EMF ECBC

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Summary

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ECBC Responds to European Commission Consultation on Covered Bonds in the EU

By Waleed El-Amir, Head of Group Finance, UniCredit & Chairman, ECBC

On the 5th of January 2016, the ECBC – as the voice of the European covered bond industry – formally responded to the European Commission's Consultation Document on Covered Bonds in the European Union (EU) (available here), which was published on the 30th of September 2015 as part of the Commission's Capital Markets Union (CMU) initiative.

In launching this exercise, the Commission recognised that, *"European credit institutions are world leaders in covered bond issuance"*. However, in parallel it stated its view of the market as currently being fragmented along national lines, which it believes, *"constrains standardisation in underwriting and disclosure practices, and creates obstacles to deep, liquid and accessible markets, in particular across borders."* In this context, the Commission's Consultation Document proposed a pan-European framework for covered bonds which would build on national regimes that work well without disrupting them and it would be based on high-quality standards and best market practices.

In responding to the Consultation, the ECBC welcomed the European Commission's proposal for further convergence in European covered bond markets and thanked the Commission for the invitation to submit comments on the Consultation Document, which, in the Industry's view, constitutes one of the most important legislative consultations on covered bonds in decades. To ensure a comprehensive, wide ranging and detailed response to the Consultation Document, the ECBC collected feedback from more than 750 national covered bond experts.

As an initial comment, the ECBC welcomed the European Commission's cautious approach towards harmonising covered bond frameworks in the EU. The subjects addressed in the Consultation Document are of crucial importance to the very different legislative frameworks that exist in Europe, which are a consequence of historical national differences in terms of mortgage markets, housing policies, consumer behaviour, insolvency law, credit and valuation regulation etc. Consequently, the ECBC believes that the concept of full EU covered bond harmonisation is a utopia.

However, the ECBC does see room for improvement and further convergence in specific areas in order to safeguard the recognised quality of EU covered bonds, which justifies their preferential regulatory treatment. Further convergence in covered bond frameworks would also enhance transparency, support the rationale of preferential risk weighting and make it easier for investors to take more informed investment decisions.

In the view of the ECBC, a balance must be struck between maintaining national covered bond legislative frameworks and establishing a common European framework, by means of (i) a recommendation to encourage Member States to increase convergence and (ii) a high quality principle-based directive ensuring harmonisation of certain minimum standards.

A combination of a recommendation and a principle-based directive will ensure that national markets continue to function whilst safeguarding the prominent role of covered bonds as a crisis management tool able to promote: (i) investors' confidence; (ii) financial stability; and (iii) long-term financing. In addition, this will maintain competition amongst Member States' covered bond markets, thereby ensuring that EU covered bond markets remain attractive to investors, whose investment decisions are currently mainly driven by risk appetite and search for yield.

> *"...the concept of full EU covered bond harmonisation is a utopia."*

COUNTRY SPECIFIC ISSUES

The ECBC agrees that certain country-specific issues must be taken into account by the European Commission when evaluating the responses to the Consultation Document. Given the structural differences that exist between national covered bond market structures (see above), the many subjects addressed in the Consultation Document are of vital importance to the very different covered bond legislative frameworks within the EU and, consequently, Member States will react individually and according to their national interest.

The ECBC encourages the European Commission to review these national country-specific issues in order to ensure that currently well-functioning national covered bond markets continue to do so in the coming years, and, thereby, avoid disrupting EU covered bond markets more than the Commission deems absolutely necessary.

Finally, the ECBC would like to emphasise the importance of drafting a legislative proposal which incorporates these country-specific points and is sufficiently principles-based so as to provide flexibility for the different national covered bond structures across the EU.

EUROPEAN COMMISSION'S COVERED BOND CONFERENCE

The deadline for the submission of responses to the European Commission's Consultation was the 6th of January 2016 and since this date officials within the Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) have been assessing the comments received. The Industry will have a first opportunity to hear DG FISMA's views in this regard in Brussels on the 1st of February 2016 at the European Commission's Conference on Covered Bonds. The Conference will be opened by DG FISMA Commissioner Jonathan Hill with the remainder of the event being broken down into sessions reflecting the structure of the Commission's Consultation paper as follow:

- **Session 1**: Covered Bonds Markets – Analysis of Market Trends
- **Session 2**: A more integrated Covered Bond Framework? The investor's perspective
- **Session 3**: A more integrated Covered Bond Framework? Assessing the options
- **Session 4**: Technical-Legal Panel: Elements for an integrated Covered Bond Framework

The Industry will be well represented during the Conference and it looks forward to this opportunity to elaborate upon the ECBC position regarding the Commission's initiative on covered bonds.

The full ECBC Response to the European Commission's Consultation on Covered Bonds in the EU can be accessed here and further details concerning the Commission's 1st of February 2016 Conference (including the live video stream of the event) can be found here.

The Energy Efficiency Debate is Knocking at the Door of Your House

By Luca Bertalot, Secretary General, EMF-ECBC

Investment in energy efficiency is one of the most cost effective ways to reduce the EU's reliance and expenditure on energy imports, costing over €400 billion a year. While energy efficiency investments have been occurring gradually for decades, today the EU finds itself in a situation where these investments have become of strategic importance due to the high level of energy imports required by the EU bloc, energy price instability and the need to transition to a competitive low-carbon and resilient economy.

Indeed, the energy efficiency debate is knocking at the front door of every European citizen's house and it is also taking centre stage in institutional and capital market debates. It is clear that investment in energy efficiency has a fundamental and beneficial role to play in the transition towards a more competitive, secure and sustainable energy system with an internal energy market at its core. Nonetheless, in our view, a crucial question remains open and difficult to answer for the European Institutions: how can a bridge be built between the energy efficiency investments required and the private capital markets financing these? Should the EU rely only on fiscal support to boost energy efficiency investments or is there a role to be played by private finance?

"How can a bridge be built between the energy efficiency investments required and the private capital markets financing these? Should the EU rely only on fiscal support to boost energy efficiency investments or is there a role to be played by private finance?"

Particularly since the COP21 Agreement in Paris in December 2015, it is clearly of strategic importance for the EU to engage multiple stakeholder groups and scale-up the use of several financial instruments within a clear and enforced "carrot and stick" legislative framework. However, this might not be sufficient: we also see the need to engage the financial services sector to trigger a mechanism according to which each and every EU citizen is incentivised to adopt energy efficient behaviour, and to trigger the market consensus of a broad spectrum of stakeholders and institutional support with a pan-European scope of action.

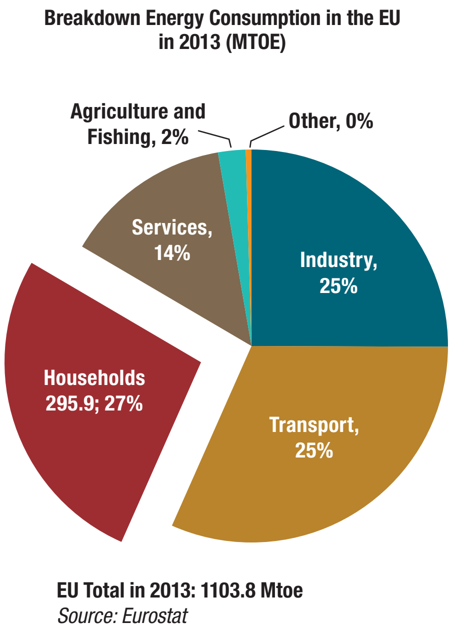
Against this background, is there a role to be played by the mortgage industry? Is it possible to incentivise a capital markets-based financing system which would help the EU to meet the requirements agreed in December in Paris? What are the energy efficiency parameters which should be adopted in order to ensure simplicity, materiality and to avoid the speculative trends associated with "green washing"? Do we have the pillars with which to build a business case for the financing of energy efficiency? These are questions which are currently being discussed by the major mortgage lenders of the Old Continent, which are in the midst of one of the most important phases of transition perhaps ever experienced, reorganising their business models as a result of the massive regulatory changes implemented in the years since the crisis. In addition, and perhaps more importantly, they are also facing high market volatility and fundamental demographic changes with unprecedented macroeconomic and social implications.

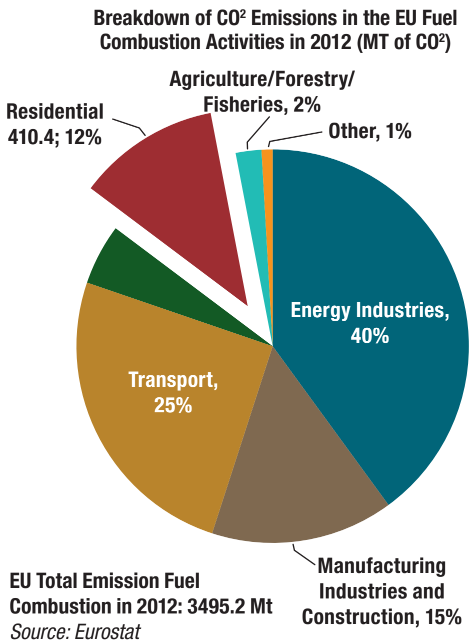
The energy efficiency debate presents two major challenges for the mortgage industry: firstly, how to contribute to the long-term financing of energy efficiency solutions for housing; and secondly, how to adopt a harmonised approach within the EU against a background of heterogeneity of housing markets and of citizens' behaviour and expectations towards both housing and the energy efficiency debate.

Almost one third of the EU's energy consumption is attributed to households. Consequently, a reduction in the energy consumption of housing units would enormously facilitate compliance with the COP21 Paris Agreement. The barriers to renovating buildings for energy efficiency purposes are well-known and require multiple solutions that should be implemented consistently and in a coordinated manner. Unlocking financing in order to render the EU's residential building stock more energy efficient will require not only a long-term vision but also policy breakthroughs to allow for more than one barrier at a time to be overcome.

We are also all aware that the long-term lack of energy efficiency investments could have a detrimental impact on property values in the future.

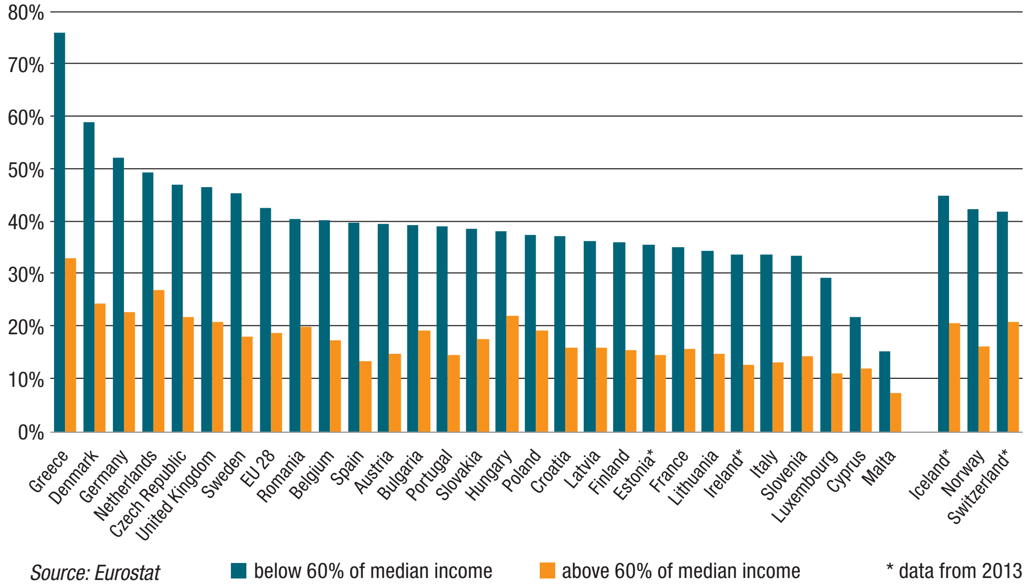
Environmental impact of housing in the EU





Housing cost in disposable income

Share of housing costs in disposable income, by income group (2014)



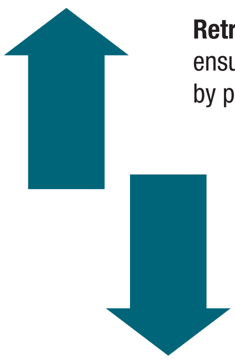
We consequently have to factor-in a potential "brown discount" element when analysing future values and the impact on banks' loss mitigation capabilities. With public finances under pressure and a low spread and high market volatility environment, this consideration could be particularly relevant for the due diligence of investors and issuers, especially when monitoring non-performing loans, property values and, from a more political point of view, when analysing housing cost impacts on disposable income or citizens' capability of wealth conservation.

As such, a financing initiative in this area could entail the following: a borrower willing to retrofit his/her housing unit in an energy efficient manner would have access to a preferential channel of financing, which would provide a "green discount" to be factored into the mortgage, providing the retrofit works fulfil a series of material energy saving parameters. From a practical and material perspective, an improvement in energy savings due to retrofit works in a "ménage" would improve the capacity of the household to meet its financial commitments, thereby reducing the associated risk for the lender. This causality emerges from analysis carried out in the US market, which indicates that the default risk of the "energy efficient" borrower declines progressively as the energy efficiency rating of the home is improved. If this trend were to be confirmed in the EU, conceivably this could trigger an institutional reflection at European Commission and Basel Committee level with regard to a discount in the capital charge for an "energy efficient" mortgage.

In the spirit of developing a common understanding, specific competence and synergies amongst stakeholders involved in energy efficiency, and also its financing, the EMF-ECBC is organising a stakeholder and institutional Roundtable in Brussels on the 26th of February 2016, the objective of which will be to analyse the potential creation of an Energy Efficiency Label for mortgages and a related data "warehouse". In this context, the EMF-ECBC will bring together the European Commission, the Basel Committee on Banking Supervision, the United Nations, the World Bank, energy efficiency specialists, building constructors, energy efficiency contractors, the valuation profession, property owners, issuers, investors and lenders from Europe and beyond.

The EMF-ECBC, for its part, is committed to analysing this issue very carefully from a market perspective according to a holistic and gradual approach. The Industry is keen to understand the feasibility of building a business case for the financing of energy efficiency, on the basis of a clear incentive chain, which would generate benefits for the borrower, the lender, the investor and, ultimately, the environment.

Energy efficiency drivers impacting market characteristics:



Retrofitting impacts positively on property value ensuring **wealth conservation** & **loss mitigation** by preventing "brown discount"

Energy efficiency leads to a reduction in the impact of energy costs to income, reducing borrowers' **probability of default**

NEWS IN BRIEF

Estonia Announces Intention to Introduce Covered Bonds

On the 5th of January 2016, the Estonian Ministry of Finance announced its intention to draft a Covered Bonds Act in order to create the legal environment in Estonia that would allow banks to issue covered bonds.

"Covered bonds have not been issued in Estonia yet," said Finance Minister Sven Sester. "A well-functioning covered bond market would give a boost to the Estonian securities market and improve the financing options of companies. Broader investment and financing options would in their turn support economic growth and the creation of new jobs."

According to the Ministry of Finance, banks operating in Estonia have shown interest in issuing covered bonds and their introduction into the market would provide an additional source of financing for Estonian banks. Trading activity on the Estonian capital market has not increased much over the years. The creation of a legal basis for issuing covered bonds would be a measure that could give a boost to the capital market and also create additional investment opportunities for investors on the domestic market.

Further details concerning the Estonian Ministry of Finance's announcement are available here.

BCBS Issues Revised Framework for Market Risk Capital Requirements

On the 14th of January 2016, the Basel Committee on Banking Supervision (BCBS) issued the revised minimum capital requirements for market risk as agreed by its oversight body – the Group of Governors and Heads of Supervision (GHOS). The revised market risk framework is a key component of the Basel Committee's overall efforts to reform global regulatory standards in response to the global financial crisis.

The purpose of the revised market risk framework is to ensure that the standardised and internal model approaches to market risk deliver credible capital outcomes and promote consistent implementation of the standards across jurisdictions. The final standard incorporates changes that have been made following two consultative documents published in October 2013 and December 2014, and several quantitative impact studies.

The key features of the revised framework include:

- **A revised boundary between the trading book and banking book**. A better defined boundary will serve to reduce incentives to arbitrage between the regulatory banking and trading books, while still respecting banks' risk management practices.
- **A revised internal models approach for market risk**. The new approach introduces a more rigorous model approval process that lets supervisors remove internal modelling approval for individual trading desks. It also allows a more consistent identification and capitalisation of material risk factors across banks, and sets constraints on the capital-reducing effects of hedging and diversification.
- **A revised standardised approach for market risk**. The standardised approach has been overhauled to make it sufficiently risk-sensitive to serve as a credible fall-back as well as a floor to the internal models approach, while still providing an appropriate standard for banks that do not require a sophisticated treatment for market risk.
- **A shift from value-at-risk to an expected shortfall measure of risk under stress**. Use of expected shortfall will help to ensure prudent capture of "tail risk" and so maintain capital adequacy during periods of significant market stress.
- **Incorporation of the risk of market illiquidity**. Varying liquidity horizons are incorporated into the revised standardised and internal model approaches to mitigate the risk of a sudden and severe impairment of market liquidity across asset markets. These replace the static 10-day horizon assumed under VaR for all traded instruments in the current framework.

The BCBS has conducted impact analysis using data provided by banks and assuming the revised market risk framework was fully in force as of end-June 2015. The revised framework produces market risk risk-weighted assets (RWAs) that account for less than 10% of total RWAs, compared to approximately 6% under the current framework. Compared with the current market risk framework, the revised market risk standard would result in a median (weighted mean) increase of approximately 22% (40%) in total market risk capital requirements. These impact estimates take account of the calibration refinements endorsed by the Committee in December 2015.

The revised market risk framework comes into effect on the 1st of January 2019. Over the implementation period, the Committee will continue to monitor the capital impact of the revised standard in order to ensure consistency in the overall calibration of the Basel capital framework.

The full text of the BCBS' revised minimum capital requirements for market risk can be accessed here.

A Broader Scope of the Definition of Default is Necessary

In response to the European Banking Authority's (EBA) call for an increased level of harmonisation in the application of the definition of default across the EU prudential framework, on the 22nd of January 2016 the European Mortgage Federation – European Covered Bond Council (EMF-ECBC) responded to the EBA outlining its key views on the initiative:

- The EMF-ECBC **welcomed the objective of the EBA Guidelines to harmonise** the definition of default to ensure consistency of its application and transparency as well as the comparability of risk parameters across Member States.
- However, due to the importance of **the concept of default**, it is essential to guarantee its **consistency** also within the larger supervisory framework. Accordingly, the definition of default should be consistent across the EU's capital requirements, the EBA technical standards and the implementation of the International Financial Reporting Standards on Financial Instruments (IFRS 9), and any future EBA guidelines.
- The EMF-ECBC expressed its concerns on implementing a **too narrow harmonised definition of default** across different credit institutions and jurisdictions in the EU. For example, the EMF-ECBC considers the definition of technical default proposed by the EBA to be too narrow in scope. In addition, the EMF-ECBC proposed that the sale of credit obligations is considered as an indication for unlikeliness to pay but should be associated with other indicators and not used as a stand-alone criterion.
- The EMF-ECBC believes that the new definition **should not be applied retroactively**. The Guidelines should **allow for sufficient time** needed **for** the **implementation** of them by the Industry.

Commenting on the EBA proposed Guidelines, **Luca Bertalot, EMF-ECBC Secretary General**, said:

> *"Improving the consistency of the way EU credit institutions apply the definition of default is a welcome step forward. However, for it to be successful the EBA must consider widening the scope of the harmonised definition and provide sufficient time for credit institutions to adjust their internal rating systems accordingly."*

In this context, the EMF-ECBC encourages the EBA to engage with the Industry to determine feasible proposals and rules safeguarding a level playing field in the introduction of the new harmonised definition of default.

The full EMF-ECBC Response is available here.

ESA Letter to European Commission on Cross-Selling

On the 26th of January 2016, the chairpersons of the three European Supervisory Authorities (ESA's – namely the European Banking Authority (EBA), the European Securities & Markets Authority (ESMA) and the European Insurance & Occupational Pensions Authority (EIOPA)) sent a joint letter to Jonathan Hill, European Commissioner for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) with regards to the cross-selling of financial products in the European Union.

In their letter, the ESA chairpersons raise a number of concerns with respect to certain inconsistencies in the existing EU legislation that impacts upon regulation in the area of the cross-selling of financial products in the banking, insurance and investment sectors, and urge the European Commission to undertake any necessary steps in this respect.

The full text of the ESA chairpersons' letter can be found here.

European Commission Live Chat on Mortgages

On the 26th of January 2016, the European Commission held an online live chat entitled ***"Bank accounts, mortgages, loans or insurance: Tell the Commission what should be done!"*** during which Mario Nava, Director of Regulation & Prudential Supervision of Financial Institutions, DG FISMA, and his team answered questions from the public and other stakeholders on consumer financial services.

This event took place in the context of the European Commission's currently ongoing consultation on its Green Paper on Retail Financial Services, which was published on the 10th of December 2015 and which runs until the 18th of March 2016 (further details available here).

During the chat, a number of questions were raised concerning access to mortgages in the EU, mainly in the context of cross-border lending. All of the questions asked during the chat together with the European Commission's responses to them can be accessed via the event's website, here.

ECBC Events in Singapore – March 2016

Following on from the success of previous years' events, we are pleased to announce that the ECBC will be returning to **Singapore** on the **9th of March 2016** in order to host the third edition of the **ECBC Asian Covered Bond Investor Roundtable**.

To recap, this event aims at:

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

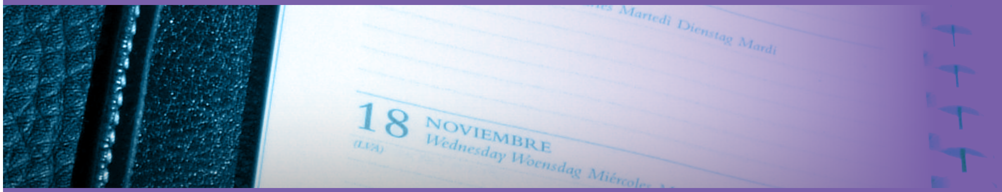
As such, the event will attract mainly investors, but also potential new covered bond issuers and national authorities currently working on drafting covered bond legislation. During the events participants will be able to discuss the current major developments in the covered bond space such as resolution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

In addition, we are delighted to confirm that the **European Central Bank** (ECB) will participate in these discussions, represented by Ad Visser, Head of the ECB's Financial Markets & Collateral Section, Market Operations Analysis Division.

If you would like to know more about this Roundtable event please contact the Secretariat at ecbcinfo@hypo.org.

As in previous years, this event will be preceded on the 8th of March 2016 by the **Euromoney/ECBC Asian Covered Bond Forum**, which will also be held for the third time. Further details regarding the draft Agenda for this year's Forum, how to apply for a place and information on previous editions can be found here.

In addition to these events, we are delighted to announce that the inaugural meeting of the new **ECBC Global Issues Working Group** will also take place in Singapore on the 7th of March and will be kindly hosted by the **Association of Banks in Singapore (ABS)**.



AGENDA

FEBRUARY 2016

01/02	European Commission Conference on Covered Bonds – Brussels
02/02	European Covered Bond Council (ECBC) Long-Term Financing Task Force Meeting – Brussels
02/02	European Covered Bond Council (ECBC) Statistics & Data and Fact Book Working Groups Joint Meeting – Brussels
05/02	European Banking Authority (EBA) 5th Anniversary Conference – London
11/02	Crédit Foncier de France Conference on Real Estate Markets – Paris
15/02	European Banking Industry Committee (EBIC) Plenary Meeting – Brussels
16/02	Long-Term Investment Intergroup Conference "COP21: What's next?" – Brussels
17/02	Basel Committee on Banking Supervision (BCBS) Hearing on Revisions to Standardised Approach for Credit Risk – Basel
18/02	European Banking Authority (EBA) Working Group on Securitisation & Covered Bonds Meeting – London
22-23/02	Investor Days 2016 – Brussels
23/02	European Parliament Financial Services Forum (EPFSF) Event on Improving SME Access to Finance – Brussels
24/02	Build Upon Event (Green Financing) – London
24/02	Cicero Roundtable on the Green Paper on Retail Financial Services – Brussels
25/02	European Mortgage Federation (EMF) Economic Affairs Committee Meeting – Brussels
26/02	2nd European Mortgage Federation – European Covered Bond Council (EMF-ECBC) Roundtable on Financing Energy Efficiency – Brussels
29/02-02/03	IMN ABS Event – Las Vegas

MARCH 2016

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