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European Covered Bond Council

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The Negative Rate Challenge: Match Funding and a Currency Peg

By Martin Kjeldsen-Kragh, Manager - Regulatory and Economic Affairs, Danish Mortgage Banks Federation



A currency peg like Denmark's used to be standard in Europe. Nowadays it's a special case. So is the match funded mortgage system. Both meant that Denmark had some issues to deal with when interest rates became negative.

Negative interest rates are a challenge across Europe. Financial institutions are struggling with profitability and investors are struggling to obtain satisfactory returns.

In an effort to boost sluggish economies, policy rates have been set below zero and have remained there, in the absence of a self-sustaining recovery.

Denmark shares this fate with much of the euro zone. But it does not share the currency and the mortgage model. This means we have at least two unique challenges.

ECB AT THE ORIGIN

The policies of the European Central Bank (ECB) have sent rates below zero, especially at the short end of the curve. Also, many EUR-denominated covered bonds now have negative yields, despite the credit risk.

Other central banks, e.g. in Sweden, also have negative policy rates. Either they agree with the ECB

that such a policy is needed or they feel they have little choice but to follow suit. Maintaining higher rates would lead to capital inflows and, possibly, currency appreciation.

In Denmark the answer to this policy dilemma has been the same since 1982, in the form of a currency peg, first in the Exchange Rate Mechanism (ERM) and then to the euro under the ERM-II, in both cases with a variation margin of 2.25%. In practice, the (Danish) Central Bank keeps variations well below 0.5%.

In the 1980's this was a much needed stabilisation device, following a period of instability in the 1970's.

Today, it still has the role of making monetary policy predictable, but it also works as a political signal of commitment to the European currency union.

Traditionally, the important policy challenge has been to make sure that there was always enough foreign currency to maintain the peg when faced with speculation. Raising interest rates was the tool at hand.

CHALLENGE UPSIDE DOWN

In February 2015, the challenge turned out to be the opposite. In the aftermath of the Swiss currency shock, markets were speculating that Denmark would make a similar policy move.

The Central Bank was adamant that the parity would not be changed. If the markets want more of our currency, they can have it. We have got plenty of it, they declared. An obvious point, but it did not immediately convince everyone. After all, the Swiss abandoned their peg voluntarily.

There may have been speculation that if rates went too far into negative territory, the situation would become too awkward or perhaps damaging to the financial system or the economy in general.

Despite a policy rate of -0.75% to discourage speculators, the effect was a very large capital inflow, depressing money market rates further than in the euro area.

Mortgage bonds traded at yields of -0.2% to -0.3% for 2-3 year maturities.

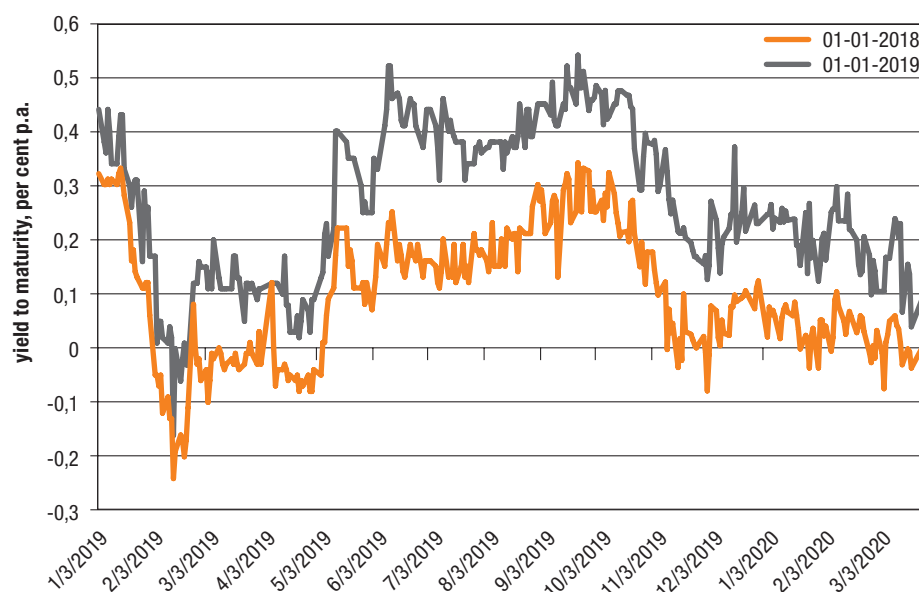
Gradually the speculative onslaught lost force and market conditions became comparable to those of the euro area, although the lowest policy rate – the deposit rate – remains at -0.65%.

NOT PROVIDED FOR ANYWHERE

Over the years the notion of negative interest rates, if considered at all, was not regarded as a real possibility. Negative interest rates would be of interest only to academically inclined economists who also dismissed them as impossible, arguing that cash is always a zero yield alternative.

Both financial contracts and legislation lacked provisions pertaining to that situation. The tax code, for example, defined “interest” as a payment made by a borrower to a lender and no explicit provisions existed for taxation or deductibility if the direction of the payment were reversed. This situation was swiftly remedied by making amendments and insertions in the appropriate legislation. That did not include any legislation on the mortgage industry or the bond market.

Figure 1 ► Yields for two mortgage bond maturities



The prospectuses for floating rate mortgage bonds lacked provisions on what to do if the reference rate, and thus the coupon, became negative. Would it be legal to deduct the negative payments from future positive payments?

MATCH FUNDING

Furthermore, the Danish match funded mortgage system added an extra challenge. For each bond with a negative coupon, there would be a loan with terms matching those of the issued bond. A claim for negative interest payments from bond holders would – if applied consistently – translate into an obligation to pay negative interest rates to borrowers. And if the issuer decided that the negative rate should not apply to bond holders, would they be entitled to withhold the corresponding payments to borrowers?

The challenge was not the negative rate as such, but a negative coupon. Three-quarters of all mortgage bonds have fixed positive or zero coupons. Yields become negative when the bonds are purchased at prices above par, and this situation is handled quite easily. Negative coupons on floating rate mortgage bonds – the last quarter of the market – were a separate challenge.

Most issuers concluded that the entitlements of borrowers would not be violated if their interest payment were simply set at zero. In the absence of any reference to a negative rate, borrowers would not be legally entitled to such payments.

However, for new floating rate loans granted after the situation had arisen and for the corresponding bonds, the problem had to be addressed explicitly.

Most issuers opted for a model in which interest could become negative and in which the necessary deductions in simultaneous or subsequent positive payments would be made. This applies to both investors and borrowers, maintaining consistent match funding.

One issuer decided to keep a floor at zero based on indications of investor preferences. This makes for a less complicated and investor friendly instrument, and reduced requirements for new technical solutions. A disadvantage to some investors and borrowers may be that the payment profile no longer dovetails with a standard swap contract, which has no similar floor on the variable rate.

IT WAS MANAGEABLE

Although policy rates remain low, it seems that markets are no longer expecting a “Swiss exit.” The DKK money market was only seriously affected by such speculation in February 2015. What remains is the challenge of negative rates, as seen in most other European countries. The system has coped well, even with the awkward negative coupons. Mortgages based on floating rate bonds are becoming increasingly popular and the negative coupon issue has not deterred investors.

Key Takeaways of the 23rd ECBC Plenary Meeting

By Luca Bertalot, Secretary General, EMF-ECBC



On the 14th of April, over 230 covered bond experts convened in Copenhagen for the 23rd ECBC Plenary Meeting. It was a pleasure to welcome representatives from the Danish Financial Supervisory Authority, the Single Resolution Board, the European Central Bank (ECB), key issuers, investors, government and regulatory officials, rating agencies, journalists and other covered bond stakeholders to the event.

Denmark, a country of long-standing covered bond traditions, was a natural host location for the Industry's key discussion forum. On behalf of the ECBC's Chairman, **Waleed El-Amir**, we would like to express our thanks to the **Association of Danish Mortgage Banks** and the **Danish Mortgage Banks' Federation** for their kind hospitality and support in hosting the event, and many thanks also to all the speakers and guests for their active participation in the panel discussions and debates.

NEGATIVE INTEREST RATES, NEW CAPITAL REQUIREMENTS AND ECB MEASURES

The day started with an introduction to the Danish mortgage financing system by **Jesper Berg** from the Danish Supervisory Authority, and the first panel discussion addressed recent developments in the Danish mortgage and covered bond markets. Current challenges include negative rates and the potential for increased capital requirements for lenders as a result of Basel IV, and the conclusion of the Danish mortgage industry representatives was that decision makers should shift focus from increasing regulation to supporting growth and jobs.

The second panel – Covered Bonds: Where are we now & what lies ahead? – gave a larger overview on primary and secondary covered bond markets in Europe. The European Central Bank's measures and purchase programmes were a main point of discussion, but negative rates and covered bond consents were also debated by the experts on the panel.

MARKET-LED INITIATIVES: HTT AND ESN

Anne Caris, Bank of America Merrill Lynch and Chairwoman of the ECBC Transparency Task Force, gave a synopsis on the state of play of the Harmonised Transparency Template (HTT). This market-led initiative has been welcomed by issuer and investor communities, and is seen as the right step forward by regulators and the Industry in general, as it is a tool to enhance transparency in the market.



The next discussion focussed on covered bond harmonisation and the results of the European Commission's consultation on the topic. The clear message on being cautious in terms of harmonisation and on the need to defend the asset class' quality

has been well received by the European Commission, which addressed the Industry's concerns during its February 2016 conference; however, it remains to be seen what next steps will be undertaken by the regulators in the coming months.

The EU's Capital Markets Union (CMU) initiative formed the topic of the day's fourth panel. To support funding for the real economy, the ECBC is exploring a new funding tool, European Secured Notes (ESN), which would facilitate financing for small and medium sized enterprises (SMEs) and infrastructure projects. In Italy, a funding tool of this kind is already emerging, as the first legislative steps have been taken to allow the use of legally backed SME covered bonds as a new type of funding product.

One of the keynote speakers of the Plenary included **Timo Löytyniemi**, Vice Chair of the Single Resolution Board (SRB), who gave the audience an introduction to the mission and activities of the SRB.

GLOBAL ISSUES AND GREEN FINANCING INCREASINGLY IMPORTANT

The ECBC launched its new Global Issues Working Group in March 2016 due to increased interest from stakeholders outside of Europe, including Singapore, Brazil, South Korea and Canada. The Chairman of the Working Group, **Colin Chen** from the Association of Banks in Singapore (ABS), provided an overview of Singapore's growing covered bond market. **Felipe**

Pontual from the Brazilian Association of Real Estate Loans and Savings Companies (ABECIP) outlined recent developments in Brazil, where covered bonds are also increasingly gaining interest from the investor community.

The day's closing panel discussed energy efficient mortgages and covered bonds. "Green financing" is receiving increasing attention and green covered bonds are attracting a lot of new investors. **Jennifer Johnson** from the EMF-ECBC introduced the EMF-ECBC private financing initiative to support the energy efficient renovation of homes with an "energy efficient" mortgage. Energy efficient houses can contribute to meeting the EU's climate and energy goals. They also offer benefits to consumers, by protecting their properties against a "brown discount", and the banking industry due to lower loss given default (LGD), lower probability of default and, as a result, potentially lower capital charges. Banks can play a game-changing role in providing long-term financing for energy improvements to the current European housing stock. They intervene at the most critical moment, when citizens purchase a property, and mortgages help individuals and

families to access home ownership, thereby allowing them to secure a key part of their social expectations. The banking industry has a key role to play in improving the quality and energy performance of housing so as to free-up disposable income and, in parallel, reduce credit risk for borrowers, lenders and investors. A pan-European initiative in this area will help to coordinate market interventions, which will reduce the public resources necessary to boost households' energy savings.

Presentations and video highlights from the 23rd Plenary Meeting will be made available via the ECBC website ([here](#)).

We would already like to invite members to save the date for the next, **24th ECBC Plenary Meeting**, which will take place on the **14th of September 2016 in Düsseldorf** and will kindly be supported by **DZ Bank**. We would also like to welcome you to the 2016 edition of the **[Euromoney/ECBC Covered Bond Congress](#)**, which will take place on the **15th of September 2016 at the Swissôtel Düsseldorf**. More information on these events will be made available soon.



Pfandbrief Act – Pfandbrief Banks Propose Maturity Extension

By Otmar Stöcker, Managing Director, Association of German Pfandbrief Banks (vdp)



At the end of October 2015 the vdp submitted to the Federal Ministry of Finance its thoughts on integrating the possibility of maturity extension into the Pfandbrief Act. The following provides an account of the ideas behind and the content of that proposal.

Given that, since the insolvency of Lehmann Brothers in September 2008, the default even of a large international bank can no longer be ruled out, investors, analysts and rating agencies repeatedly ask very in-depth questions about what would happen to a covered bond if insolvency proceedings were initiated against the issuer. Before then, the usual questions were only about whether, from that point in time, a cover pool would be available and how strong it would be. Since then, the focus lays more and more on the consequences should the cover pool prove to be insufficient.

SEPARATE INSOLVENCY PROCEEDINGS IN RESPECT OF THE COVER POOL

The Pfandbrief Act has long held a clear answer in § 30, para. 6, sentence 2: if the cover pool is over-indebted or illiquid, in addition to the insolvency proceedings against the Pfandbrief bank, separate insolvency proceedings must be initiated in respect of the cover pool or – to be more precise – of the “Pfandbrief bank with limited business activity” (*Pfandbriefbank mit beschränkter Geschäftstätigkeit*), as the Pfandbrief Act has called it since 2010.

But how, theoretically speaking, could such a case of lacking liquidity come about? The Pfandbrief Act provides the cover pool administrator (*Sachwalter*) – who is to be appointed when insolvency proceedings are initiated against a Pfandbrief bank in addition to the insolvency administrator (*Insolvenzverwalter*) – with a host of options to procure the liquidity needed to warrant timely payment of the Pfandbriefe. These include, for example, the 180-day liquidity buffer, the possibility to raise collateralised loans with credit institutions and the central bank, and the issuance of short-dated Pfandbriefe to bridge liquidity shortages, as well as the sale of individual cover assets or even of portfolios, or of transferring the entire cover pool including the Pfandbriefe to another Pfandbrief bank or a bridge institution. The success of the particular option chosen by the cover pool administrator would depend on the individual circumstances: besides

the cover assets and the Pfandbriefe, notably also on the state of the capital and banking markets. If the cover pool administrator faced a shock situation similar to that following the opening of insolvency proceedings against Lehmann Brothers and were in need of liquidity, he might find a situation in which other market participants either cannot or will not grant a collateralised loan or buy cover assets. With such a worst-case scenario in mind, the vdp has thought long and hard about whether the secondary insolvency proceedings as provided for to date should be the only way to handle that problem: because it is possible that this paralysis would only last for a few weeks or months – as indeed it happened after the Lehmann insolvency.

OTHER COUNTRIES

For situations such as those, many covered bond issuers in other countries have long since switched to issuing covered bonds with what are called soft bullet structures. Yet the range is so varied that it is difficult to say exactly what constitutes a soft bullet. Usually, however, it is a quasi-automatic maturity extension that depends on a pre-defined trigger event or occurrence such as the failure to meet a minimum requirement contained in the terms and conditions of the issue. So far, only Poland has anchored details of what constitutes a soft bullet in law.

Often, the reason for this is and has been rating agencies' requirements on overcollateralisation and the liquidity buffer. Such requirements sometimes clash with the objective of supervisory authorities, namely the reduction of the asset encumbrance ratio. Ultimately, then, the introduction of soft bullet structures is often driven by ratings – the wish to achieve the same rating with less overcollateralisation, or to achieve a higher rating with the same overcollateralisation.

THE VDP'S POSITION

However, the vdp's thoughts on the matter are neither driven by rating considerations nor does the vdp want to see overcollateralisation or the liquidity buffer reduced. Instead, the objective is that the cover pool administrator should not be forced, in extreme market situations, by short-term liquidity gaps to initiate special insolvency proceedings in respect of the cover pool through the Federal Financial Supervisory Authority (BaFin) if there is a reasonable prospect of closing the liquidity gap

again soon. For this reason, the vdp calls it “maturity extension” rather than “soft bullet.”

After a long and thorough internal debate, at the end of October 2015 the Association sent a proposal to the Federal Ministry of Finance in support of introducing a rule enabling the cover pool administrator to defer the servicing of maturing Pfandbriefe by not more than 12 months in each case.

This legislative amendment should also be applied to Pfandbriefe that are currently outstanding, as this is the only way to ensure the desired protection for a Pfandbrief bank with limited business activity. Moreover, this would prevent a split of the Pfandbrief market into old and new bonds. A legal opinion commissioned by the Association confirms that such a change to the Pfandbrief Act would be constitutional.

DESIGN OF A MATURITY EXTENSION

In addition to this fundamental stance, a number of important details would have to be observed:

- The extension is to serve only as an option for the cover pool administrator and by no means as a measure that would come into play automatically.
- It is to apply as a legal provision for all Pfandbriefe of all German Pfandbrief banks: for old and new Pfandbriefe alike.
- The extension may not exceed one year. Earlier payment should remain possible if liquidity is available to avoid having to reinvest at low interest rates.
- Only payment of the principal may be deferred, as the non-servicing of interest would probably be regarded by rating agencies as default.
- If applied at all, a maturity extension should be availed of as a last resort and ultimately constitutes just one further possibility for the cover pool administrator to address temporary liquidity shortages. For this reason, the maturity extension option must not be taken into account when calculating cover.
- The 180-day liquidity buffer would be maintained for principal and interest.

- The cover pool administrator's decision to extend the maturity of a maturing Pfandbrief could change the order of the maturities. However, today a cover pool administrator already has the possibility to issue new Pfandbriefe in order to bridge short-term liquidity shortages. Moreover, he could buy back a small-volume registered Pfandbrief that is scheduled to mature later, while servicing a large-volume benchmark bond at the agreed maturity date. Such measures, too, would lead to a change in the order of the maturities. But the cover pool administrator should also have the option of deferring several maturing Pfandbriefe to a single new servicing date to avoid reversing the order of the maturities. The crucial point is that the cover pool administrator can carry out the extension only if he is convinced that all Pfandbriefe can be serviced fully and – apart from this limited deferability – punctually.
- The interest terms would need to be set forth in the Pfandbrief Act to save investors from having to study the individual issue prospectuses. Against this background the vdp advocates switching to a floating interest rate for the duration of the extension. This provision could be worded, for example, as follows: *"In the period following the originally agreed maturity, the interest rate shall be 0.5 percentage points above a reference rate that is customarily used by the banking sector for payment periods of one month in the respective currency."* Whether or not the term "reference rate" should be concretised or defined, or an alternative wording chosen, would be a matter for discussion.
- A maturity extension is to be considered as a last resort for the cover pool administrator, enabling him to prevent the opening of separate insolvency proceedings with the effect of accelerating all Pfandbrief liabilities. For this reason, there should

be no automatic maturity extension. Instead, a maturity extension should come about only if the cover pool administrator so decides. The objective is to ensure that the cover pool administrator has the flexibility needed both to remain capable of acting and to have liquidity at his disposal in a temporary stress situation.

In their first public comments, the rating agencies Fitch and Moody's both draw positive conclusions from the suggestions made by the vdp. Fitch stated in a press-circular that if the law were amended accordingly, the Pfandbrief *"would be stronger than standard provisions used in the covered bonds market"*. Moody's comment in its Credit Outlook newsletter is positive too: *"A maturity extension would reduce the risk of payment default from a lack of liquidity or operational issues directly after an issuer default and would be credit positive for German Pfandbriefe."*



The World Bank Group will hold its **7th Global Housing Finance Conference in Washington, DC on 25-26 May 2016**. Jointly hosted biannually by the World Bank and the International Finance Corporation (IFC), the underlying theme of the conference is based around the new Sustainable Development Goals (SDGs), which replace the Millennium Development Goals. Goal 11 focuses on sustainable cities and communities, and the conference, through robust panel discussions, will explore new and innovative ideas on how to ensure access for all to adequate, safe and affordable housing and basic services.

As in previous years, the conference attracts an audience of officials, practitioners, NGOs and donors from the developed countries and emerging markets. The principal aim of the Conference is to exchange views and experiences and derive the key operational conclusions for policy makers and housing finance practitioners. The conference creates awareness of the major challenges in developing or strengthening housing finance markets and seeks cooperation for better solutions.

To download a preliminary programme and register for the event, please [click here](#).



NEWS IN BRIEF

Second BCBS Report on Risk-Weighted Assets in Banks

On the 1st of April 2016, the Basel Committee on Banking Supervision (BCBS) published a second report on risk-weighted assets (RWAs) in banks using internal ratings-based models to calculate credit risk capital requirements, as part of its Regulatory Consistency Assessment Programme (RCAP) to ensure full and effective implementation of the Basel III framework.

The study examines the variability of RWA in banks that use internal models to calculate their credit risk regulatory capital requirements. It follows the Committee's [2013 report](#), which found considerable variation in average RWAs for credit risk in the banking book, and extends that analysis in two respects:

- Data were collected from 35 major internationally active banks on their retail and small and medium-sized enterprise (SME) lending portfolios. When averaging across banks in the sample, the report finds a reasonable relationship between estimates of probabilities of default and actual default rates. A weaker relationship is observed between loss outcomes and other parameters estimated by credit risk models (such as loss-given-default). At an individual bank level, there is much greater variation between parameters estimated using credit risk models and actual outcomes. As retail business is predominantly local, these variations are partly explained by differences in local circumstances.
- The report also evaluates the variability in estimates of exposure at default for all asset classes, using data from 37 banks. These reveal wide variation in bank practices, which can contribute materially to overall RWA variability. It was also found that some of the estimates used in internal credit risk models lack empirical support. Further, some data relating to one asset class are being used to support estimates for unrelated asset classes.

The report also describes sound practices relating to banks' independent model validation functions, as observed during the Committee's engagement with banks in the course of this study. These practices apply to the governance, methodology and scope of banks' validation functions, as well as to the role of validation across different phases of model development and implementation.

The BCBS Report can be accessed [here](#).

BCBS Consultation on Revisions to Basel III Leverage Ratio Framework & FAQs

On the 6th of April 2016 the Basel Committee on Banking Supervision (BCBS) published a consultative document on Revisions to the Basel III leverage ratio framework, together with a series of responses to a set of frequently asked questions (FAQs) on the same subject.

To recap, the Basel III framework introduced a simple, transparent, non-risk-based leverage ratio to act as a supplementary measure to the risk-based capital ratio. This consultative document proposes a set of changes to the standard released in January 2014. The proposed changes to the framework are an important element of the regulatory reform programme that the Basel Committee has committed to finalise by the end of 2016.

The proposals in the consultative document have been informed by the parallel run period since 2013, by feedback from market participants and stakeholders, and by the frequently asked questions process since the release of the standard in 2014.

The proposed revisions cover the following issues:

- To measure derivative exposures, the Committee is proposing to use a modified version of the standardised approach for measuring counterparty credit risk exposures (SA-CCR) instead of the Current Exposure Method (CEM).
- To ensure consistency across accounting standards, two options are proposed for the treatment of regular-way purchases and sales of financial assets.
- Clarification of the treatment of provisions and prudential valuation adjustments for less liquid positions, so as to avoid double-counting.
- Alignment of the credit conversion factors for off-balance sheet items with those proposed for the standardised approach to credit risk under the risk-based framework.
- An additional leverage ratio requirement applicable to global systemically important banks.

The final design and calibration of the proposals will be informed by a forthcoming comprehensive quantitative impact study.

On the 25th of April the BCBS issued a revised copy of its consultative document, which is available [here](#). The consultation runs until the 6th of July 2016. The related FAQ document can be accessed [here](#).



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BIS Study on the Effect of Bank Capital on the Supply of Mortgages

On the 1st of April 2016 the Bank for International Settlements' (BIS) published a study on the effect of bank capital on the supply of mortgages, authored by two economists from the Bank of Italy.

The quantitative study fully controls for endogenous matching between borrowers, loan contracts, and banks by submitting randomised mortgage applications to the major online mortgage broker in Italy.

The main findings of the Study are:

- A higher bank capital is associated with a higher likelihood of application acceptance and lower offered interest rates.
- Banks with lower capital reject applications by riskier borrowers and offer lower rates to safer ones.
- Non-parametric estimates of the probability of acceptance and of the offered rate show that the effect of bank capital is stronger when capital is low.

The full BIS Study can be accessed [here](#).

BCBS Consultation on Prudential Treatment of Problem Assets - Definitions of Non-Performing Exposures and Forbearance

On the 14th of April 2016 the Basel Committee on Banking Supervision (BCBS) published a consultative paper on the prudential treatment of problem assets - definitions of non-performing exposures and forbearance.

Currently, banks categorise problem loans in a variety of ways and there are no consistent international standards for categorising problem loans. The definitions proposed by the Basel Committee aim to foster harmonisation in the measurement and application of two important measures of asset quality and, thereby, promote consistency in supervisory reporting and disclosures by banks:

- The definition of **non-performing exposures** introduces criteria for categorising loans and debt securities that are centred on delinquency status (90 days past due) or the unlikelihood of repayment. It also clarifies the consideration of collateral in categorising assets as non-performing. The definition also introduces rules regarding the upgrading of an exposure from "non-performing" to "performing" as well as for the interaction between non-performing status and forbearance.
- **Forbearance** refers to concessions, such as a modification or refinancing of loans and debt securities, that are granted as a result of a counterparty's financial difficulty. The proposed definition sets out criteria for when a forbore exposure can cease being identified as such and emphasises the need to ensure a borrower's soundness before the discontinuation.

The proposed definitions complement the existing accounting and regulatory framework in relation to asset categorisation. They are intended to be used, for example, in the supervisory monitoring of a bank's asset quality as well as by banks in their credit risk management and as part of their internal credit categorisation systems.

The BCBS consultation, which runs until the 15th July 2016, can be accessed [here](#).

Fitch Ratings Exposure Draft: Counterparty Criteria for Structured Finance and Covered Bonds

On the 14th of April 2016 Fitch Ratings published its "**Exposure Draft: Counterparty Criteria for Structured Finance and Covered Bonds**". This report describes the credit rating agency's approach to counterparty risk in structured finance transactions rated on a long-term basis and covered bond programmes.

The overall analytical framework remains unchanged and the proposals at hand are largely related to the introduction of the so-called "derivative counterparty ratings" by Fitch Ratings' Financial Institution Group. Moreover, the report touches upon considerations related to counterparty eligibility, collateral posting by derivative providers and likelihood of operational disruption upon banks' distress. The report also describes certain covered bond-specific aspects such as covered bond programmes' reliance on issuers and direct/indirect support counterparties.

Market participants and interested parties have the opportunity to provide Fitch Ratings with any comments they may have on this subject by the 16th of May 2016.

The full Fitch Ratings document is available [here](#).

European Commission's First Status Report on the Capital Markets Union & European Financial Stability and Integration Review

On the 25th of April 2016 the European Commission published a staff working document entitled "**Capital Markets Union (CMU): First Status Report**", which outlines the steps taken since the adoption of the CMU Action Plan in September 2015 and indicates a number of key initiatives planned by the end of 2016.

In terms of preparation of other CMU actions in 2017-2018, the Commission mentions its recent consultation on covered bonds (page 8 of the Report) and indicates that the feedback received in this context encourages the exploration of the potential for greater market integration based on high-level principles, respecting national specificities and building on frameworks that are currently working well.

The Commission's CMU First Status Report can be accessed [here](#).

In parallel, the Commission also presented a new edition of the **European Financial Stability and Integration Review (EFSIR)**, which this year focusses on the CMU and identifies some promising developments in the European capital markets. The EFSIR builds on the economic analysis that had supported the publication of the CMU Action Plan and can be found [here](#).

BCBS Issues Standards for Interest Rate Risk in the Banking Book

On the 21st of April 2016 the Basel Committee on Banking Supervision (BCBS) issued standards for Interest Rate Risk in the Banking Book (IRRBB). These standards revise the Committee's 2004 *Principles for the management and supervision of interest rate risk* (available [here](#)), which set out supervisory expectations for banks' identification, measurement, monitoring and control of IRRBB, as well as its supervision.

The key enhancements to the 2004 Principles include:

- **More extensive guidance on the expectations for a bank's IRRBB management process** in areas such as the development of shock and stress scenarios, as well as key behavioural and modelling assumptions to be considered by banks in their measurement of IRRBB.
- **Enhanced disclosure requirements** to promote greater consistency, transparency and comparability in the measurement and management of IRRBB. This includes quantitative disclosure requirements based on common interest rate shock scenarios.
- **An updated standardised framework**, which supervisors could mandate their banks to follow or banks could choose to adopt.
- **A stricter threshold for identifying outlier banks** that has been reduced from 20% of a bank's total capital to 15% of a bank's Tier 1 capital. In addition, interest rate risk exposure is measured by the *maximum* change in the economic value of equity under the prescribed interest rate shock scenarios.

The IRRBB standards reflect changes in market and supervisory practices since the Principles were first published in 2004, which is particularly pertinent in light of the current exceptionally low interest rates in many jurisdictions. The revised standards, which were published for consultation in June 2015 (available [here](#)), are expected to be implemented by 2018.

The full BCBS standards can be accessed [here](#).

EU Mortgage Industry Representative Appointed to EBA Banking Stakeholder Group

On the 15th of April 2016, following an open selection process, the Board of Supervisors of the European Banking Authority (EBA) appointed 23 new members to its Banking Stakeholder Group (BSG), as the mandate for the majority of the previous members expired on 14 April 2016.

In accordance with the EBA Founding Regulation, the BSG is composed of 30 members; of them, 23 members have been newly appointed for a period of two and a half years, while the remaining seven will continue their mandate. The EMF is delighted to report that **Mr Søren Holm**, Group Managing Director and member of the Group Executive Board of Nykredit Realkredit (Denmark), and a member of the EMF Executive Committee, is amongst the newly appointed members of the BSG.

The full list of members of the current BSG is accessible [here](#) and the Group's first meeting in its new composition took place on the 18th of April 2016.

EBA Consultation on Draft RTS on the Disclosure of Encumbered and Unencumbered Assets Under the CRR

On the 25th of April 2016 the European Banking Authority (EBA) published a Consultation Paper on draft Regulatory Technical Standards (RTS) on the disclosure of encumbered and unencumbered assets under Article 443 of the Capital Requirements Regulation. These draft RTS, which build on the EBA Guidelines on the same topic, detail the disclosure requirements and provide additional information.

Essentially, disclosure on asset encumbrance based on consistent definition and formats increases market discipline of institutions, and allows the provision of transparent and harmonised information on the topic across EU Member States so as to enable market participants to compare the institutions in a clear and consistent manner. In view of this, the draft RTS are addressed to institutions and provide three disclosure templates to be completed and published, along with line-by-line instructions for completing them. Institutions will have to disclose information in accordance with these disclosure templates and provide additional information on the importance of encumbrance in their individual funding model.

Further details on the EBA consultation, which runs until the 25th of July 2016, can be accessed [here](#). In addition, the EBA will host a Public Hearing on this subject at its premises in London on the 1st of June 2016 (registrations details available [here](#)).

EMF Publishes Full Quarterly Review for Q4 2015

Further to the publication of the headline figures and findings in last month's edition of *Market Insights & Updates*, the EMF has now published the full Quarterly Review of European Mortgage Markets for the last quarter (Q4) of 2015, which includes the full set of data tables.

To recap, produced in cooperation with the Federation's national experts, the Quarterly Review presents the latest short-term developments in mortgage and housing markets across the EU. The publication provides expert analytical commentary together with data tables and charts on the following key indicators:

- Mortgage interest rates
- Total residential lending outstanding
- Gross and net residential mortgage lending
- Nominal house price indices

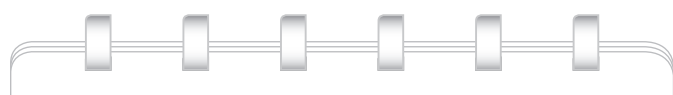
In commenting on the findings for Q4 2015, EMF-ECBC Secretary General Luca Bertalot said:

"2015 ended positively with an improving economic environment, leading to an overall recovery of gross lending figures. House prices show a general increase throughout the continent and especially in the major cities, but with slightly different nuances in the different countries. Finally, historically low interest rates reflect the expansionary monetary policies of the European Central Bank (ECB) and other central banks."

The full Quarterly Review – Q4 2015 and the archive of previous editions (back to Q3 1998) are available via the EMF website [here](#).



AGENDA



MAY 2016

- 10/05** Euromoney Central and Eastern European Covered Bond Forum – London

- 11/05** European Covered Bond Council (ECBC) Task Force on Long-Term Financing Meeting – Milan

- 12-13/05** Italian Banking Association Funding & Capital Markets Forum – Milan

- 13-14/05** TEGoVA Conference on European Valuation Standards in an Ever-Closer Union – Brussels

- 17/05** European Commission Public Hearing on the Call for Evidence on the EU Regulatory Framework for Financial Services – Brussels

- 19/05** Third Energy Efficiency Financial Institution Group (EEFIG) Meeting – Brussels

- 20/05** Italian Banking Association Seminar on Residential Credit – Rome

- 20/05** Brunel University Conference on Consumer Over-Indebtedness – London

- 24/05** European Parliament Financial Services Forum (EPFSF) Event on Forthcoming Action Plan on Retail Financial Services and Insurance – Brussels

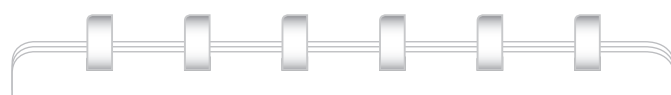
- 24/05** International Finance Corporation (IFC) Workshop on Minimum Quality Standards in Mortgage Lending – Washington, DC

- 25/05** World Bank Group's 7th Global Housing Finance Conference – Washington, DC

- 27/05** European Mortgage Federation (EMF) Valuation Committee Meeting – Cluj

- 31/05** Build Upon Financial Workshop – Zagreb

- 31/05** European Banking Authority (EBA) & European Investment Bank (EIB) Seminar on Synthetic Securitisation & Financial Guarantees – London



JUNE 2016

- 01/06** European Banking Authority (EBA) Public Hearing on Draft RTS on Disclosure of Asset Encumbrance – London

- 01/06** Norddeutsche Landesbank Annual Capital Markets Conference – Hannover

- 02/06** European Covered Bond Council (ECBC) Steering Committee Meeting – Venice

- 03/06** European Mortgage Federation (EMF) Executive Committee Meeting – Venice

- 08/06** European Mortgage Federation – European Covered Bond Council (EMF-ECBC) Annual Meeting with the European Central Bank (ECB) – Frankfurt

- 09/06** International Capital Market Association (ICMA) & The Covered Bond Report Covered Bond Investor Conference 2016 – Frankfurt

- 09/06** European Commission's Brussels Economic Forum – Brussels

- 14-16/06** IMN & Association for Financial Markets in Europe (AFME) 20th Global ABS Conference – Barcelona

- 21/06** European Parliament Financial Services Forum (EPFSF) Event on Follow-Up to the Action Plan on Capital Markets Union (CMU) – Brussels

- 21-22/06** Italian Banking Association Conference on Banking Union & Basel III: Risk & Supervision 2016 – Rome



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