on appropriate behaviour and action.

The IES will not be a lengthy document. The original version of the well-known Hippocratic Oath contained only nine ethical principles. The International Ethics Standards for real estate and related professions aims for a similar high-level, principles-based approach; it will then be up to the IES Coalition members to promote them in their own way. This might be through providing regular advice and guidance or by proactively regulating compliance through mandating and monitoring.

WHAT CAN YOU DO TO ENSURE WE END UP WITH THE BEST ETHICS STANDARDS POSSIBLE?

Principles help guide professional judgement when individuals and organisations need to decide on appropriate behaviour and action. The extensive consultation process which the IES Coalition is promoting on the draft standard will help to ensure that the final published standard is globally applicable.

We are sure there are many good examples you could share with us, such as the "banker's oath" in The Netherlands. Tell us what you think of the draft standard by responding to the consultation, which is open until the **30th of April 2016**.

Covered Bonds – A Snow White Slumber for SRI Investors?

By Jan Köpper, Head of Fixed Income ESG Research, imug

Over recent years and specifically during and in the aftermath of the global financial crisis, the concept of covered bonds has gained widespread additional recognition among responsible investors (also known as SRI Investors) as regards its positive characteristics of low risk levels for investors, the diversification of long-term funding sources for borrowers as well as its direct connection to projects in the real economy. Hence, covered bond volumes tend to increase in times of economic volatility when the interbank market yearns for collateral to provide reliable funding. Still, this does not hold true for all covered bond markets. In a September 2015 article in the online issue of the Financial Post, Barbara Shecter quotes Fitch Ratings stating that *"historically low interest rates combined with investor appetite for 'high quality assets' has already pushed the issuance of covered bonds collateralised with residential mortgages beyond last year's volume [in Canada]"* (Shecter, 2015). Therefore, the attractiveness of covered bonds can be assumed to be driven by a complex mix of local and international market conditions as well as monetary and regulatory policy developments.

More recently however, lender and borrower focus has even shifted to include **Environmental, Social and Governance (ESG)** aspects in the issuance and investment process of covered bonds. Prominent examples include the recent issuance of ESG mortgage covered bonds by ABN AMRO Bank N.V., Münchener Hypothekenbank eG and BerlinHyp AG. This development is in line with an overall upgrade of global market maturity to take a holistic approach towards traditional value drivers of capital in all asset classes, and take into account the impact of ESG risks and opportunities on performance, default risk and innovation capability amongst others. According to the Global Sustainable Investment Association (GSIA) *"the global sustainable investment market has continued to grow both in absolute and relative terms, rising from USD 13.3 trillion at the outset of 2012 to USD 21.4 trillion at the start of 2014, and from 21.5 percent to 30.2 percent of the professionally managed assets in the regions covered"* (GSIA, 2014). This sounds like fertile ground for future efforts to increase the sustainability leverage of SRI on the real economy and global development.

Nonetheless, not only covered bonds have gained increased focus of SRI investors but also bank bonds in general. The UNPRI states that *"investors have become increasingly sensitive to the potential financial impacts of risk management failures, malpractice fines and banks' ability to meet new regulatory standards. These issues also present reputational risks, making the investments in bonds issued by some banks less attractive"* (UNPRI, 2015). Hence, though recent developments have shown a dip in debt issuance of some banks the central function of bank bonds and covered bonds in portfolio construction is still prevalent.

Interestingly for SRI investors, global covered bond volumes at year end 2014 amounted to EUR 2.6 trillion while outstanding mortgage covered bonds amounted to approximately 83% of the total. And it seems that the role of covered bonds as strategic long-term funding tool will even increase when it comes to topics of global sustainable & social development. The European Covered Bond Council exemplarily puts it like this, *"looking at the numbers produced by the World Bank, 8.3 billion people are expected to be alive by 2030, with 60 percent of them living in cities. Consequently, the global demand for new dwellings is foreseen to rise by 565 million over the same period. Furthermore, the World Bank considers that in emerging markets, five permanent jobs are created for every new housing unit built, with the figure being even higher in the developed world, thus making housing a key driver for economic growth and social stability"* (ECBC, 2015). This example of future financing needs opens up opportunities for SRI investors to identify suitable investment options based on the application of sound ESG criteria and visions for sustainable development on the covered bond market. Good reasons to expect that the integration of ESG aspects in covered bond issuances and rating assessments has the potential to significantly impact on the ability of the market to recover from its anticipated Snow White slumber, right?

LET'S BE VERY HONEST – DEVELOPMENT DOESN'T EQUAL DEVELOPMENT!

For SRI investors and any reasonable investor digging below the surface of traditional financial aspects, bank bonds and covered bonds specifically need to be subject to an in-depth analysis of the sustainability of the issuer as well as the sustainability of the use of proceeds or the cover pool respectively. To assess the sustainability of the issuer and its collateralised capital market issuances, traditional ESG analysis needs to shed light on the material aspects of financial institutions' sustainability leverage. What are the key aspects that tend to define a financial institution's impact on societal development and the course of the real economy? Surely, it isn't internal environmental management or philanthropy since these are simply must-haves in an increasingly mature sustainability debate framed by pressing global challenges and tangible impacts. Rather, the indirect impacts stemming from financial institution's business activities is what needs to be assessed in order to draw well founded conclusions on the sustainability of relevant business models.

imug Sustainable Investment – German research and sales partner of the Vigeo Eiris Global Network – together with its clients has engaged in an effort to develop a dedicated rating methodology for bank bonds, including uncovered bonds, public sector covered bonds, mortgage covered bonds and ship mortgage bonds, to allow investors to define the questions that provide answers to individual and universal positions of sustainable development. Since 2007, imug offers the "imug Sustainability Rating of Bank Bonds" and in 2015 has launched an online-database – the "imug bond sonar" – for its clients to access and customise respective sustainability approaches. Since late 2015, this product has been included in the product portfolio of the Vigeo Eiris Global Network and is offered to international clients interested in an application of sector specific research criteria for financial institutions and their collateralised capital market issuances.

imug is committed to the translation of the guiding principles of materiality and impact into clear and replicable rating criteria for financial institutions. Prominent examples of this specific approach include the introduction of a rating criterion on "secrecy jurisdictions and tax avoidance" in 2011 – and therefore well before Tax Leaks & Lux Leaks – as well as the evaluation approach regarding "environmental impacts of the investment and commercial credit portfolio" in 2012. Dedicated research criteria for real estate lending and ship financing epitomise another differentiating factor of the rating approach.

In the process of the “imug Sustainability Rating of Bank Bonds” two areas are analysed: on the one hand, the sustainability performance and management systems of the issuer (for uncovered bonds); and on the other hand, the sustainability of the cover pool (covered bonds). This method allows for consideration of the sustainability performance of a financial institution as well as the business model that provides the basis of the cover pool at hand. As a result, both areas are aggregated applying customisable weightings to come to a final assessment for each bond type (see Figure 1).

Another major distinguishing feature is the focus of the ESG rating on business activity (18 issue areas) and business behaviour (12 issue areas) of the issuer. Hence, the rating extends the conventional ESG analysis to cover the full spectrum of direct and indirect impacts of financial institutions. Finally, making use of the “imug bond sonar” database allows each client to exploit numerous options to customise the rating approaches and results presentations.

WHEN THE COCK CROWS TWICE!

The abovementioned insights illustrate the importance of a broad sustainability movement. The delicate balance between various perspectives and requirements provide a space for innovative solutions to develop, and a test laboratory for their social acceptance and practical feasibility. However, under the weight of the pressing ESG-related challenges of our time, the possibilities of extended test phases are greatly limited, and the retreat to the lowest common denominator not enough to make the necessary change. The sustainability players are thus called upon to take a bold step forward and, together with their stakeholders, find solutions to serve as an example to others.

Covered bonds and bank bonds in general provide an opportunity to assess financial institutions' levels of sustainability in their economic core function (lot-size transformation), their leverage on the orientation of the real economy as well as their investment activity and other service offerings. The imug results point to the urgent need for profound integration of ESG standards in all business activities to allow for positive long-term contributions to financial market stability and capital mobilisation for a sustainable future.

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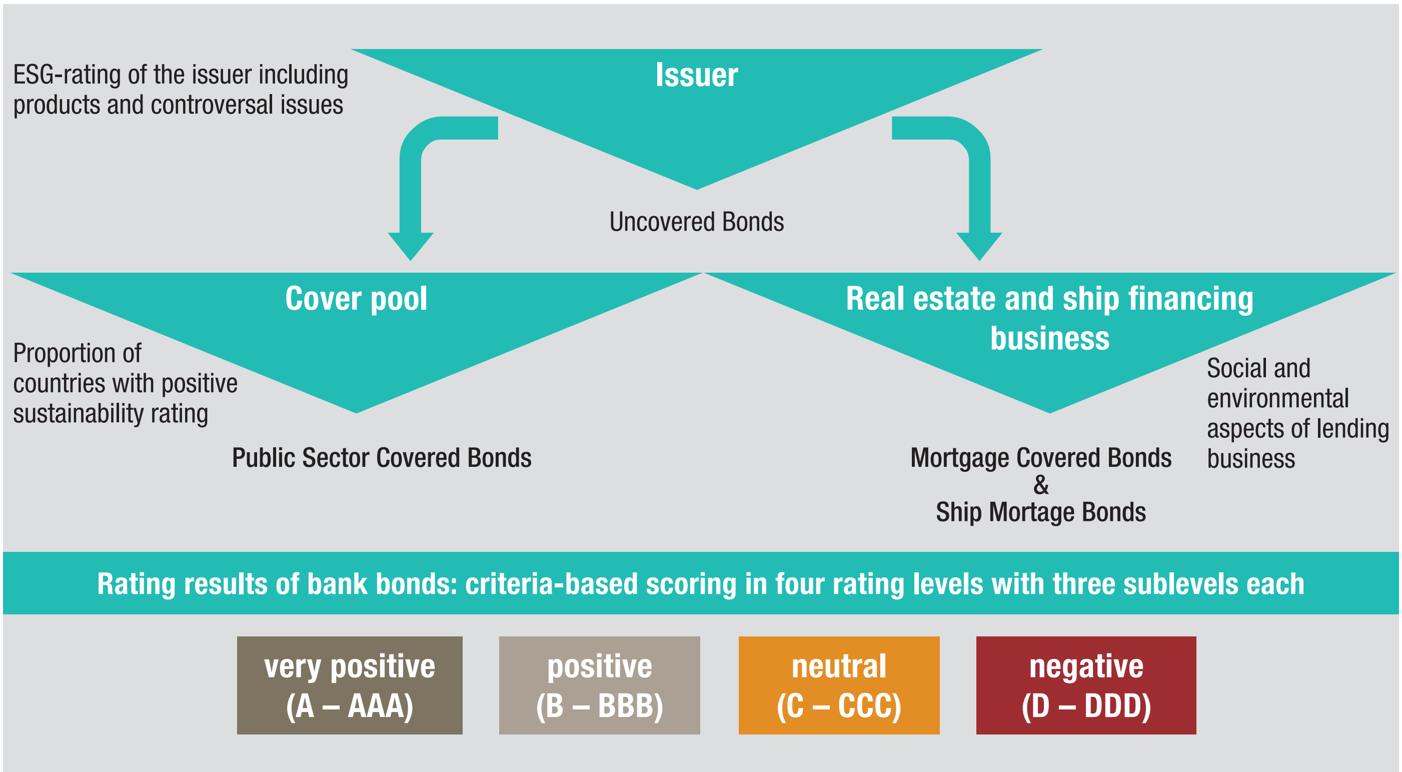
Figure 1



NEWS IN BRIEF

EBA Opinion on General Principles & Timelines for Implementation of the Regulatory Review of the IRB Approach

On the 4th of February 2016, the European Banking Authority (EBA) published an Opinion specifying the general principles and timelines for the implementation of the regulatory review of the internal ratings-based (IRB) approach. The aim of the Opinion is to provide guidance and clarity to both Competent Authorities and institutions on the planned review and its implementation. The Opinion is supported by a Report (here), which summarises the feedback received from the public consultation on the EBA discussion paper on the future of the IRB approach.

The EBA has been working on identifying the main drivers of variability in the implementation of IRB models in light of concerns that were raised about the lack of comparability of capital requirements determined under the IRB Approach across institutions. A substantial number of areas were identified as potential sources of variability and the EBA published a discussion paper (here) on the future of the IRB Approach (EBA/DP/2015/01) in March 2015, which detailed the EBA's proposed regulatory response to the identified issues. This is a follow-up action on the content of the regulatory review of the IRB Approach within the scope of the CRR.

In particular, in its Opinion, the EBA reiterates its stance in favour of the continued use of the IRB approach and introduces changes which aim at harmonising definitions and supervisory practices in the definition of default, the estimation of risk parameters and treatment of defaulted assets, credit risk mitigation techniques and disclosure in four phases. These changes should be supplemented by amendments to the underlying framework – beyond what is currently allowed in European legislation – in order to reduce undue variability in the implementation of the IRB models.

The regulatory developments are scheduled to be introduced in four phases according to the table below:

PHASE	REGULATORY PRODUCTS	PRIORITY
PHASE 1: IRB assessment methodology	RTS under Articles 144(2), 173(3), 180(3b) on the assessment methodology	By Q1 2016
PHASE 2: definition of default	RTS under Article 178(6) on the materiality threshold	By mid-2016
	GL under Article 178(7) on the application of the definition of default	
PHASE 3: risk parameter estimation and treatment of defaulted assets	RTS under Articles 181(3a), 182(4a) on the nature, severity and duration of economic downturn	By mid-2017
	GL on downturn LGD estimation – EBA own initiative (report on Article 502)	
	GL on PD estimation – EBA own initiative (report on Article 502)	
	GL on LGD in-default, ELBE and IRB shortfall calculation – EBA own initiative (report on Article 502)	
PHASE 4: credit risk mitigation	RTS under Article 183(6) on the recognition of conditional guarantees RTS under Article 194(10) on liquid assets	By end 2017
	RTS under Article 221(9) on the Internal Models Approach for master netting agreements	
Across phases: transparency	Implementation of the Basel Committee disclosure proposals (Pillar 3 disclosures) in the EU	Pillar 3: work to start in 2016

The full EBA Opinion is available here.

DBRS Request for Comment on Proposed Update of its "Rating European Covered Bonds" Methodology

On the 4th of February 2016, DBRS published a Request for Comment requesting feedback on the proposed update of its "Rating European Covered Bonds" methodology.

In essence, DBRS proposes a new analysis for deriving the Covered Bonds Attachment Point (CBAP) of all European covered bonds programmes that have a Reference Entity (RE) that is subject to the Bank Recovery and Resolution Directive (BRRD), enacted on the 15th of May 2014. The proposed method involves the use of the RE's Critical Obligations Rating (COR) alongside the current senior unsecured rating (RE-SUR) as a reference rating for the CBAP and the possibility of notching the rating of the CBAP down by up to one notch from the COR, or up by up to two notches above RE-SUR in certain circumstances.

The level of notching will depend on DBRS's assessment of the following main factors: (1) whether there is a COR assigned for an RE or not; (2) when a COR is not assigned but the RE is subject to a BRRD-equivalent regime, then the systemic importance of the RE; (3) the importance of the CB as an instrument for the economic and financial system of the relevant country; and (4) the importance of the covered bond programme as a funding instrument for the core business of the RE.

The CBAP is one of the building blocks of the Methodology and represents the likelihood that the RE will keep meeting timely payments on the covered bond before the source of payment switches to the cover pool. The CBAP currently references the RE-SURs. The COR addresses the risk of default of particular obligations/exposures at certain banks that have a higher probability of being excluded from bail-in and remaining in a continuing bank in the event of the resolution of a troubled bank, than other senior unsecured obligations, and is generally two notches above the Intrinsic Assessment (IA) of banks. This notching may widen at the point of the resolution of the bank as the SUR/IA of the bank is likely to transition further down due to the higher risk of bail-in. Nevertheless, it is less likely that the COR will remain higher than the SUR in the case of a systemic banking crisis.

The full DBRS Request for Comment can be accessed here.

EBA Opinion on Proposed Amendments to Final RTS Concerning MREL

On the 9th of February 2016, the European Banking Authority (EBA) issued an Opinion to the European Commission (EC) expressing its dissent over some of its proposed amendments to the EBA final draft Regulatory Technical Standard (RTS) on the criteria for setting the minimum requirement for own funds and eligible liabilities (MREL) and encouraging the prompt adoption of the standard.

To recap, on the 3rd of July 2015, the EBA submitted its final draft RTS to the EC, which included references to the conditions for accessing resolution, specific provisions for setting MREL for systemic institutions, and an option to set a limited compliance transition period. On the 17th of December 2015, the EC proposed a number of amendments to the RTS submitted by the EBA.

Relevant points of dissent between the EBA and the EC are:

- EC proposed to amend the reference to the burden-sharing requirement by shareholders and creditors of institutions of significant importance. Although the EBA agrees with the Commission's argument that the RTS cannot set a harmonised level of MREL, it dissents from some of these amendments as it believes legal clarity and certainty is needed when setting MREL for a systemic institution which may need to access resolution funds.
- EC proposed to remove several specific provisions relating to the criteria for setting MREL for systemic institutions, to the consultation between competent and resolution authorities on specific matters and the upper limit on the transitional compliance period. The EBA dissents from these amendments as it believes they would reduce the effectiveness of the RTS in promoting smooth cooperation and convergence when setting MRELs.

The full EBA Opinion can be accessed here.

ESMA Publishes Discussion Paper on Benchmarks Regulation

On the 15th of February 2016, the European Securities and Markets Authority (ESMA) published a Discussion Paper regarding the technical implementation of the incoming Benchmarks Regulation. In this regard, ESMA is seeking stakeholders' input in order to be able to formulate its draft Regulatory Technical Standards (RTS) and Technical Advice to the European Commission.

As a matter of background information, benchmarks are used in financial markets as a reference to price financial instruments and to measure performance of investment funds. They are an important element in many financial contracts and, as such, their integrity is crucial to financial markets and to investors. The Benchmarks Regulation has the primary objective to improve the quality of the input data and methodologies used by benchmark administrators and to ensure that benchmark contributors are subject to supervision.

In view of this, the Discussion Paper is seeking stakeholder's feedback in the following areas:

- Definition of benchmarks.
- Requirements for the benchmark oversight function.
- Requirements for the benchmark input data.
- Governance and control requirements for supervised benchmark contributors.
- Authorisation and registration of an administrator.
- Transparency requirements regarding the benchmark methodology.

The ESMA is collecting stakeholders' comments until the **31st of March 2016**. An open hearing on this subject will be held on the **29th of February 2016** in Paris.

The full ESMA Discussion Paper can be accessed here.

EC Extends Application Date of MiFID II Package

On the 10th of February 2016, the European Commission proposed a one year extension to the entry into application of the revised Markets in Financial Instruments Directive, or MiFID II. Therefore, the new introduction date is the 3rd of January 2018. This is due to technical implementation challenges faced by regulators and market participants.

Speaking on the extension, Lord Hill, Commissioner for Financial Services, Financial Stability and Capital Markets Union said: *"Given the complexity of the technical challenges highlighted by ESMA, it makes sense to extend the deadline for MiFID II. We will therefore give people another year to prepare properly and make the necessary changes to their systems. Meanwhile, we are pressing ahead with the level II legislation to implement MiFID II and expect to announce those measures shortly."*

This extension will not have an impact on the timeline for adoption of the "level II" implementing measures under MiFID II/MiFIR. The European Commission will proceed with their adoption irrespective of the new date of entry into application of MiFID II.

A period of 30 months between the adoption and the entry of application of MiFID II had already been foreseen to take account of the very high level of complexity of the package. The extension of the deadline is strictly limited to what is necessary to allow the technical implementation work to be finalised.

Further details on the European Commission's extension can be found here.

EMF-ECBC Position Paper on the Treatment of Covered Bonds in the SRF

On the 22nd of February 2016, the EMF-ECBC published its Position Paper on the Treatment of Covered Bonds in the Single Resolution Fund (SRF) Scheme.

The EMF-ECBC believes that there is a strong case to make for the improvement of the treatment of covered bonds in the annual Single Resolution Fund (SRF) contribution scheme given the fact that covered bonds foster financial stability and support critical functions of the issuing institutions. Covered bonds are characterised by significant financial strength, security and a low risk profile and, as a result, the EMF-ECBC believes that a 50% discount rate should be applied to all outstanding covered bonds in the calculation of financial institutions' annual contributions to the resolution financing arrangements. The EMF-ECBC Position Paper goes on to set out a number of arguments in support of this proposal.

The full EMF-ECBC Position Paper is available here.

EBA Launches the 2016 EU-Wide Stress Test

On the 24th of February 2016, the European Banking Authority (EBA) launched the 2016 EU-Wide stress test of European banks, which is designed to provide supervisors, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of EU banks to economic shocks.

For this exercise, no single capital thresholds have been defined as the results will inform the 2016 round of Supervisory Review and Evaluation Processes (SREP) under which decisions are made on appropriate capital resources. The EBA expects to publish the results of the exercise in early Q3 2016.

Further details concerning the features, methodology and the adverse scenario assumed for the 2016 stress test can be accessed here.

New Zealand Joins the ECBC Covered Bond Comparative Database

On the 25th of February 2016, New Zealand was added as a new country in the ECBC Covered Bond Comparative Database. With the aim of increasing convergence in the different covered bond models, the ECBC believes that providing information on the legislative and regulatory details of covered bond jurisdictions at a global level is essential in facilitating investors' due diligence. The ECBC Covered Bond Comparative Database now provides legislative information on 35 different countries and allows for the comparison of national legal details among the various covered bond frameworks.

Launched in 2009 in cooperation with national experts, covered bond specialists and issuers, the ECBC Covered Bond Comparative Database is a market-led initiative which has the aim to facilitate the comparison of existing covered bond frameworks around the world. The publicly available online platform has unique tools allowing stakeholders to:

- Compare key features of covered bond jurisdictions globally;
- Access links to issuers' cover pool information;
- Access national covered bond legislation (in English);
- Raise a question to a covered bond expert; and
- Access detailed national overviews from the ECBC Fact Book and mortgage market overviews from the EMF Hypostat, where relevant.

Announcing New Zealand's inclusion, EMF-ECBC Secretary General Luca Bertalot said: *"The ECBC Covered Bond Comparative Database, being directly linked to the Covered Bond Label website, provides a central hub of legislative information on the different covered bond frameworks at a global level, thus facilitating the exchange of market best practices. The addition of New Zealand as a new country profile makes the Comparative Database even more comprehensive and increases its added value for the covered bond community."*

The ECBC Covered Bond Comparative Database is available here and the Covered Bond Label website is available here.

European Commission Public Hearing on the Green Paper on Retail Financial Services

In the context of a broader consultation with stakeholders, the European Commission is holding a public hearing on retail financial services in Brussels on the 2nd of March 2016. The hearing will bring together participants and speakers from the financial industry, consumers and users associations, national public authorities and EU institutions to discuss in depth the issues that have been raised in the consultation on the Green Paper on Retail Financial Services, which was launched in December 2015 and runs until the 18th of March 2016.

The hearing will be divided into four sessions covering different aspects of consumer finance discussed in the Green Paper:

- How can consumers access the best deals in the EU?
- What about pan-European retail financial products?
- How can we make the most of the opportunities presented by innovation?
- Trusting products from other Member States.

During the event the Commission is hoping to not only receive stakeholders' feedback on the problems presented in the Green Paper, but to hear their views and suggestions about possible medium- and long-term solutions to these.

Further information on the Public Hearing and how to register to attend can be found here.

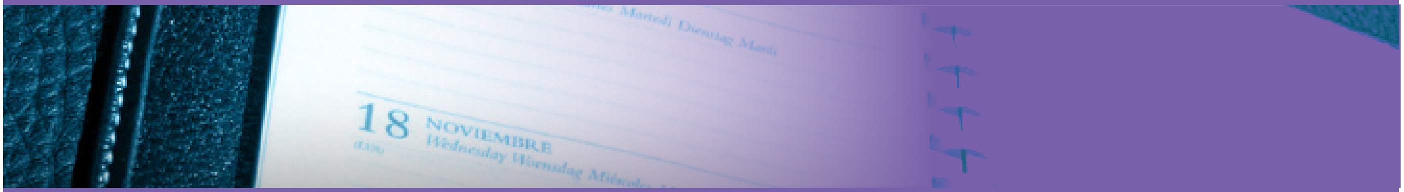
3rd ECBC Asian Covered Bond Investor Roundtable

On the 9th of March 2016, the ECBC will welcome over 50 key stakeholders in Asian covered bonds to Singapore for the 3rd edition of the ECBC Asian Covered Bond Investor Roundtable. To recap, this event aims at:

- Educating potential new categories of investors and national authorities on the subject of covered bonds.
- Providing detailed expert information on the different existing covered bond jurisdictions/issuers.
- Highlighting the key qualitative features characterising the European covered bond market.
- Facilitating the convergence of upcoming legislative developments in Asia towards the traditional key qualitative characteristics of covered bonds (i.e. the Covered Bond Label), which can then facilitate the recognition of the macro prudential value of covered bonds within the Basel Committee on Banking Supervision framework.

As such, the event will attract mainly investors, but also potential new covered bond issuers and national authorities currently working on drafting covered bond legislation. During the events participants will be able to discuss the current major developments in the covered bond space such as resolution regimes, liquidity, asset encumbrance, covered bond supervision/market best practices and the evolution of the Covered Bond Label – especially the implementation of the Harmonised Transparency Template (HTT).

The full Agenda for the Roundtable can be accessed here. The Roundtable, which is co-organised with Euromoney Conferences, will be preceded by a Welcome Dinner on the evening of the 8th of March, which is kindly supported by:



AGENDA

MARCH 2016

29/02-02/03	IMN ABS Event – Las Vegas
01/03	European Mortgage Federation (EMF) Legal Affairs Committee Meeting – Brussels
02/03	European Commission Public Hearing on the Green Paper on Retail Financial Services – Brussels
03/03	LBBW European Covered Bond Forum (10^{th} Anniversary Event) – Mainz
07/03	European Covered Bond Council (ECBC) Global Issues Working Group Meeting – Singapore
08/03	3^{rd} Euromoney/European Covered Bond Council (ECBC) Asian Covered Bond Forum – Singapore
09/03	3^{rd} European Covered Bond Council (ECBC) Asian Covered Bond Investor Roundtable – Singapore
10/03	European Consumer Day Conference, Brussels
14/03	9^{th} Annual IMN Global Covered Bond Conference – London
22/03	European Parliament Financial Services Forum (EPFSF) Event on Impact of Regulatory Reforms on Market Liquidity – Brussels

APRIL 2016

06-08/04	7^{th} Annual Affordable Housing Projects Conference – Kuala Lumpur
07/04	City & Financial European Capital Markets Union Summit – London
07/04	11^{th} TXS Pfanbriefforum – Hamburg
13/04	European Covered Bond Council (ECBC) Steering Committee Meeting – Copenhagen
13/04	Covered Bond Label Foundation Covered Bond Label Committee Meeting – Copenhagen
14/04	European Covered Bond Council (ECBC) Plenary Meeting – Copenhagen
15/04	European Mortgage Federation (EMF) Statistics Committee Meeting – Copenhagen
19/04	European Parliament Financial Services Forum (EPFSF) Event on Innovations in the European Financial Sector and Digitalisation of Financial Services – Brussels
20-22/04	EUROFI High Level Seminar 2016 – Amsterdam
29/04	First Single Resolution Board (SRB) Conference – Brussels