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## EMF Quarterly Review – Q4 2016

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### INTRODUCTION

After the British decision to leave the EU, the election of Mr Trump as the 45<sup>th</sup> President of the United States marked the icing on the cake of an unpredictable 2016. Nevertheless, the housing and mortgage market in the (for the time being) EU28 shows a remarkable resilience, fostered by an ongoing expansive monetary policy, together with a macro-economic upswing and a general widespread improvement of the economic conditions. In 2016, for the first time since 2007, all EU Member States depicted a positive GDP growth. Moreover,

notwithstanding the growth of the construction industry in several countries, the well-known excessive demand for housing, especially in the most thriving regions of the European continent, pushed up house prices.

### MORTGAGE LENDING

Gross mortgage lending in aggregated terms for our EU sample<sup>1</sup> continued to grow for the fourth quarter in a row, nearly reaching the peak of Q2 2015 and increased by 1.6% y-o-y reaching around EUR 280 bn. The strong performance can be explained by a

widespread improved economic environment with decreasing unemployment, rising GDP growth, improved consumer confidence and low interest rates. Some countries, to prevent an overheating market, have also introduced macro-prudential measures. The outstanding figures show that the decrease started in Q4 2015, bottomed out in Q3 2016 and registered a timid increase of 0.8% over the last quarter of 2016. The evolution with respect to the same period of the previous year shows a 1.5% contraction. National peculiarities together with both market and non-market factors show different pictures across the continent.

<sup>1</sup> In Q4 2016 the sample for the Quarterly Review included BE, CZ, DE, DK, ES, FI, FR, HU, IE, IT, NL, PL, PT, RO, SE and UK. (i.e. around 95% of the total outstanding mortgage lending in the EU28 in 2015).

The Iberic peninsula resembles the same pattern of increasing gross lending while decreasing outstanding loans. In **Spain** gross residential lending increased by 21.4% over the last quarter, of which 10.7% was due to re-mortgaging. Also, the aggregate lending of 2016 compared to that of 2015 showed a healthy increase of 5% and it can be considered the best figure since 2010. The growth in gross lending was not enough to compensate amortisations and cancellations of loans, which decreased by more than 3% with respect to Q4 2015, but due to the positive gross figures the turning point is expected to arrive soon. Equally, in **Portugal** the increased real estate demand both by international investors and households showed a nearly 30% increase y-o-y in terms of gross lending. Nevertheless, in Q4 2016 outstanding residential loans continued their downward path observed since Q1 2011 with a 3% y-o-y decrease.

In **France** as well as in **Italy** the housing market showed a positive trend throughout 2016, with gross lending increasing by 9.1% and 1.0% y-o-y respectively. In France, in line with the momentum of the credit market, sales of existing homes grew by 6% reaching 848,000 units for 2016. New houses also had a particularly active year with 125,000 developer-built and 133,600 privately built units, which show an increase of around 20% with respect to 2015. In Italy growing confidence, coupled with favourable housing prices, resulted in a strong increase of 21.3% in terms of new mortgages according to a study elaborated by CRIF.

Moving north to **Belgium**, in Q4 2016 new mortgages increased by 5% y-o-y, 6.5% if refinancing loans are also considered. Looking only at new mortgages, except for Q4 2014, when a specific government measure concerning taxes was in place, the most recent quarter has reached an all-time high with almost 67,000 mortgage credit contracts amounting to around EUR 8.3 bn. More than 93% of new loans have been stipulated with an initial fixed interest rate period of 10 or more years, while only 0.3% of new loans have an initial fixed period of one year. Overdue contracts, apart from the upturn during the recession, have stabilised around the long-term trend of 1.1% of outstanding mortgage loans. In the **Netherlands**, gross lending continued to increase in the last quarter of the year by nearly 24% y-o-y, thus closing a 2016 with an overall strong increase. Structural reforms in 2017 are going to be launched to decrease maximum possible LTV from 102% to 101%.

In **Ireland** and the **UK** mortgage and housing markets showed overall a positive trend in 2016. In Ireland in Q4 2016 the volume of mortgages drawdown rose by 14.0% y-o-y, while the value of drawdowns grew by 26.1%. Accounting for the overall 2016 drawdown volumes and values grew by 9.7% and 16.2% respectively. In the UK mortgage

lending showed a 12% increase in 2016 with respect to 2015. This rate masks the somewhat bumpy ride parts of the housing and mortgage market have been on in 2016. Mortgage lending was distorted in the first half of 2016, as a tax change on second homes led to a big jump in activity before March, offset by weak activity in the months thereafter. This made it difficult to say what the impact of the EU referendum in June 2016 had on the market. The fact is that during the summer there was a dip, likely to have been caused by the sharp weakening of consumer sentiment and increased uncertainty immediately after the referendum. Part of this dissipated soon after, as some of the political uncertainty was resolved, and the Bank of England announced a significant monetary stimulus package in August, to support the domestic economy. This led to a recovery in approval numbers, and an increase in mortgage lending, in the last quarter of the year. On re-mortgage activity, momentum has built up slowly over the past two years, as competition amongst lenders has helped push mortgage rates to historic lows. This is encouraging more and more people to refinance and switch to better deals. As a result, the mix of lending has moved towards re-mortgage activity, away from house purchase activity.

In **Denmark** the number of homes sold in Q4 2016 was slightly higher than in Q4 2015. In general the number of transactions experienced a steep increase in the previous years and had a more stable evolution in 2016. Gross residential mortgage lending decreased by DKK 4.8 bn over the last quarter, but it increased by DKK 24.7 bn over the same quarter last year. Over the last year floating interest rate mortgages having nearly halved their presence over the first nine months of the year from 22% to 11.2% gained again momentum over the last three months and stood at 18.1% at year end to the detriment of long-term fixed loans in particular. Outstanding figures of Q4 2016 show a 2.5% y-o-y increase. In **Sweden** net mortgage lending is still comparably high, but it seems to have peaked and is slowly sinking to 7.2%, compared to 7.8% in the previous quarter and to 8.1% in Q4 2015. The increases in household indebtedness and house prices are currently hot topics and amortisation rules have been introduced to take the heat out of the market. These measures seem to have shown some effect at the end of the year, when house prices increased at a slower pace, but the well-known undersupply compared to demand continues to provide tension in the market. Likewise, in **Finland** mortgage lending accelerated due to the improved economic conditions and the Finnish Supervisory Authority imposed LTV caps starting from July 2016, namely first time buyers must put up at least 5% from their own funds, while for the others it is at least 10%. For the time being this measure has not shown significant effects. Re-mortgaging has also become a popular instrument due to a campaign

by banks in which 'payment-holidays' were offered to borrowers.

Moving to **Poland** nearly 42,000 residential loans were granted in Q4 2016 showing a small decrease of 1.7% with respect to the previous quarter. The easing of credit conditions and the forthcoming entry into force of the new provisions of Recommendation S, which requires an increase in the owner's own contribution to up to 20%, lead to rising levels of gross lending. In the **Czech Republic** both the volume and the average loan amount of new mortgages increased by 18.6% and 9.2% respectively. Here too changes in the law were put in place to curb the market. In October 2016, a new rule was introduced to decrease the maximum allowed LTV from 100% to 95% and by the end of the year new legislative changes entered into force regarding stricter conditions for providing mortgage and consumer loans. The impact has still to be assessed but in November 2016 the historically highest level of new mortgages was reached. In **Romania**, while credit standards were kept unchanged, according to the BLS of the Romanian Central Bank the mortgage market was on an upward trajectory and continued to grow at 3% q-o-q as in the preceding quarter. NPLs decreased by 1 pp to 4.5% compared to Q3 2016.

## HOUSE PRICES

In line with recent quarters the general trend throughout the EU shows rising house prices because of the imbalance between available space and dwellings, especially in the economically most active areas, and the rising demand pushed by the improved well-being of households and of very favourable financing conditions. In aggregate terms, with the data at hand<sup>2</sup>, the median growth rate q-o-q shows a deceleration to nearly 0.7% from 1.9% in Q4 2016, which is around half of the figure of the same period in 2015.

Starting in Central and Eastern Europe, house prices in the **Czech Republic** increased at a double-digit pace. As an example, the price of a two-bedroom room flat increased by 14% over the year. Moreover, it is not uncommon to spot accommodations in the top market segments also outside of the most important cities of Prague or Brno. This dynamic is principally due to the lack of new dwellings, which decreased by 57% in 2016, principally because of tight legal requirements, which may balloon the length of the implementation of residential projects. Therefore, supply will continue to remain low. Moving to **Hungary** a new upwards trend in construction can be spotted. In fact, the number of building permits granted in 2016 nearly tripled compared to the previous year, reaching almost 32,000. In parallel, housing completions doubled in Q4 2016 with respect to Q3 2016 and more growth is expected in 2017. However, this dynamic is mostly concentrated in the most important centres, while

<sup>2</sup> House Price index data on Q4 2016 is available for 10 out of 16 countries of the sample.

in smaller villages construction contracted. The house price evolution showed that in Q3 2016 (the latest available data) prices rose by 3.2% q-o-q after 8% in Q1 2016 and 1.3% in Q2 2016. Since the beginning of the market's recovery in April 2014, house prices increased by roughly 50%. In **Romania**, although no official data for Q4 2016 is yet available, credit institutions are reported to have witnessed a substantial price increase with respect to the previous quarter. As a countertendency to the other Central and Eastern European jurisdictions, in **Poland** prices remained stable in Q4 2016, especially in the secondary market, while in the primary market some minor increases were noticed. The construction sector was subdued with 14.5% less housing starts and 16% less permits obtained. These numbers need to be read as a complement to the rising supply of unsold homes in the six largest markets in the country, showing that developers' investment decision follow the cyclical demands of the market.

Moving West to **Germany** prices continued their upward trajectory with a tense situation, especially in the centres where living space is scarce. Despite the rise in construction activity, demand still exceeds supply. Rental and owner-occupied housing saw increased prices by 3.5% and 6.6% y-o-y respectively. These trends are explained both by the necessity of finding accommodation and for investment opportunities in the current low-yield environment. Contrary to its southern neighbour, in **Denmark** house prices dropped marginally in the last quarter of 2016 by 1.4% for single family houses and by 0.8% for owner-occupied apartments. On a yearly basis, they increased by 3.8% and 8.1% respectively. This trend can be explained, among others, by the drop in long-term interest rates, as currently a 30-year mortgage rate is around 3%, which is an historic low. In **Sweden** one-family homes increased by 6.1% over the last year. What may seem a large increase is, for the Swedish standards of the past years, quite modest as in 2015 prices increased by 12%. Similarly, apartment prices slowed down, reaching 'only' 7.2% in 2016 compared to 18.1% in 2015. Construction figures continued to increase in 2016 and the National Board of Housing expects that construction figures in 2017/18 will top the current record level reached in 1990. However, Swedish building permits and standards are quite strict and as construction workforces become more and more scarce, and notwithstanding the current pace, few expect to close the housing gap soon.

In the **UK** house price growth has continued to be strong despite the Brexit inspired uncertainty, and has persistently grown faster than earnings. In **Ireland** residential property prices increased by 6.4% y-o-y with Dublin increasing by 1.9% and the rest of the country by 10.1%. According to the Banking & Payments Federation Ireland (BPF), the principal reason is the lack of available housing, especially that suitable for a family. Building activity has increased in recent years with completions up

17.9% y-o-y and building starts up by 66.3%. But here too, notwithstanding the important construction increase, building levels do not reach the annual estimated demand of 25,000 units.

Crossing the Channel, in **Belgium** the latest estimation shows that nationwide house prices grew by 2.1% y-o-y, with 2.3% in Flanders and 3.8% in Wallonia. However, in Brussels house prices contracted by 0.6%. Apartments depicted a steeper price increase, with a 5.2% national average, 6.5% in Flanders, 5.9% in Wallonia and 2.9% in Brussels. Also in the **Netherlands** house prices are increasing. In **France** the growing trend in house prices has continued since Q2 2015. On average the y-o-y growth in Q4 2016 was 1.8% for the whole country, with individual and collective housing in the regions around Paris growing by 3.5% and 2.6% respectively, while in the other regions they grew in aggregate terms by 0.6% and 1.6% respectively. New home prices grew by 4.4% for collective housings and by 2.1% for the individual ones. This positive trend is ascribed principally to the first-time buying incentives as well as to tax measures for lenders. Moving across the Pyrenes to **Spain**, house prices continued their upward trend since 2014 which contributes to the consolidation and recovery of a battered market and reached the highest value seen since Q1 2013. In Q4 2016 house prices grew by 1.5% y-o-y and now the average square meter cost is a little more than EUR 1,500. Real estate in general is growing due to international funds looking for profitable investments. In **Italy** for the first time since Q1 2011 the house price index shows a positive, albeit marginal, 0.1% increase with respect to the previous quarter, with new houses remaining stable and existing dwellings increasing by 0.1%. Though on a yearly basis houses prices continued to lose nearly 1% the larger loss was ascribed to new houses with 2.1%, while existing ones lost 0.6%.

## INTEREST RATES

Notwithstanding the increased political stability risk, EU mortgage interest rates continue to generally move down or have stabilised around all-time lows. In the analysed sample the aggregate representative interest rate reached 2.4%, decreasing by 0.22 pps with respect to the end of 2015. In this environment, several countries noticed how longer fixed-terms on mortgages are becoming more and more popular to lock into the current favourable conditions.

In **Ireland** in Q4 2016 nearly 40% of the value of new mortgage loan agreements, including renegotiations, was on those with an initial fixation period of more than one year, while the long run average reached only 20%. Mortgage rates on outstanding loans are also heavily influenced by the ECB base rate because about 48% of mortgages outstanding were on tracker rates, which average 1.03% for private dwelling home mortgages and 1.06% for buy-to-let. In **Denmark** all mortgage

types with varying fixation agreements experienced a drop in their interest rate. Interest rates on variable loans with a fixation period of up to one year decreased by 0.1 pp while the 30-year fixed rate loans decreased by 0.14 pps. In **Sweden** the situation was stable during the last quarter of 2016, with variable and medium-term fixed interest rates standing at around 1.6%, while the longer-term fixed rates of above five years increased slightly to 2.4%. In **Poland** rates remained virtually unchanged, but the increase of inflation may push the Central Bank to increase the interest rates in 2017. In **Romania** the representative interest rate continued to decrease slightly to 3.52%. In **Italy** interest rates on long-term fixed rates remained around 2.16% while the interest rates on the more variable agreements decreased to 1.70% from 1.74% in Q3 2016.

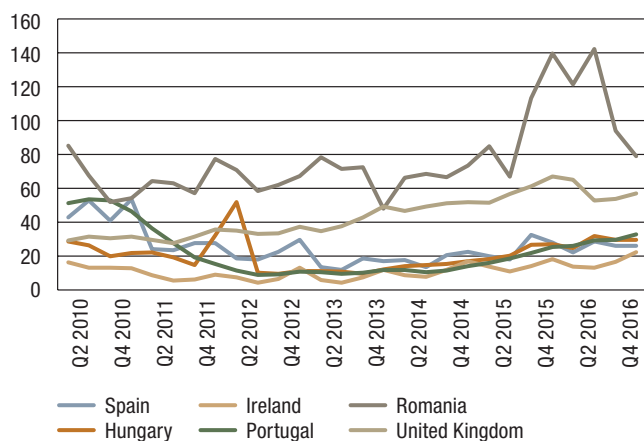
In the **Czech Republic**, **France**, **Hungary**, the **Netherlands** and **Spain** interest rates at the end of Q4 2016 all reached historical lows. In the Czech Republic interest rates reached 1.77% at year end. This trend is expected to bottom out and eventually to reverse in 2017 due to legislative changes affecting loans to clients, as a consequence of which banks already started to increase rates during the first months of 2017. In France the quarterly average rate fell to 1.32% from 1.69 in the previous quarter. In Hungary most mortgage loans have a variable interest rate coupled to the three-month Budapest interbank rate, which continues its downwards path reaching little more than 4% at the end of 2016. Spain saw, for the first time, its average interest rate drop below 2% in Q4 2016. Moreover, following the EURIBOR variable rate loans also continued their decreasing trend registering 1.62% in Q4 2016. Agreements with longer initial fixed periods showed decreases in interest rate, standing at 2.19% in Q4 2016, a 0.49 pps decrease with respect to the same period last year. The security and attractiveness of long-term fixed loans was also seen in the exponential growth of this type of agreement reaching 30.5% of market share over new loans in Q4 2016, compared to 6.9% of just one year ago. This evolution came at the detriment of the variable rate agreements, which lost their absolute majority of 62.4% in Q4 2015 and stood at 42.2% in Q4 2016. The share of medium fixed-term mortgage agreements roughly remained unchanged. In **Finland** interest rates follow the EURIBOR path, which is currently at an historical low.

On the contrary, in **Portugal**, for the first time since Q2 2014 the variable rates for new loans registered a small increase to 1.77%. The interest rate on new loans has two components, namely an external index and a spread. The former is given by the EURIBOR and the latter considers the riskiness of the client and is based on the LTV ratio. The persistent low rate of the EURIBOR has been at historical lows for a long period of time and it contributed to an increase in gross lending and to reduced household debt.

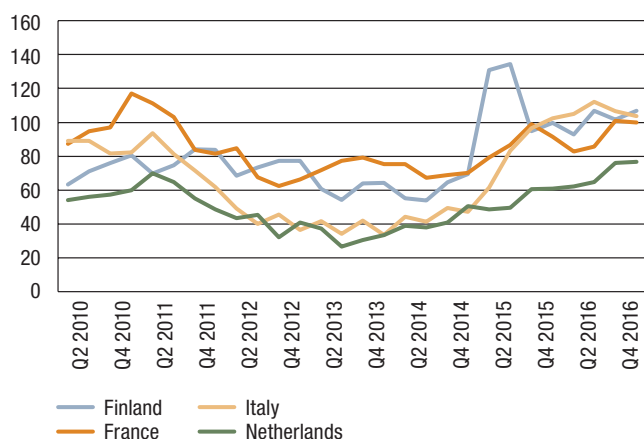


**Chart 1 ► Gross Residential Lending (2007=100; in euro; seasonally adjusted data)**

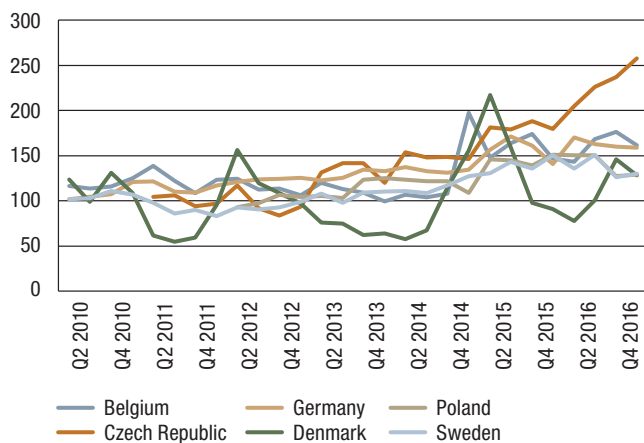
a) Countries where gross residential lending has remained below 80% of 2007 levels



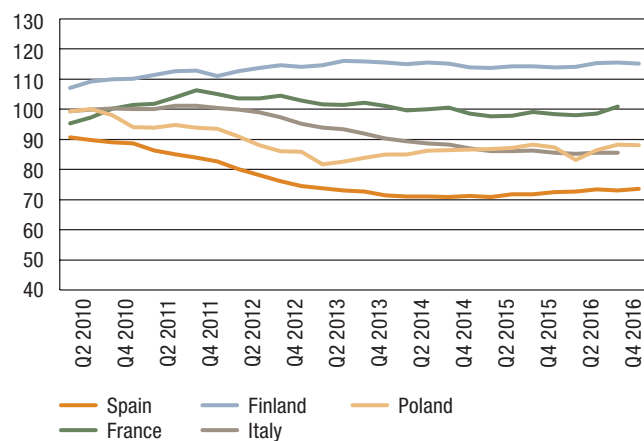
b) Countries where gross residential lending has remained between 80% and 120% of 2007 levels



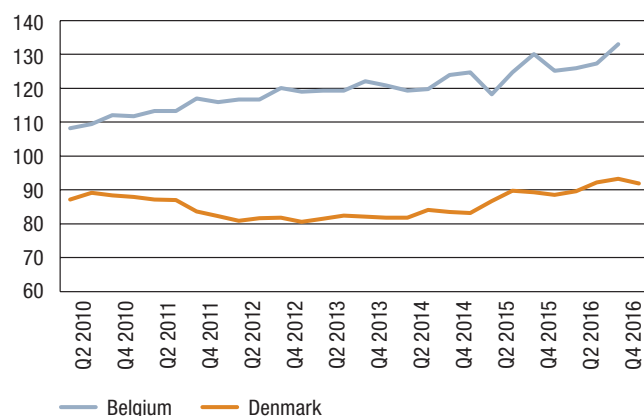
c) Countries where gross residential lending has risen above 120% of 2007 levels

**Chart 2 ► Nominal House Price Indices, 2007=100**

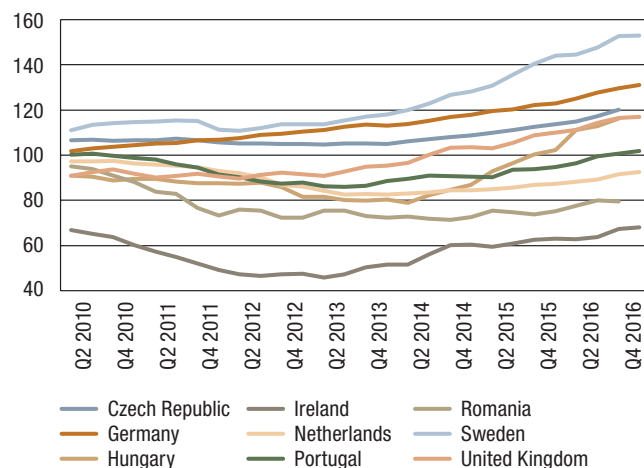
a) Countries where house prices have increased at most 2% y-o-y



b) Countries where house prices have increased between 2% and 5% y-o-y



c) Countries where house prices have risen by at least 5% y-o-y



# An Anatomy of a Successful Covered Bond Jurisdiction

By Agustin Martin and Aaron Baker, BBVA & Colin YS Chen, DBS Bank and Chairman of the ECBC Global Issues Working Group

Covered bonds, since their inception in 1769 in Prussia, have grown to become a significant bank wholesale funding instrument across Europe, praised for their stability and limited credit risk (to date, there has been no actual default of a covered bond programme); in fact, banks in certain jurisdictions such as Denmark fund their entire mortgage lending activities via covered bond issuances.

There are 17 European countries which have market quoted covered bonds outstanding with the largest markets being Germany, France, Spain and the Nordics. That said there are a multitude of other European countries which have seen no meaningful issuance despite the existence of covered bond legislation (28 countries in the EEA have a covered bond legislation) permitting their issuance including Bulgaria, Hungary and Lithuania.

Since 2013, covered bonds have become an increasingly global debt product, with a steadily declining proportion of Europe-based issuers, with Canadian and Australian issuers notably ramping up their issuances; in fact, YtD (April 2016), Canadian issuers have issued the most covered bonds (EUR 17 bn equivalent) per issuer nationality. Furthermore, we have seen recent additions to the

**Figure 1 ► Covered bond issuances outstanding by region of issuer (EUR bn)**

Developed Western Europe	1,567
Emerging Western Europe	1.7
Developed Non-Western Europe	207
Emerging Non-Western Europe	0.5

Source: Bloomberg, BBVA GMR

covered bond family with South Korea, Singapore and most recently Turkish issuers all engaging in the covered bond market, whereas revamps of covered bond frameworks to make them more internationally desirable have made rapid advances in emerging Europe, for example in Romania and Poland.

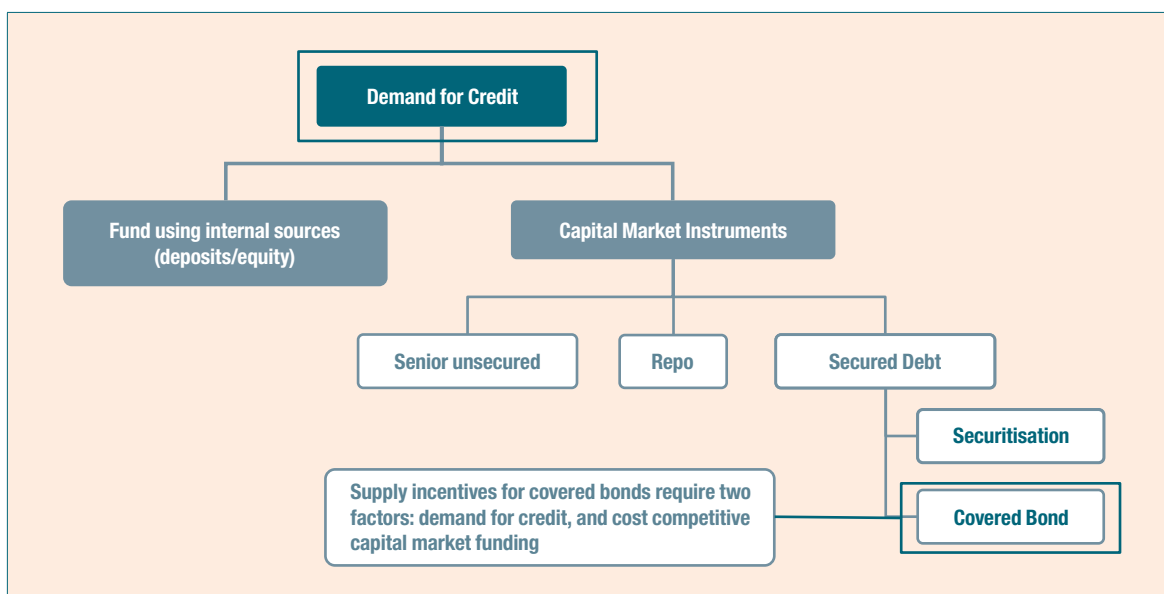
In this article, we attempt to answer the question of what are the necessary pre-conditions for the incorporation of a meaningful covered bond bank funding channel for issuers. We focus on Turkey and Brazil, given our expectation that these jurisdictions could see the development of substantial covered bond markets in the medium term.

In our view, covered bond legislation is a necessary but not a sufficient condition for the successful introduction of the covered bond product, albeit

with the notable exception of the UK covered bond market before legislation was enacted in 2008. There have even been examples within developed covered bond markets where legislation has opened a door that no bank has actually needed to open such as the Spanish export-guarantee loan covered bonds (Cedulas Internacionalizacion) whose legislation received royal assent in 2013, which has never reached a publically issued format, which supports our argument.

Shifting our gaze to Latin America, there are a multitude of covered bond legislations with various levels of robustness, when compared to European equivalents, including legislations present in Colombia, Uruguay, Peru, Paraguay, Panama and Chile with only arguably the latter having limited, locally distributed covered bond issuance with certain

**Figure 2 ► Funding demand for credit (simplified, loans omitted)**



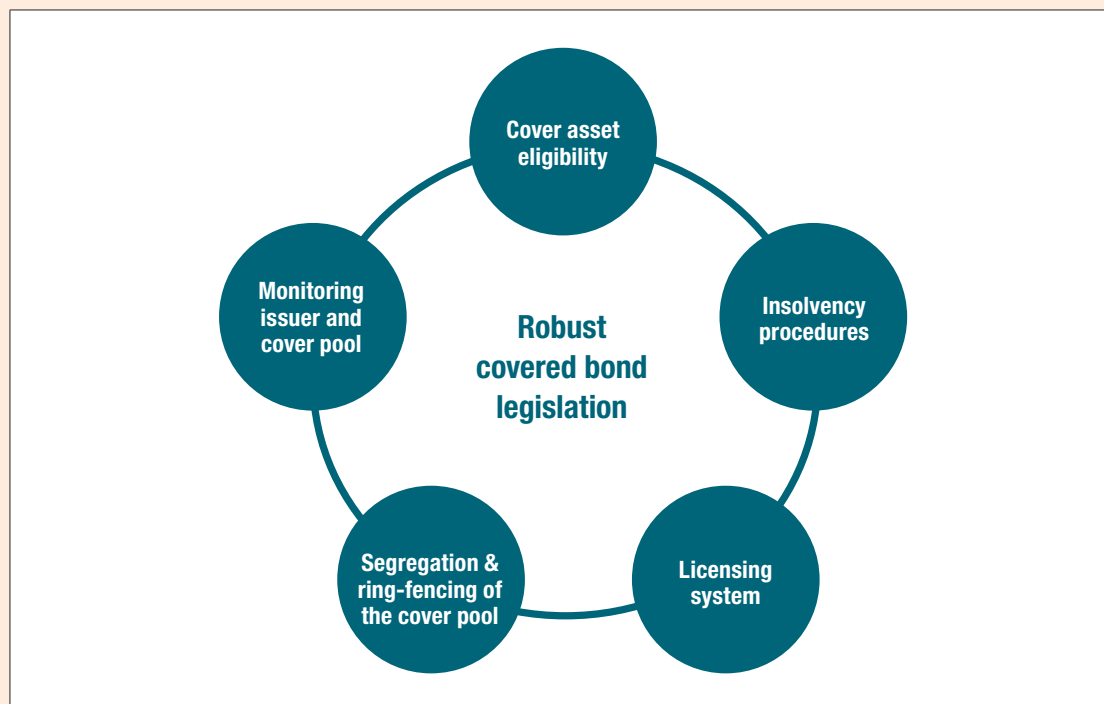
Source: BBVA GMR

## ANATOMY OF COVERED BOND LEGISLATION

A traditional feature of all major covered bond markets is that they tend to be structurally supported by dedicated legislation which carves out covered bonds from general insolvency proceedings, and segregates the secured assets ('cover pool') should an issuer default. This legal protection, in contrast to other forms of secured funding such as securitisation, is a crucial characteristic for covered bond investors.

Covered bond legislation basically falls into two parts, a) primary legislation, and b) secondary legislation. Primary legislation tends to carve out covered bond security and enable ring-fencing over the cover assets from general insolvency and/or bank resolution regimes. Secondary legislation refers to rules relating to the operation of covered bond programmes and supervisory responsibilities; this can include eligible assets, stress-testing, cover pool management and monitoring requirements.

**Figure 3 ► Essential elements of a robust covered bond legislation**



Source: BBVA GMR

features which make the product less compelling for international investors. We would posit that there are four key factors which explain the success of a jurisdiction in issuing covered bonds, with each factor explained in more detail in Appendix 1.1.

Moving to the specific cases of Turkey and Brazil, the former has had primary and secondary legislation in place since 2007, albeit updated in 2014 to enable the technical use of residential covered bonds for international investors, whereas the latter passed primary legislation in 2015 (still awaiting secondary legislation and regulatory requirements as at the time of writing). Turkey has already seen the first issuance by Vakifbank sold into Europe with much fanfare (over 4x subscribed, making it the largest book order in EUR covered bonds YtD), which closed on 26 April 2016; such robust demand indicates that the monetary conditions and yield compression in the European fixed-income markets can have beneficial spill-over effects for developing covered bond markets.

**Figure 4 ► Key factors that are condition precedents for successful covered bond market**

Key Factor	Explanation
<b>Macro-conditions</b>	Essentially the factors which predicate demand for residential housing, the principal collateral backing covered bonds including GDP, unemployment, inflation and credit demand.
<b>Market infrastructure</b>	Security enforceability for the underlying collateral, including foreclosure processes and real estate information in order to accurately gauge collateral value.
<b>Financial markets</b>	The degree to which the financing is in demand by end-users (to purchase properties), the degree to which funding is needed outside the deposit-based system and the degree to which financial, in particular bond, markets are developed alongside alternative debt products
<b>Legal and regulatory provisions</b>	Confidence in the legal and regulatory supervision as well as its comparability to established covered bond jurisdictions. In order to internationalise the market, issues relating to withholding taxes for foreign investors are also crucial.

Source: BBVA GMR

Mindful of this, we take a look at some of the key factors which we list in Appendix 1.1 which help to explain the initial green shoots of a covered bond market in Turkey versus the promised Brazilian covered bond programmes.

## BRAZILIAN COVERED BONDS: WAITING FOR THE SAMBA TO START

Brazilian covered bonds, by definition backed by residential mortgage assets, require not only demand for residential credit within the banking system, but also the exhaustion of more typical emerging market banking funding sources like deposits. Demand for residential mortgages is highly correlated with GDP growth, which in turn drives demand for credit within the economy for investment, residential or otherwise.

The ability of Brazilian banks to advance longer-term credit, crucial for products like residential mortgages, is helped by the relative stability of inflation numbers with inflation figures being in a range of 3-7% between 2006 and 2015, although more recently, this figure has surged to 9.4% as a result of wider macro-economic instability.

Demand for housing is underpinned not just by population growth (+11% between 2006 and 2013), but also more importantly, the emergence of a larger middle class i.e. the 'aspiring class' which tends to seek residential ownership thereby providing a structural underpinning to the housing market in Brazil.

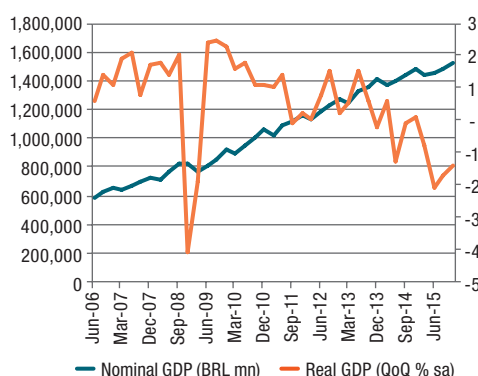
The main sources for financing residential housing demand is via the Savings and Loans Banking System (SBPE) and the Employee Retirement Fund (FGTS), which together account for over 90% of the financing of the Brazilian real estate market. According to the Central Bank of Brazil, 65% of savings accounts are funnelled through to real estate credit as a matter of regulatory preference whereas the FGTS are utilised for low-income housing.

The Brazilian banking system's capacity to sustain the growth in demand for housing credit is showing increasing signs of strain, with earlier estimations by the Brazilian Association of Real Estate Loans and Savings Companies (ABECIP) indicating that the savings account funding method could be exhausted in the next few years.

Naturally, the reliance on such short-term liabilities to fund longer-term assets poses a financial stability question with Brazilian regulators looking to alternative funding products which can be used to 'term-out' the funding for residential mortgages; covered bonds are an obvious bank funding product for such purpose.

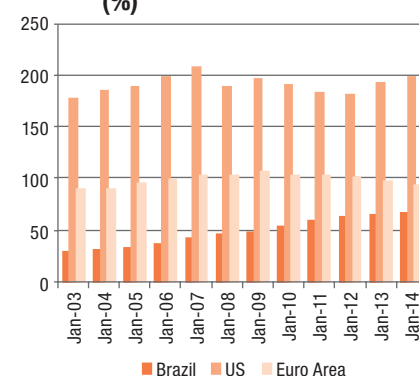
Before looking at a place where a covered bond market could fit into the banking system, it is important to note that by and large, covered bonds are funding instruments of private banks. This is because while they offer defined pricing advantages over senior

**Figure 5 ► Nominal and GDP growth rates**



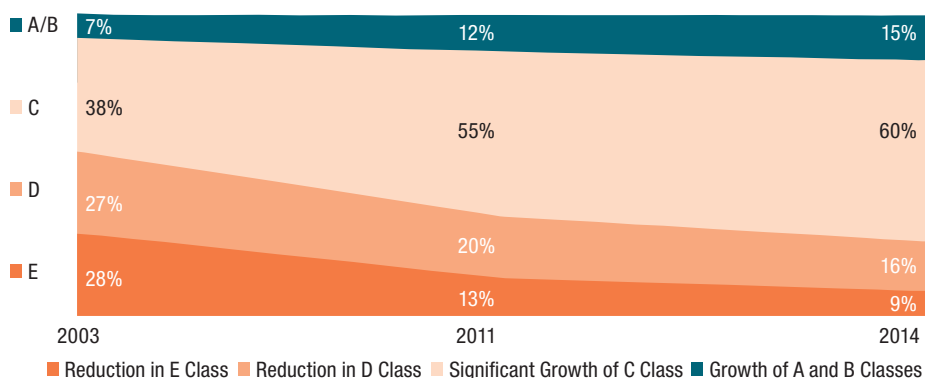
Source: Bloomberg, BBVA GMR

**Figure 6 ► Domestic private credit to GDP (%)**



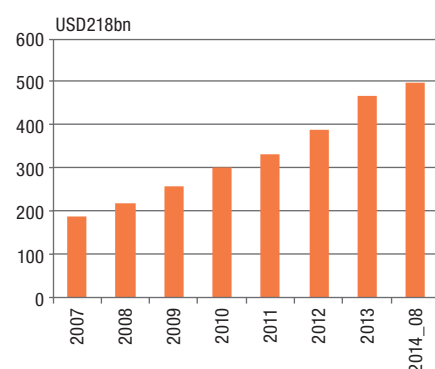
Source: World Bank

**Figure 7 ► Brazilian socio-economic classes (% of total)**



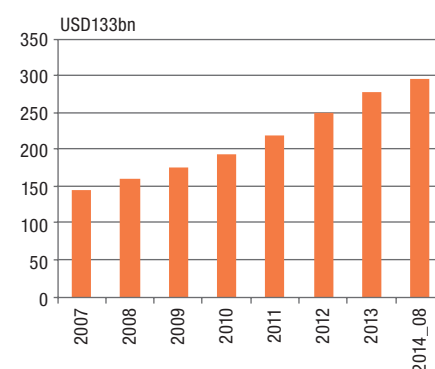
Source: FGV, BBVA GMR

**Figure 8 ► SBPE (BRL bn)**



Source: BCB and Federal Savings Bank (CEF)

**Figure 9 ► FGTS (BRL bn)**

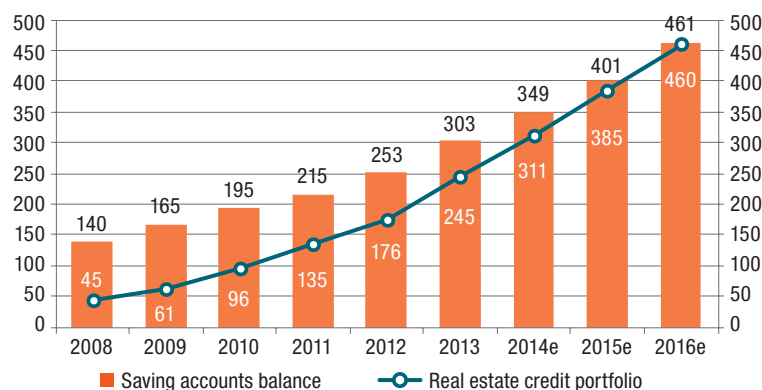


Source: BCB and Federal Savings Bank (CEF)

unsecured issuances, their price advantage over sovereign and/or sovereign-related enterprises has only really been seen in peripheral Europe, in a market where there is arguably the over-arching authority of the EU to protect the systemic importance of the covered bond product. In Brazil, c.45% of the banking assets are in the hands of state banks, which while not necessarily unusual for

emerging economies, does limit the potential size of any embryonic covered bond market.

Finally, it is important to note that wholesale real estate debt financing products are not non-existent in Brazil, and there are several competing alternative wholesale financing products to covered bonds. In Brazil there are:

**Figure 10 ► Brazilian saving account balances still largely fund the banks' real estate credit provision**

Source: ABECIP

- **Real Estate Investment Funds (FII):** these are a type of mortgage REIT which enables the investment into real estate leases, property development and other real estate-related financing activities.
- **Certificate of Real Estate Credit Receivables (CRI):** these are effectively securitisations backed by real estate loans and purchased by institutional investors.
- **Real Estate Letters of Credit (LCI):** these are fixed-income securities, backed by real estate loans, which are tax-exempt for domestic investors and whose returns are typically backed by some percentage of a house price and/or interest-rate index.

The global covered bond community's expectation for many years has been that Brazil will join the covered bond fraternity, although there have been headwinds since 2H15, notably from macro-economic instability partly caused by the fall in commodity prices, which has led to a contraction in GDP and rising inflation.

Having said that, the principal condition precedent for the establishment of a covered bond market, legislation, still remains elusive in Brazil. In 2015, there was a stepped move towards the establishment of covered bonds in Brazil with the passing of primary legislation which set up the legal establishment of covered bonds and their asset cover pool segregation. As at the time of writing, we are still waiting for the secondary legislation to be passed, detailing the regulatory limitations for Brazilian covered bonds and crucially, in terms of domestic and international capital demand vs. existing real estate-related capital market products, the income tax exemption status.

In our view, Brazilian covered bonds would make an important contribution to private Brazilian banks' funding toolkit, especially in respect of reducing their asset-liability duration mismatch. The success of the product is predicated on there being sufficient domestic and international investor demand, in addition to continued increases in demand for real estate credit which has recently substantially tapered owing to wider macro-economic uncertainties.

### BENEFITS OF COVERED BONDS IN THE BRAZILIAN FINANCIAL SYSTEM

The expected benefits of the incorporation of covered bonds as an alternative funding source for Brazilian real estate credit include:

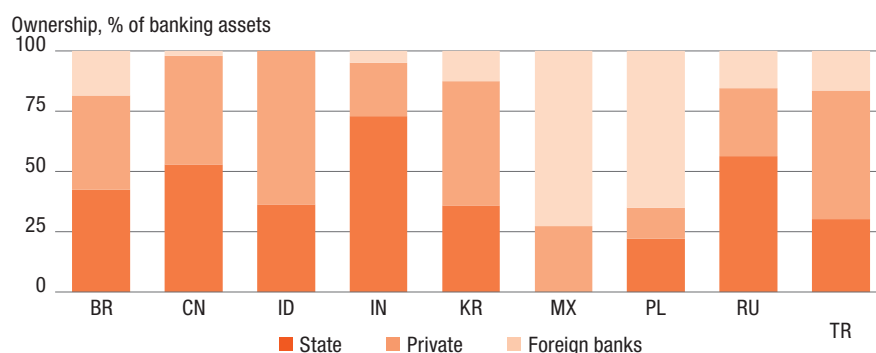
- Increased overall funding for real estate credit beyond what the savings and loan system can sustain.
- Better matching of assets and liabilities with covered bonds known to have amongst the longest tenors for bank debt other than capital instruments.

The Brazilian Association of Real Estate Loans and Savings Companies (Abecip) forecast in 2015 of the need for an extra funding source by the end of 2016. This estimate was likely on the higher side given recent economic developments.

Other challenges:

- Diversification of funding;
- Improve the matching of assets and liabilities.

*Note: The "Savings Accounts Balance" corresponds to 65% of the total value of Savings, which must be allocated to housing loans.*

**Figure 11 ► Brazilian banking assets have a high state ownership rate, but this is not necessarily unusual**

Source: Fitch, BBVA GMR

### TURKISH COVERED BONDS: BREAKING THE EMERGING MARKET COVERED BOND PARADIGM

Unlike Brazil, Turkish covered bonds have had legislation since 2007, alongside the first SME-backed issuances in 2011, albeit their widespread adoption and crucially, appeal to international investors had not

been tested until recently. The market has taken time to get off the ground, in our view predominately due to:

- SME-covered bonds still lack material investor appetite amongst traditional covered bond investors.
- The release of the first version of the Turkish covered bond legislation was in 2007, shortly before the market turmoil caused by the credit crunch.



- The mortgage-backed covered bond framework required updating in order for it to be comparable to nearby European jurisdictions, which happened in 2014.
- Currency stability versus EUR in light of commodity market volatility, political uncertainty and market expectations of US monetary policy has helped settle EUR/TRY volatility, making the required covered bond swap more economical to use.
- Difficulties in breaking the emerging market investor focus on sovereigns/large corporates and covered bond investors who invest in developed markets prompting a disconnect in terms of investor attraction for Turkish covered bonds.

While the above list is not intended to be exhaustive, Turkish covered bonds blasted out of the starting bloc on 26 April 2016 when Vakifbank issued the inaugural EUR denominated EUR500mn Turkish covered bond, attracting over EUR3bn of demand from more than 300 accounts, shattering the illusion that covered bonds were solely an instrument for developed economies.

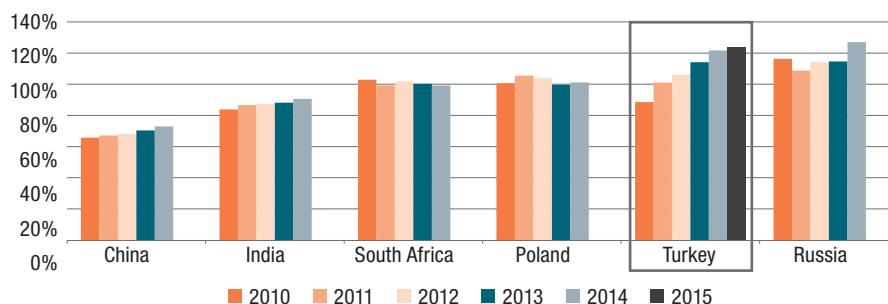
While Turkish covered bond legislation has been in place for several years already, even in its updated format, which has comparable features to the best practices of several European jurisdictions, there has been little interest from real-money investors; six Turkish banks have created covered bond programmes with four having issued notes. Prior to the Vakifbank transaction, which was not only the first Turkish covered bond to be placed with real money investors but also the first foreign currency denominated bond, demand for Turkish covered bonds predominately came from multilateral development banks as part of their capital market development programmes.

In our view, the successful placement of the Vakifbank mortgage covered bond has been heavily influenced by the now stable government following the elections in November 2015, and favourable issuing conditions for covered bonds in the Euro market; the latter, given the role of CBPP3 in depressing spreads for the European product has only enhanced the relative value of the Turkish product with beneficial rotation of investors outside of European covered bonds into higher yielding alternatives.

Unlike the Brazilian situation, the Turkish banking system's capacity to fund loan demand with deposits has been surpassed for a number of years now with the Turkish banking system having a loan-to-deposit ratio of c.120%. This reliance on funding, other than deposits, is a function of Turkey's relatively low savings rate (Turkey's FY15 savings rate was 15% of GDP) and robust demand for loan growth, which has been supported by favourable demographics and GDP growth.

Mortgages, the staple collateral in the majority of global covered bond programmes have increasingly

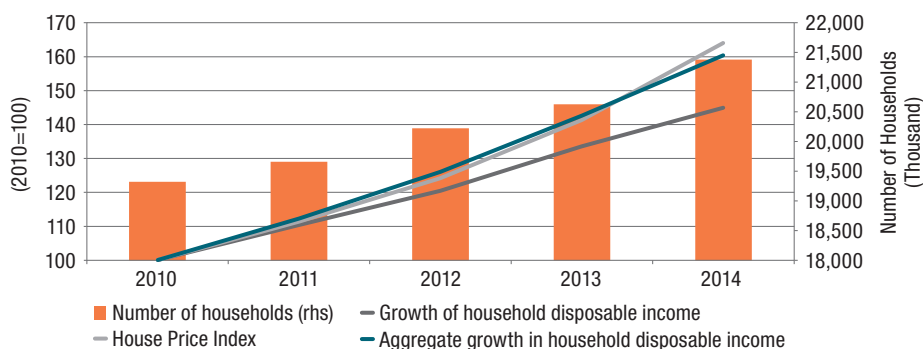
**Figure 12 ► Loan-to-deposit (LTD) ratios of Turkish banks have risen sharply over the last five years**



Note: System wide bank only figures for Turkey

Source: Moody's Investors Service, BRSA

**Figure 13 ► House price increases supported by increase in disposable income and number of households**



Source: Moody's and TurkStat

made up a greater proportion of credit demand, with mortgage lending itself increasing 14% YoY as at YE15. In fact, investors tend to prefer residential mortgage collateral over riskier SME collateral with the difference in the average Moody's Collateral Score being almost double for Turkish SME backed covered bonds vs their mortgage equivalent (22% vs. 10.4%); this also pans out in sector NPL ratios with residential mortgages having a c.0.5% ratio versus more than 3.9% for SME NPLs.

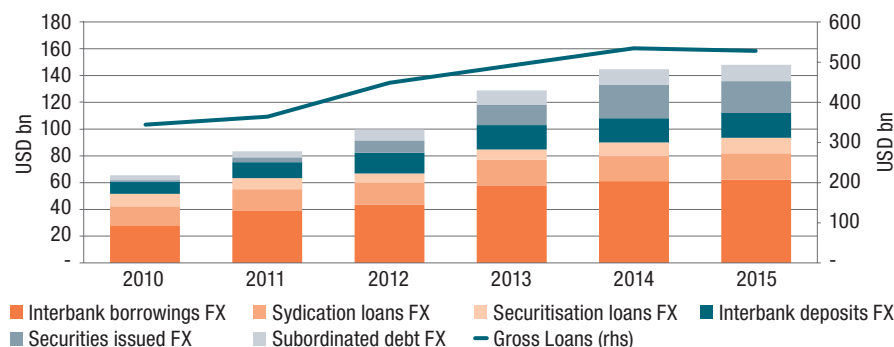
The demand for mortgage credit has been enhanced, as in Brazil, by increasing household growth and increased household disposable income with a shortage in existing housing stock contributing to Turkish house prices being amongst the global top 5 in terms of house price appreciation, increasing 30% and 84% since 2010 in real and nominal terms respectively.

In order to fund lending beyond internal balance sheet sources including deposits, Turkish banks have increasingly sought to borrow from the capital markets with capital market borrowing at a bank system level effectively doubling in the last five years. Notably interbank deposits, syndicated loans, and securitisation loans (diversified pay-

ment right securitisations) make up the majority of the capital market funding instruments of choice. Senior unsecured issuances are increasing their footprint in the Turkish banks' capital market funding footprint and it is the comparative funding advantage of covered bonds versus senior unsecured which would provide increased impetus following the lead of Vakifbank with an increased penetration of the Turkish covered bond product.

Turkish covered bonds have the benefit of widening the investor base for Turkish bank debt products, especially to an investor segment whose traditional product has been subject to substantial reductions in market yields (i.e. European covered bonds); they also have key benefits which Turkish supervisors have noted.

At a system level, Turkish banks have duration gaps in their funding whereby their assets have a much longer duration than the funding liabilities, increasing the liquidity gap. Utilising covered bonds, when proxying the maturity profile of their European counterparts, can add longer term funding beyond duration levels which investors target in the senior unsecured market; this is primarily because covered bonds tend to have a lower beta than senior unsecured.

**Figure 14 ► Turkish banks' capital market borrowing has more than doubled in the last five years**

Source: Moody's Investors Service, BRSA, CBRT

Furthermore, covered bonds can lead to profitability enhancements which can contribute to bank earnings given their lower funding cost versus senior unsecured. This differential increases notably where jurisdictions have passed bank resolution legislation in order to 'bail-in' senior unsecured as per the European case.

The appeal of the Turkish product for European covered bond investors is underpinned as the legislation and regulation are aligned with European standards and in some cases, are stricter such as the 75%/50% LTV limit for residential/commercial mortgages. Interestingly, all mortgage covered bond programmes, that to our knowledge are in existence contractually, preclude commercial mortgages from inclusion in the cover pool.

Vakifbank's covered bond issuance and demand was a case in point for this pricing/investor demand advantage which not only priced 30bp tighter than IPTs at issue at m/s+250bps but according to syndicate commentary, priced +c.15-20bp vs. a hypothetical similar maturity Turkish sovereign and

c.80bp inside where a Vakifbank senior unsecured deal might have traded in Euros. There is some margin of error in these estimates given the limited liquidity in the Vakifbank EUR senior unsecured curve in addition to the longer duration outstanding bond maturing two years prior to the covered bond (2019 vs. 2021).

### BRINGING IT ALL TOGETHER: OUR EXPECTATIONS FOR EMERGING MARKET COVERED BONDS

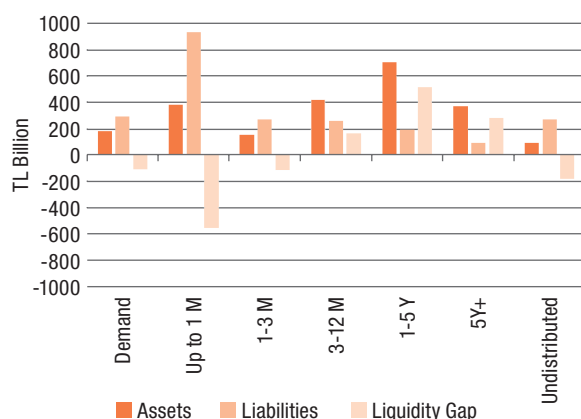
Referencing our two case studies of Turkey and Brazil, it is important to note that there are a multitude of emerging market jurisdictions which have the mechanics in place to issue covered bonds, Brazil being the glaring exception owing to the current lack of secondary legislation. There are also a multitude of reasons why it has taken so long for the capital markets fraternity to fully welcome cross-border distributed emerging market covered bonds. We remain of the opinion that emerging market covered bonds will remain a higher yielding

niche alternative whose interest has been directly supported by the outsized impact of ECB actions on the European covered bond product.

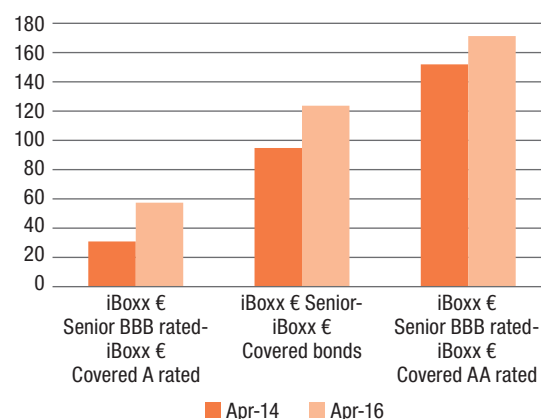
We expect Turkish covered bonds to continue to proliferate, especially given the robust demand and completion of the all-important 'price discovery' process for the first Turkish mortgage covered bond. Furthermore, the Turkish banking system's need for viable, economical alternatives to fund credit demand gives covered bonds a natural advantage given the viability of Vakifbank in demonstrating investor demand and reduced execution risk. We continue to see 'spill-over' investor demand into emerging jurisdictions which are close to the Western European investor base, including Romania and Poland.

This was confirmed up by recent comments affirming the European Bank of Reconstruction & Development's (EBRD) commitment to investing in covered bonds from this region, which we believe could lead to it becoming an anchor investor to enable a deeper penetration rate by European covered bond investors. We have already seen evidence of this support in the EBRD's investment in the first local currency Polish covered bond under their revised and updated covered bond legislation. Furthermore, there is a notable increase in interest in the product among Eastern European regulators, with the starkest example being a recent regulatory rule in Hungary stipulating that 15% of mortgages have to be financed through covered bonds.

Outside of emerging jurisdictions that are bordering Europe, we continue to see the biggest market potential in Brazil; aside from the legislation however there are a multitude of tax, investor education and macro-economic stability hurdles that this jurisdiction will need to overcome, probably in the medium term, before we can welcome it to the global covered bond fraternity.

**Figure 15 ► Maturity structure of Turkish banks' assets and liabilities (Sept 2015)**

Source: The Banks Association of Turkey

**Figure 16 ► European covered bond & senior unsecured spreads have widened since 2014**

Source: Markit via FactSet

## APPENDIX 1.1: KEY CHECKLIST FOR ESTABLISHMENT OF A SUCCESSFUL COVERED BOND MARKET

Figure 17 ► Checklist for establishment of a successful covered bond market

Key Point	Sub-point	Explanation
Macro-conditions	GDP	GDP growth tends to be positively correlated with demand for credit and thus the need to fund such credit. Where there is growth, especially in emerging markets, deposit-based financing systems eventually become exhausted necessitating external financing, of which covered bonds, when well designed, provide a stable entry point for investors.
	Unemployment	Lower unemployment tends to have a positive effect on consumer sentiment which drives demand for longer-dated credit i.e. mortgages.
	Demographics	Increases in population, and positive increases in 'striving' socio-economic groups (young & upwardly striving) set the stage not only for increased housing demand, but also for housing purchases. Furthermore, demographics is a key factor in household formation, which has an important role to play in demand for new housing stock.
	Inflation	Stable and predictable inflation is important for the accurate pricing of long-term debt. Chile is an interesting case as its covered bonds are issued in inflation protected units (Unidad de Fomento) even though the cost of the inflation-hedge is absorbed by the issuer. We do not see high inflation, should it be structural, as a substantial issue as long as the inflation level is stable and/or predictable in order to aid proper pricing.
Market infrastructure	Housing Title system	The certainty of property rights needs them to be defined which in turn is reliant on some form of housing registry system. Coverage of rural areas in such a system can be an issue in emerging markets, and ideally these records are computerised in order to ensure the robustness of the recording system.
	Mortgage transfers	Transfer of ownership between individuals/companies, and where relevant, across states, are important considerations should such mortgages be considered to be monetisable through refinancing/repo-ing.
	Foreclosure process	Efficient, and cost effective foreclosure process is ideal in order to improve cash flows on defaulted mortgage assets should payment reliance switch to the cover pool. However long foreclosure periods such as an average of c.5 years in Italy, are not necessarily a hard barrier to covered bond adoption.
	Real estate information	Information related to real estate markets including valuation proxies and appraisal standards with a data history are necessary in order for investors to derive comfort from the value of the collateral backing the covered bond.
Financial markets	Critical mass of investors	<b>Domestic investors:</b> the presence of a strong domestic investor base tends to be predicated on governmental policies to encourage savings to create institutional investment capacity.  <b>International investors</b> tend to rely on at least the partial 'buy-in' of domestic investors in order to 'market-test' the product as well as covered bond legislation which is comparable to European standards. Co-investment with development banks tends to be important for first-mover investors in new covered bond jurisdictions. Covered bond investors tend narrow their investment geographies to those they consider 'developed markets' (hence the Canadian, Australian, South Korea, Singapore focus outside of European covered bonds).  <b>Economic levels:</b> the relative value versus sovereigns as well as the local currency equivalents of any EUR/USD (the predominant currencies for covered bond issuances) covered bonds marketed internationally is important, as well as a saving vs. other debt instruments which compete with covered bonds as a funding channel from the issuers' perspective. Local currency stability to the EUR/USD is important for any either issuer or investor led swaps to be cost effective.
	Issuer needs	<b>Funding requirement:</b> covered bonds, being a wholesale debt market instrument are only required to the extent that, most typically, the deposit base is not sufficient to meet credit demand for mortgages.  <b>Maturity requirement:</b> covered bonds have been praised by various sections of the market and regulatory community for their ability to 'term-out' funding for longer-term lending like mortgages, reducing the mismatch between short-duration deposits/commercial paper and longer duration mortgage lending.  <b>Beneficial pricing:</b> covered bonds, while useful in many issuers funding toolkit are only considered, given the work involved to set up a programme and commit to investor education, where they offer a pricing alternative to other funding alternatives including securitisation, syndicated loans and senior unsecured bond issuances.  <b>Type of issuer:</b> We distinguish between government, specialised and general private banks. The latter two, through the virtue of their non-sovereign like risk profile tend to benefit most from covered bond programmes which can offer savings vs. other capital market term instruments like senior unsecured. Government issuers tend to issue at near sovereign-bond levels and at least outside of peripheral Europe, covered bonds do not offer savings to government bond curves, reducing their attractiveness. There are particular cases however such as the Korea Housing Finance Corporation where even government related enterprises can benefit through capital market leverage.
	Investor needs	<b>Diversification:</b> investors looking to gain lower beta forms of bank credit can benefit from going into covered bonds. Developed market investors can gain international diversification outside of Europe for example in order to generate incremental yield.  <b>Duration requirement:</b> in general, covered bonds tend to have longer duration than their senior unsecured brethren, and outside of sovereign bonds, covered bonds, where established, can be a good option to get long duration exposure with lower-beta credit risk.  <b>Regulatory benefits:</b> clearly the most favourable regulatory regimes for both risk weight and repo criteria are in Europe. To the extent that investors, domestic or otherwise gain such benefits, they can lead to a structural demand for covered bonds; this is shown by the demand from European investors for Canadian covered bonds given their eligibility for ECB repo.
	Bond market	Covered bond market development is predicated on there being an existing, active bond market with liquid sovereign and corporate curves in order to provide pricing guidance. To the extent that the bond market is dominated by just government issuances, then it becomes more difficult to price financial credit, and by extension covered bonds, hindering their development.
Legal and regulatory provisions	Covered bond law	This is mandatory in order to differentiate the dual-recourse nature of the covered bond product, without which, the market would simply discount the bond as a senior unsecured which would not be economically desirable from an issuers' perspective. Comparability with European jurisdictions best practice is considered mandatory for international investor buy-in. Furthermore, carve-out from 'super-priority' exposures such as depositor preference and wage/tax claims are important for international standard covered bonds whereby cover pools are explicitly to be used to guarantee covered bondholders (alongside any derivative claims attached to the cover pool for purpose of cover pool specific hedging).
	Supervision	Independent and credible supervision of the covered bond programmes in a particular jurisdiction is arguably more important than the covered bond law given that close supervision has helped keep the covered bond as a 'default-free' asset class to date. Furthermore, reliance on data, structural tests and asset-liability mismatch mitigants are all largely reliant upon the close auditing of the respective supervisor.
	Credible sovereign support	Credible sovereign support is important in order for investors to be comfortable that the law, which backs the covered bond legislation, will not be unfavourably changed for example, in order to bail-in creditors during a bank resolution/insolvency. In our view, the primary reason why peripheral European covered bonds can trade significantly below the sovereign curve is that the sovereign is back-stopped by an EU oversight mechanism which strongly supports covered bonds across member states.
	Withholding tax	Ensuring withholding tax provisions do not apply to international investors is a key criterion for ensuring their involvement in internationally placed bond transactions, covered bonds are no exception.

Source: BBVA GMR

This article is taken from the 2016 edition of the ECBC's European Covered Bond Fact Book, the full copy of which can be accessed [here](#).

# Coming Up: 25<sup>th</sup> ECBC Plenary Meeting

The 25<sup>th</sup> ECBC Plenary Meeting will take place in **Oslo**, Norway, on the 6<sup>th</sup> of April 2017 with the kind support of **Finance Norway** and **The Norwegian Covered Bond Council**.

Over 245 participants are registered to attend the event, where discussions will focus on the key issues of the day for covered bond markets in Europe and beyond. These will include sessions focused on: the Norwegian covered bond market; harmonisation of covered bonds; the global outlook for the asset class; and the use of “green” covered bonds and the role of the EMF-ECBC EeMAP Initiative to finance energy efficiency in Europe.

Please find below the full draft Agenda for the 25<sup>th</sup> ECBC Plenary Meeting.

## 25<sup>th</sup> ECBC Plenary Meeting – Oslo, 6<sup>th</sup> of April 2017 – Draft Agenda

8h30 – 16h30 (CET), Opera House Oslo, Norway ([Map](#))

Supported by Finance Norway and The Norwegian Covered Bond Council:



- 8.30 Registration and Welcome Coffee**
- 8.45 ECBC Acting Chairman's Note**  
*Niek Allon*, NIBC Bank
- 8.55 Agenda Overview**  
*Luca Bertalot*, European Mortgage Federation – European Covered Bond Council (EMF-ECBC)
- 9.00 Welcome Speech**  
*Idar Kreutzer*, CEO, Finance Norway
- 9.15 Keynote Speech**  
*Jon Nicolaisen*, Deputy Governor, Central Bank of Norway
- 9.30 Focus on Norwegian Covered Bonds**  
**1<sup>st</sup> Panel Discussion**  
 ■ Moderator: *Erik Johansen*, Finance Norway  
 ■ Panellists: *Jane Soldera*, Moody's; *Emil Steffensen*, The Financial Supervisory Authority of Norway; *Arve Austestad*, SpareBank 1 Boligkredit / SpareBank 1 Næringskredit; *Nils Gunnar Baumann*, Nordea; *Svein Aage Aanes*, DNB Asset Management  
 ■ House price developments in Norway and the robustness of Norwegian covered bond issuers  
 ■ Impact of new regulation – NSFR, BRRD (MREL) and potential amendments to Norwegian covered bond legislation etc.  
 ■ Norwegian covered bond characteristics
- 10.15 European Covered Bond Markets – State of Play & Current Trends**  
 ■ Extendable Maturities  
*Florian Eichert*, Crédit Agricole CIB & Chairman of ECBC Statistics Working Group
- 10.35 Covered Bond Label – HTT Voluntary Addendum & New Features**  
*Luca Bertalot*, European Mortgage Federation – European Covered Bond Council (EMF-ECBC)
- 10.45 Coffee Break**
- 11.15 European Banking Authority Report on Covered Bonds**  
*Christian Moor*, European Banking Authority
- 11.35 Keynote Speech**  
*Didier Millerot*, European Commission, DG FISMA
- 11.55 Harmonisation of Covered Bonds – Next Steps**  
**2<sup>nd</sup> Panel Discussion**  
 ■ Moderator: *Luca Bertalot*, EMF-ECBC  
 ■ Panellists: *Christoph Kimmmerle*, European Parliament; *Ad Visser*, European Central Bank; *Richard Kimmish*, Richard Kimmish Consulting Ltd.; *Frank Will*, HSBC & Chairman of ECBC EU Legislation Working Group; *Morten Bækmand Nielsen*, Nykredit & Chairman of ECBC Technical Issues Working Group; *Andreas Denger*, Covered Bond Investor Council  
 ■ Is harmonisation of covered bonds becoming a “casse-tête/brain teaser” for European stakeholders and institutions? What are the perceived opportunities and risks?
- CMU: could a potential common covered bond framework serve as a market benchmark for the implementation of covered bonds in Europe and at a global Level? If yes, what are the legislative options on the table?  
 ■ In the current debate, what is the role for market initiatives? How can market participants be involved in the national legislative review triggered by the potential implementation of a common European Framework?
- 12.40 Lunch Break**
- 14.00 Musical Performance**  
*Ingebjørg Kosmo*, Mezzo Soprano & *Bjarne Sakshaug*, Pianist  
 ■ *Amor* by William Bolcom; *Song of Black Max* by William Bolcom; *Fyret* by Ola Bremnes
- 14.15 European Bank for Reconstruction & Development and Covered Bonds – Overview**  
*Jacek Kubas*, EBRD
- 14.30 Global Outlook for Covered Bonds**  
**3<sup>rd</sup> Panel Discussion**  
 ■ Moderator: *Colin Chen*, DBS & Chairman of ECBC Global Issues Working Group  
 ■ Panellists: *Jacek Kubas*, EBRD; *Antonio Farina*, S&P Global; *Sascha Kullig*, vdp; *Lily Shum*, Canada Mortgage and Housing Corporation; *Steffen Dahmer*, JPMorgan & Chairman of ECBC Market Related Issues Working Group; *Fritz Luithlen*, DZ Bank  
 ■ Risks and opportunities for the globalisation of the covered bond market  
 ■ How to secure a proper treatment of covered bonds in the Basel debate?  
 ■ Reporting on latest covered bond developments: where and when?
- 15.15 European Commission's Energy Package – Overview**  
*Timothée Noel*, European Commission, DG ENERGY
- 15.30 Financing Energy Efficiency: Green Covered Bonds & the EeMAP Initiative**  
**4<sup>th</sup> Panel Discussion**  
 ■ Moderator: *Jennifer Johnson*, EMF-ECBC  
 ■ Panellists: *Timothée Noel*, European Commission, DG ENERGY; *Friedemann Roy*, International Finance Corporation; *Agnès Gourc*, BNP Paribas; *Joop Hessels*, ABN AMRO; *Bodo Winkler*, Berlin Hyp  
 ■ How is the green bond/covered bond market changing? How are issuers and investors engaging in this market? What are the longer-term perspectives?  
 ■ How could the EeMAP initiative and, as an extension of this, an Energy Efficient Covered Bond label help to further grow this market?  
 ■ How do we envisage the further evolution of the newly adopted ECBC sustainable covered bond definition towards an Energy Efficient Covered Bond Label and beyond i.e. green, social?
- 16.15 Closing Remarks**
- 16.30 End of the event**





# NEWS IN BRIEF

## EBA Publishes Results of CRDIV-CRR/Basel III Monitoring Exercise

On the 28<sup>th</sup> of February 2017 the European Banking Authority (EBA) published its 11<sup>th</sup> Report of the CRDIV-CRR/Basel III monitoring exercise on the European banking system (available [here](#)). This exercise, run in parallel with the one conducted by the Basel Committee on Banking Supervision (BCBS) at a global level, presents aggregate data on capital ratios – risk-based and non-risk-based (leverage) – and liquidity ratios – the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) – for banks across the European Union (EU). It summarises the results using data as of 30 June 2016 but does not reflect any BCBS standards agreed since the beginning of 2016, such as the revisions to the market risk framework, or any other BCBS proposals, which have not yet been finalised, including the revisions to credit and operational risk frameworks.

Overall, the results of this exercise show a further improvement of European banks' capital positions, with a total average Common Equity Tier 1 (CET1) ratio of 12.8% at end June 2016 assuming full implementation of the CRD IV-CRR. All banks in the sample comply with the future regulatory capital requirements, exhibiting zero shortfall to meet the full-implementation minimum CET1 requirement, including the capital conservation buffer (7%) at end June 2016.

The analysis of the leverage ratio shows that there has been a continuous increase in the last periods. A small percentage of institutions in the sample (4.7%) would be constrained by the minimum leverage ratio requirement (3%) additionally to risk-based minimum requirements.

The LCR analysis is based on data in accordance with the Commission's Delegated Regulation. The average LCR is 133.7% at end June 2016, while 95.4% of the banks in the sample show an LCR above the full implementation minimum requirement applicable from January 2018 (100%). The shortfall to meet the full-implementation minimum LCR requirement is EUR 2.5 billion. In addition, time-series analyses show that the weighted average LCR has increased since June 2011, mainly due an increase in banks' liquidity buffers.

In absence of a finalised EU definition, the report monitors the NSFR compliance with the current Basel III standards. The analysis shows an overall average ratio of 107.8% with an overall shortfall in stable funding of EUR 158.7 billion.

Compared with previous periods, there has been a continuous increase in banks' NSFR, which is mainly driven by the increasing amount of available stable funding (ASF) for both groups. Currently, around 80.6% of participating banks already meet the minimum NSFR requirement of 100%.

## EBA Provides Transparent and Harmonised Information on Asset Encumbrance Across EU

On the 3<sup>rd</sup> of March 2017 the European Banking Authority (EBA) published its final draft Regulatory Technical Standards (RTS – available [here](#)) on the disclosure of encumbered and unencumbered assets for the provision of transparent and harmonised information on this topic, as laid down in the Capital Requirements Regulation (CRR). Through the disclosure of asset encumbrance based on a consistent definition and formats, these standards will enable market participants to assess the information provided by institutions in a clear and consistent manner. In particular, these draft RTS set out the data which is required to be disclosed on encumbered and unencumbered assets and the relevant templates and substantially enhance the level of disclosure compared to the EBA Guidelines currently in place (see [here](#)).

These 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. These templates are designed to show the amounts of encumbered and unencumbered assets of an institution and differentiate between assets that are needed to support existing funding or collateral needs and those that are available for potential funding needs. Institutions will have to disclose information in accordance with these templates, and provide some additional details on the importance of encumbrance in their individual funding model.

Smaller institutions which do not have material levels of asset encumbrance, as well as investment firms, are exempt from disclosing information on the quality of encumbered and unencumbered assets, so as to avoid incurring disproportionate costs. Also, to facilitate the disclosure of the quality criteria for large institutions, these requirements only need to be implemented one year after the entry into force of this Regulation.

## ECB Publishes Q&A on Minimum Disclosure Requirements for Covered Bonds

On the 8<sup>th</sup> of March 2017 and following on from its announcement of the introduction of minimum disclosure requirements for covered bond ratings (see [here](#)), as anticipated, the European Central Bank (ECB) published a Q&A on the Eurosystem's disclosure requirements for covered bond ratings. This Q&A (available [here](#)) clarifies some of the new requests of the ECB such as the ability to not disclose confidential information and the entry into force of the new rules.

## Covered Bonds Look to the East

On the 3<sup>rd</sup> of March 2017 the European Covered Bond Council ([ECBC](#)) began a series of meetings in India and Singapore with key Asian national authorities and stakeholders from both existing and potential future covered bond jurisdictions. These meetings allowed discussions to take place on the latest state of play concerning covered bond markets in Europe and other markets represented by the ECBC, as well as to consider the potential for the asset class to play a role in ensuring access to stable and sustainable long-term financing in a number of other Asian countries.

The ECBC, represented by its Secretary General, **Luca Bertalot**, and Chairman of the ECBC Global Issues Working Group, **Colin Chen**, met with representatives of national authorities from **India, Singapore and Malaysia**. In addition to these bilateral meetings, on the 8<sup>th</sup> of March 2017 the ECBC hosted the fourth edition of the **ECBC Asian Covered Bond Investor Roundtable** in Singapore where over 65 key stakeholders in Asian covered bond markets, including representatives from **Australia, Brazil, China, Denmark, Finland, France, Germany, India, Japan, Malaysia, The Netherlands, Norway, Singapore, South Korea and the United Kingdom**, convened to discuss 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 Roundtable had **four principal objectives**:

- To educate potential new categories of investors and national authorities on the subject of covered bonds
- To provide detailed expert information on the different existing covered bond jurisdictions/issuers around the world
- To highlight the key qualitative features characterising the European covered bond market
- To facilitate 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 (BCBS) framework.

Commenting on these events, EMF-ECBC Secretary General, **Luca Bertalot** said:

*“The recent developments in Asia in terms of issuers’ compliance with the qualitative standards of the Covered Bond Label are paving the way for true equivalence and harmonisation in the treatment of covered bonds at the global level.”*

The Roundtable was preceded on the 7<sup>th</sup> of March 2017 by the **Euromoney/ECBC Asian Covered Bond Forum**, which was also held for the fourth time.



## EBA Publishes Assessment of EU Banks Internal Model Outcomes

On the 3<sup>rd</sup> of March 2017 the European Banking Authority (EBA) published two reports on the consistency of RWAs, and for the first time, across all EU institutions authorised to use internal approaches for the calculation of capital requirements. The reports cover residential mortgage, SME and other corporate portfolios (collectively referred to as “high default portfolios” – HDP), as well as market risk. The results confirm previous findings and establish these annual benchmarking exercises as a fundamental supervisory tool to restoring trust in internal models.

### Findings and next steps of the HDP exercise

The HDP report (available [here](#)) explains the overall level of variability in RWAs and examines the different drivers that explain the dispersion observed. Most of the results are broadly in line with previous exercises on HDP. Given the different approaches used, namely a top-down and an outturn (backtesting) approach, in addition to a distribution analysis, the respective findings should be read concurrently. Two indicators are used to summarise the results, the RW and the ‘global charge’ (GC, i.e. considering expected and unexpected losses).

A key finding from the top-down approach is that more than 80% of the observed difference in the GC levels across institutions could be explained by few drivers, namely: the proportion of defaulted exposures in the portfolio; the country of the counterparty; and the portfolio mix. The remaining variability could be attributed to differences in riskiness – i.e., idiosyncratic portfolio features, modelling assumptions and risk management practices used by banks, as well as supervisory practices. The backtesting approach shows that, in general, the estimated values for PDs and LGDs are above the observed values for defaults and loss rates. Nevertheless, some banks systematically show observed values higher than estimates and will need a closer analysis.

This exercise highlighted several areas in which supervisors – and colleges – should investigate further, for instance: the practices regarding defaulted exposures; the definition of default; the use of global models and the interaction with country-specificities for exposures with counterparties from different jurisdictions; unjustified differences between regulatory approaches and possible compensation effects between internal approaches.

### Findings and next steps of the Market Risk exercise

The market risk report (available [here](#)) presents the observed variability measures in terms of the inter-quantile dispersion statistic (IQD). In the initial market valuation results, interest rate portfolios show a lower variability than other asset classes due to a more homogeneity across banks for modelling interest rate risk. In line with the previous exercises on market risk weighted assets variability, a significant dispersion for all the risk measures provided by banks is observed. As expected, the overall variability for Value at Risk (VaR) is lower than that observed for Stressed VaR (sVaR) and more sophisticated measures like Incremental Risk Charge (IRC) and All Price Risk (APR) show a much higher level of dispersion. Modelling choices play an important role in explaining this variability, especially for the most complex risk measures.

This report highlights some areas that may require further investigations by Competent Authorities, such as accentuated pricing variability for equity derivatives, commodities trades and credit spreads products.

## EBA Publishes Final Guidelines on LCR Disclosure

On the 8<sup>th</sup> of March 2017 the European Banking Authority (EBA) published its final Guidelines on liquidity coverage ratio (LCR) disclosure (available [here](#)). These Guidelines provide harmonised disclosure templates and tables for LCR disclosure and aim at improving transparency and comparability of LCR and other liquidity risk management related information.

These final Guidelines provide harmonised disclosure templates and tables for LCR disclosure without altering the general disclosure framework provided for in the Capital Requirements Regulation (CRR). In particular, they envisage a fully-fledged quantitative LCR disclosure template – in line with that proposed by the standard developed by the Basel Committee on Banking Supervision (BCBS) – for systemic credit institutions and a simplified one (including only the LCR figure, the amount of the liquidity buffer and that of net outflows) for the rest of the credit institutions which will apply them.

Items in the LCR disclosure template are calculated as simple averages of monthly reporting observations based on the Implementing Technical Standards (ITS) on LCR reporting (see [here](#)). The LCR disclosure template is complemented by explanatory notes, both qualitative and quantitative, of the disclosed LCR items. Finally, the Guidelines provide a table for the disclosure of risk management objectives and policies for liquidity risk.

These Guidelines, which are consistent with the EBA Pillar 3 Guidelines (see [here](#)) in terms of scope and date of application, apply to credit institutions covered by the LCR Delegated Regulation and identified as Globally and Other Systemically Important Institutions (G-SIIs and O-SIIs). Furthermore, other credit institutions should apply these Guidelines at the discretion of the relevant competent authority or on a voluntary basis. The Guidelines will apply from the 31<sup>st</sup> of December 2017.

For informative purposes only, the EBA is also publishing an excel-based tool mapping the LCR disclosure template with the LCR supervisory reporting, which is not part of the Guidelines and, therefore, will not have any legal value for disclosure purposes.

## ECB Publishes Guidance to Banks on Tackling NPLs

On the 20<sup>th</sup> of March 2017 the ECB published its final guidance on non-performing loans (NPLs) (available [here](#)) and the relevant FAQs (available [here](#)). The guidance marks an important step in addressing NPLs across the euro area. It outlines measures, processes and best practices which banks should incorporate when tackling NPLs. The ECB expects banks to fully adhere to the guidance in line with the severity and scale of NPLs in their portfolios.

The guidance calls on banks to implement realistic and ambitious strategies to work towards a holistic approach regarding the problem of NPLs. This includes areas such as governance and risk management.

The ECB does not stipulate quantitative targets to reduce NPLs. Instead, it asks banks to devise a strategy that could include a range of policy options such as NPL work-out, servicing, and portfolio sales.

## Covered Bond Label Introduces a New Voluntary Addendum to the HTT and More Granularity regarding CPTs, Soft Bullets and Sustainable Bonds

On the 16<sup>th</sup> of March 2017 the Covered Bond Label Foundation (CBLF) announced the implementation of an enhanced set of features which, from that date on, allow users of the Covered Bond Label website to identify at a more granular level, ISIN by ISIN: **(1) the maturity profile of covered bonds, now including conditional pass-through (CPT), soft bullet or non-extendable maturity; and (2) sustainable covered bonds.**

In addition, the CBLF has been working on a voluntary addendum to the Harmonised Transparency Template (HTT) in coordination with a broad range of stakeholders. **The voluntary addendum, together with the increased granularity for extendable maturities, is intended to align the HTT with the additional information which the European Central Bank (ECB) will require from Q3 2017 onwards, as a result of the introduction of [minimum disclosure requirements for covered bond ratings](#).** The Covered Bond Label, together with its HTT, will facilitate timely data disclosure and ensure a homogeneous format across countries and institutions. The addendum will be unveiled at the Label Committee, the Label Advisory Council and the European Covered Bond Council Plenary meetings, which will take place in Oslo on 5-6 April 2017.

The new IT feature which **allows investors to identify Covered Bond Labelled Sustainable Bonds** consists of a “green leaf” icon appearing next to the ISIN of the relevant bonds.

Commenting on these developments, **Luca Bertalot**, Covered Bond Label Foundation (CBLF) Administrator, said:

*“The raison d’être of the Covered Bond Label is to increase transparency in the market by simplifying and standardising data disclosure whilst keeping abreast of new regulatory and market demands. These new features are testament to the ability of the Covered Bond Label to respond rapidly to new regulatory requirements and market needs. The CBLF has worked on these new features in coordination with a broad range of stakeholders, including issuers, rating agencies and investors.”*

The guidance will now form part of the day-to-day supervisory dialogue with individual banks. The ECB will apply the principle of proportionality and adjust its level of intrusiveness depending on the scale and severity of the NPLs in the banks’ portfolios. The supervisors have already commenced their engagement with banks with elevated levels of NPLs. This engagement now continues following the publication of the final guidance document and will include letters being sent to banks with elevated levels of NPLs in the near future as part of normal supervisory activities. The NPL letters will contain qualitative elements and will be focused on ensuring that banks are managing and addressing NPLs in line with supervisory expectations.

The publication of the guidance follows a consultation process that took place between September and November 2016. A feedback statement published on the ECB’s website reflects the comments received and indicates where changes to the draft guidance have been reflected in the final published guidance.



## European Commission Launches Public Consultation on ESAs

On the 21<sup>st</sup> of March 2017 the European Commission launched a public consultation on the operation of the European Supervisory Authorities (ESAs). These are the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

The ESAs are a cornerstone of the reforms put in place in the wake of the financial crisis. They have played a key role in ensuring that the financial markets across the EU are well regulated, strong and stable. Since their establishment, the ESAs have contributed to the building of the Single Rulebook for financial services (banking, insurance and capital markets) and to the convergence of supervisory practices, in order to ensure a robust financial framework for the Single Market and to underpin the creation of the Banking Union.

The European Commission's stated aim now is to identify areas where the effectiveness and efficiency of the ESAs can be strengthened and improved. More coordinated and integrated supervision will be increasingly important in future, notably to develop and integrate EU capital markets through Capital Markets Union.

Launching the consultation, Valdis Dombrovskis, Vice-President responsible for Financial Stability, Financial Services and Capital Markets Union, said: *"The EU needs to step up its efforts to build more integrated, efficient and stable financial markets so that it is equipped to deal with new challenges. Sound and efficient financial supervision is key to this goal. In the six years following the crisis, the European Supervisory Authorities have carried out important work in developing a Single Rulebook for financial services. I want to hear from all stakeholders about how we can ensure that these Authorities have the most impact in supporting greater convergence of supervisory practices in our Member States".*

A general review of the ESAs is foreseen for this year and mandated by their founding Regulations. The European Commission's consultation is accessible [here](#) and will run until the 16<sup>th</sup> of May 2017.

## European Commission Publishes Consumer Financial Services Action Plan & FinTech Consultation

On the 23<sup>rd</sup> of March 2017 the European Commission published the final version of the **Consumer Financial Services Action Plan** (available [here](#)).

Most notably, the Action Plan outlines the following three main objectives that, based on the Commission's evaluation, will help strengthen the Single Market for financial services:

- 1) **Increasing consumer trust and empower consumers** when buying services at home or from other Member States;
- 2) **Reducing legal and regulatory obstacles affecting businesses** when seeking to expand abroad, including working on common creditworthiness assessment criteria and facilitating the exchange of data between credit registers; and
- 3) **Supporting the development of an innovative digital world** in order to overcome some of the existing barriers to the Single Market.

In this context, the Commission also launched on the same date a **FinTech consultative document** (available [here](#)) aiming to gather stakeholders' feedback for the creation of a more competitive and innovative European financial sector. As such, the consultation focuses on the following four main areas:

- 1) Fostering access to financial services for consumers and businesses;
- 2) Bringing down operational costs and increasing efficiency for the industry;
- 3) Making the single market more competitive by lowering barriers to entry; and
- 4) Balancing greater data sharing and transparency with data security and protection needs.

## EMF-ECBC Responds to European Commission's CMU Mid-Term Review

On the 17<sup>th</sup> of March 2017, the EMF-ECBC submitted its formal Response to the European Commission's Capital Markets Union (CMU) Mid-Term Review. The full text of the EMF-ECBC Response can be accessed [here](#).

## New ECBC Members

The ECBC is delighted to announce that during the course of March 2017 the following institutions became ECBC Members: **Capital Intelligence Ratings**; **Rabobank** and **Sp Mortgage Bank**.



**Rabobank**



## EP ECON Committee Publishes Draft Report on Covered Bonds

On the 27<sup>th</sup> of March 2017 the European Parliament's ECON Committee published its Own Initiative (INI) Draft Report on Towards a pan-European covered bonds framework (available [here](#)).

Please find below the draft report's **explanatory statement** by the Rapporteur, Mr Bernd Lucke MEP (ECR-DE).

*"Covered bonds (CBs) have always been, ever since their invention more than two centuries ago, a very specific asset class in many ways. Long-established instruments in the financing structures of several Member States, they have proved to be reliable investments for a variety of financial institutions and a convenient and efficient funding option for issuers. They rely on very strong structural characteristics such as the dual recourse, the high quality cover pools (consisting almost exclusively of mortgage loans (85%) and public debt instruments (15%)) and the segregation of cover pool assets. Investors' trust is reinforced by CBs being subject to special public supervision. The extraordinary degree of safety and liquidity which CBs have exhibited over decades prevailed even in times of severely troubled financial markets, e. g. during the last ten years. This has led to the recognition of CBs as assets whose holding warrants preferential regulatory treatment under the EU financial services legislation.*

A fairly vague description of the asset class given in Article 52(4) of the UCITS Directive<sup>1</sup> serves as the **"definition" of covered bonds in EU law** – although the text falls short of referring to the asset class as "covered bonds". Subsequent EU legislation has built on this definition to

- **grant a favourable treatment to CBs held by banks** if the CBs meet certain precisely worded requirements under Article 129 of the CRR;
- **included CBs that meet certain specific conditions in the list of assets recognized as Level 1 High Quality Liquid Assets** under the Liquidity Coverage Requirement Delegated Act; and
- **excluded CBs, up to the collateralised part, from the bail-in when a bank is under resolution**, under Article 44(2) BRRD

The success of CBs can be pinned down to essentially two factors:

- (1) economically, to the **existence of collateral** in the form of high quality assets of a long-lasting nature **which are easily valued and repossessed**, i.e. mostly mortgages and government bonds
- (2) institutionally, to the existence of a legal and supervisory framework which **guarantees dual recourse for the investor**, the **segregation of the cover pool** and **special public supervision**.

*From the perspective of European legislation, it is interesting to note that the CB "definition" in Article 52(4) of the UCITS Directive essentially requires CBs to satisfy (2), but does not impose the high quality requirements on cover pool assets as expressed in (1). Rather, admissible cover pool assets are determined by national laws. In all Member States these laws are focused on mortgages and public sector loans, but some Member States also provide for the inclusion of other, possibly riskier assets.*

**From a perspective of systemic financial stability, (1) seems indispensable.** To exempt CB creditors from the bail-in tool of the BRRD can only be justified if CBs are different from other debt instruments on the grounds of extremely low default risk. Absence of significant default risk is also key in including CBs among the Level 1 liquid assets in the LCR Delegated Act and in granting investors higher exposures for these type of exposures than for other transferable securities or money market instruments.

The EBA in its 2016 report speaks out clearly **against granting preferential regulatory treatment to CBs whose cover pools include more risky types of assets, e. g. SME loans, infrastructure loans or loans to other non-public debtors**. The EBA is also sceptical towards movable assets such as ships (and aircrafts), which, if moved out of the EU, may be difficult to repossess.

**On the other hand, given the successful role CBs have played and continue to play in financing mortgages or public sector loans, it is suggestive to make the institutional framework (2) available also to riskier types of assets such as SME finance or infrastructure investment.** A sound legal framework providing for dual recourse, segregation of cover pools and special public supervision may provide – for both issuers and investors – an attractive alternative to securitizations or other forms of debt finance. Contractual arrangements underlying securitizations are often costly to set up, difficult to monitor and subject to legal disputes in the case of issuer default or resolution.

More transparency, more public supervision, and more legal certainty can be achieved by extending the institutional principles of CBs (2) to debt instruments **which finance important and growth-enhancing economic activities (e. g. SME or infrastructure investments)**. But financial stability must not be compromised. Exemptions from general capital requirements in banking regulation or from the bail-in tool should not be granted to securities whose collateral does not satisfy (1).

Therefore, **your rapporteur proposes a European directive which clearly defines and distinguishes two types of assets: Covered Bonds (CBs) and**

**European Secured Notes (ESNs).** Common to both types of securities would be the principles of a legal and supervisory framework (2). The label "covered bond" would be used if and only if the securities also satisfy (1) and, hence, only CBs would be able to qualify for preferential regulatory treatment. To avoid unnecessary disruptions in smoothly working CB markets, your rapporteur further suggests to define CBs building closely on Article 129 of the CRR.

The CRR is silent on the admissibility of CBs with conditional **maturity extensions** (soft bullets and conditional pass-through (CPT) structures). These types of CBs have greatly increased in recent years. While maturity extensions may serve as useful contractual provisions for predictability and for risk management, particularly in cases of issuer default or resolution, **they clearly shift part of the risks from the issuer to the investor**. This may, if no attention is paid thereto, cause broader systemic risks. **Preferential regulatory treatment should therefore not be granted to CBs with maturity extensions except for cases of default or resolution, i.e. for cases in which the alternative to a maturity extension would be a default of the issuer on the CB.** Moreover, to protect investors and safeguard financial stability, **the issuer should not have discretion in the triggering of maturity extensions**. Rather, any extension of CB maturities in the case of default or resolution should be contingent on approval by the competent supervisory authority.

**Covered bond regimes are deeply rooted in national insolvency laws.** Cover pools and the dual recourse principle are safeguards against insolvency of the issuer, where the legal proceedings necessary to satisfy creditors' claims against an illiquid CB issuer depend on national laws and vary considerably between Member States. **European legislation should cause no disruption for frameworks which are well embedded in national law and which have enabled CB markets to operate smoothly and successfully over decades. This is why European legislation should be limited to a directive which sets the principles of CB and ESN markets.** The development of technical standards should be left to the competent national supervisory authorities after in response to the transposition to national law.

Maximum loan-to-value ratios for mortgages form an important part of the eligibility criteria laid out in Article 129 CRR. Given the substantial price fluctuations which some real estate markets have experienced, LTVs must be considered a defining property of collateral for CBs which enjoy regulatory preference and not a technical standard that might be decided freely by Member States. **Your rapporteur therefore proposes to continue setting maximum LTVs by European legislation and to monitor closely if these LTVs are in line with independent assess-**

**ments of pricing conditions which might prevail in the relevant real estate markets under stress.**

Finally, **any action at the European level should also take into account three important developments not mentioned so far:**

- **Strong market-led initiatives are already in progress.** For example, the **Covered Bond Label developed by the issuer community in cooperation with investors and regulators has been agreed in 2013 and has reached in 2016 a coverage of 60% of outstanding CBs worldwide.** Where those initiatives exist, they should be encouraged and either replace public intervention or be the basis for optional or mandatory standards. In particular, **the Harmonised Transparency Template established since 2016 under the CBL could be a basis for common disclosure standards applicable to CB issuers.**

- **CBs are gaining popularity in a number of non-EU countries, e. g. Australia, Canada, Chile,**

**New Zealand, Singapore, South Korea, Turkey and Russia.** Other major jurisdictions (including Brazil, India, Japan, Mexico, Morocco, Panama, Peru, South Africa and the United States) may soon follow suit. **A careful approach of European legislation limited to basic principles combined with sufficient flexibility for the idiosyncrasies of national laws and legacies will allow to integrate European CB and ESN markets with similar markets for similarly safe financial products elsewhere in the world and will therefore reinforce the long-run prospects for economic growth in the EU and in third countries.** Moreover, EU standards would have the potential to function as a blueprint for developing CB markets worldwide

- **The market has been living, to some extent, under public support in recent years. The ECB asset purchase programme (again most recently via the CBPP3 since October 2014) has had a significant effect on primary and secondary markets of CBs, contributing, along with regulatory treatment,**

**to increasing issuance of CBs since 2013. However, this has caused significant crowding out of private investors and stakeholders have warned that this crowding out may continue and eventually destroy the market unless the ECB disengages from CB markets in the near future. Any legislative or regulatory initiative should therefore be carefully weighted. Significant change of rules would create uncertainty for markets which need to win back investors they have lost.**

Since 2015, the Commission's Capital Markets Union initiative (in particular via its public consultation on CBs of September 2015) has looked at enhancing CB markets in Europe with due respect to national preferences and frameworks. **This is important since the success of the asset class has relied on national frameworks developed over decades and tailored to the local long-term financing needs, banking or capital market structures and risk appetite. Those particularities and flexibilities are to be appreciated and cultivated for European CB markets to continue leading in the world."**

## New Voluntary Addendum to HTT Facilitates Compliance with Upcoming ECB Requirements

On the 28<sup>th</sup> of March 2017 the Covered Bond Label Foundation ([CBLF](#)) announced that after a thorough consultation process with market stakeholders, the [new voluntary addendum to the Harmonised Transparency Template \(HTT\)](#) was online. To recap, the voluntary addendum, named "Optional ECB-ECAIs Data", together with the increased granularity for extendable maturities now displayed on the Covered Bond Label website (see [here](#)), is intended to align the Label's reporting process with the European Central Bank's (ECB) new [minimum disclosure requirements for covered bond ratings](#), which will be effective from Q3 2017 onwards.

In this context, the new voluntary addendum to the HTT reports:

1. Additional information on the covered bond programme;
2. Additional information on the swaps;
3. Additional information on the asset distribution.

The addendum has been developed in coordination with issuers' representatives and several rating agencies, with the latter being the prime users of the newly disclosed data. The rating agencies and the Covered Bond Label have sought to cooperate in this exercise in order to minimise the additional reporting burden for issuers. The rating agencies' active engagement since the beginning of this project has been critical for ensuring the rapid and successful development of the new addendum.

Commenting on this development, **Luca Bertalot**, Covered Bond Label Administrator, stated:

*"For the Covered Bond Label the capacity to adapt quickly to new regulatory requirements is critical. The new HTT is proof of how the Label helps this industry coordinating and reducing regulatory burden. We invite all Labelled issuers to seize the occasion of the publication of new addendum to enrich their collection of disclosed data."*

Rating agencies also offered their point of view on the new HTT.

**Hélène Heberlein**, Managing Director at **Fitch Ratings**, stated:

*"Fitch is supportive of efforts to improve transparency for covered bonds investors. As an industry standard, the HTT will contribute to an efficient process in meeting the minimum ECB disclosure requirements."*

**Juan Pablo Soriano**, Managing Director at **Moody's Investor Service**, stated:

*"Moody's Investors Service (MIS) welcomes the ECBC's initiative on the new voluntary addendum to the HTT. MIS has developed a template that allows issuers to provide MIS with the required data by filling the template either from the issuer's existing reporting or from the HTT data, in each case by means of a macro solution."*

**Roberto Paciotti**, Managing Director at **S&P Global Ratings**, stated:

*"S&P Global Ratings welcomes the revised HTT which contains much of the information required to produce the surveillance reports as set out by the ECB. We note that the timely completion of the revised HTT template is critical to allow publication of our quarterly surveillance snapshots within the timeframe set out by the ECB. We look forward to further engagement with issuers on this initiative."*

**Karlo Fuchs**, Head of Covered Bonds at **Scope Ratings AG**, stated:

*"The enhanced HTT is a key step towards higher market transparency in Europe. It will enable investors to better rank and monitor the risks among cover pools."*



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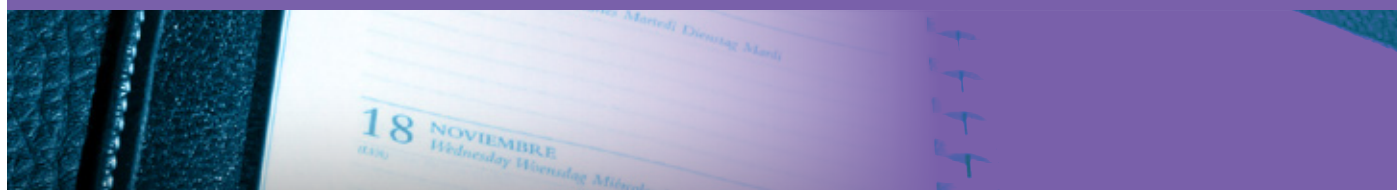
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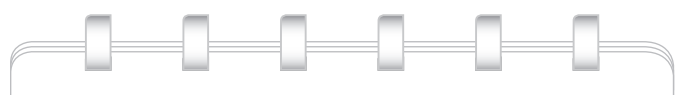
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DELOITTE	SCOPE RATINGS
DEMICA	WHITE & CASE



# AGENDA



## APRIL 2017

- 05/04** European Covered Bond Council (ECBC) Steering Committee Meeting – Oslo

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- 05/04** Covered Bond Label Foundation (CBLF) Label Committee Meeting – Oslo

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- 05/04** Covered Bond Label Foundation (CBLF) Label Advisory Council Meeting – Oslo

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- 06/04** 25<sup>th</sup> ECBC Plenary Meeting – Oslo

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- 25/04** European Parliament Financial Services Forum (EPFSF) Event on Capital Markets Union: Sustainable Finance Chapter – Brussels

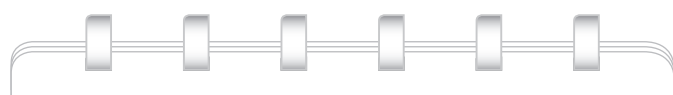
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- 27/04** Climate Alliance SEI Forum – Prague

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*All articles in this newsletter reflect the authors' views and do not necessarily represent the views and opinions of the European Mortgage Federation – European Covered Bond Council (EMF-ECBC) and/or its members as a whole.*



## MAY 2017

- 08/05** European Mortgage Federation (EMF) Valuation Committee Meeting – Bologna

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- 11-12/05** Italian Banking Association (ABI) Funding & Capital Markets Forum 2017 – Milan

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- 11/05** Berlin Hyp “Meet Berlin” Event – Berlin

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- 19/05** European Commission & European Central Bank Joint Conference on European Financial Regulation – Brussels

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- 23/05** Euromoney Conferences/EBRD/ECBC CEE Covered Bond Conference 2017 – London

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- 30/05** European Parliament Financial Services Forum (EPFSF) Event on Capital Markets Union: Pan-European Personal Pension Product (PEPP) Chapter – Brussels

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- 31/05** EMF-ECBC & European Central Bank (ECB) Annual Meeting – Frankfurt

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