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European Covered Bond Council

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EBA Recommends a Harmonised EU-Wide Framework for Covered Bonds



On the 20th of December 2016 the European Banking Authority (EBA) published a Report including recommendations on how to harmonise covered bond frameworks in the EU. The Report, available [here](#), represents an unparalleled attempt to further strengthen covered bonds across

the EU and seeks to ensure that only those financial instruments that comply with the harmonised structural, credit risk and prudential standards can be branded as “covered bonds” and have access to special regulatory and capital treatment as provided for in the current EU financial regulation.

The Report presents an in-depth regulatory and market analysis undertaken by the EBA as a follow up to the recommendation issued by the European Systemic Risk Board (ESRB). As part of the analysis, the EBA observed that covered bond instruments with different quality characteristics across the EU are subject to the same European regulatory rules and benefit from a favourable regulatory recognition.

Building on the results of the extensive study, and at the same time recognising the specificities and strengths of national frameworks, the EBA proposes

a fully-fledged framework based on a “three step approach” to harmonise covered bonds in the EU:

- First, a new covered bond directive should be developed to provide a definition of the covered bond and specify structural quality requirements for all regulated covered bonds in the EU.
- Second, the Capital Requirements Regulation (CRR) should be amended to strengthen conditions for those covered bonds that seek preferential capital treatment.
- Third, convergence of national frameworks should be encouraged on a voluntary basis in some specific cases by means of non-binding instruments.

This Report will provide input into the European Commission’s considerations on the further development of the Capital Markets Union (CMU) project.

Scope's Covered Bond Outlook 2017: Credit contraction unlikely to unravel

👉 By Karlo Fuchs, Head of Covered Bond Ratings, Scope Ratings



Scope Ratings expects in its 2017 outlook¹ that the credit performance of covered bonds will continue to improve, thanks to the enhanced regulation and supervision that is strengthening the credit fundamentals of European banks, the anchor point for this asset class' credit quality. The regulatory improvements lead not only to safer business models for issuers, but to stronger capital and liquidity profiles as well. At the same time, the European Central Bank's (ECB) quantitative easing continues to support financial stability in Europe and benefits borrowers' asset quality, and ultra-low interest rates are prompting issuers to lengthen the maturities of new covered bonds, thereby reducing their covered bonds' main risk – the asset-liability mismatch.

RATING STABILITY: THE NEW NORMAL FOR COVERED BONDS?

The credit quality of the large European banking groups that we rate continues to converge into the single A range. This reflects not only the increasingly level playing field on which banks operate, but also the converging prudential requirements, which leads to more uniform regulatory metrics. Scope's European banking outlook for 2017² notes that: ultra-low rates will continue to challenge earnings; existing overcapacity remains the industry's Achilles' heel; and better capital levels are not matched by higher earnings.

Most banks have started to adapt to the new environment, and changes to issuers' credit quality in 2016 have been very limited. Also, the bank rating changes have not affected our covered bond ratings. On aggregate, we see relative stability for the banks' credit quality to continue in 2017.

At the same time, the widened national implementation of MREL guidelines and the resulting ability to bail-in certain parts of a banks' liability structure, will result in further upgrades of the bank rating as preferred creditors will benefit from a more ample capital structure in a default like scenario.

Our ratings of banks in Germany, Belgium, the UK and Switzerland already reflect this ability to bail-in certain forms of senior bank debt. We expect ICSRs of banks in France, Spain, Italy and Sweden to also improve once national regulators have clarified their view on

MREL liabilities and banks have the ability to issue this new type of senior unsecured – but bail-inable – debt.

Improved ICSRs will bolster the resilience of existing covered bond ratings against issuer downgrades and recourse to the cover pool, and its importance for the covered bond rating, will further reduce. Already today most covered bonds rated by Scope are based on 'fundamental support'. A bank rating in the single A range, combined with our favourable view on the countries' legal frameworks and resolution regimes, supports covered bond ratings without taking recourse to the cover pool.

Only two of the 23 covered bond programmes we rate (Bankia SA's Cédulas Hipotecarias, AAA/Stable, and Dexia Kommunalbank Deutschland AG's Öffentliche Pfandbriefe, AA-/Stable) rely on the cover pool recourse to achieve and maintain current ratings.

COVERED BOND VOLUMES TO STABILISE IN 2017

Our expectation of the continuation of net negative supply for covered bonds in 2016 has largely been confirmed. We expect the European covered bond market to end 2016 at close to EUR 2.3tn, following the height of EUR 2.7tn in 2012.

We do not believe that a return to sustainable growth is already likely in 2017. European credit demand remains soft and headline risk will persist in 2017. The ECB's monetary policy continues to provide ample liquidity to the banking system and, although the deleveraging of balances sheets has slowed, it is not over. Further, French, Italian, Spanish or Swedish banks are likely to start issuing bail-inable senior debt in 2017, which will also reduce the need for covered bond funding.

Our baseline assumption is that the European economy will continue to grow – albeit at a slow and potentially volatile pace. The 2016 Brexit vote has already provided uncertainty and closed the markets for some time, and its method of execution remains unclear. Socio-political risk will persist, and it remains to be seen whether the unexpected (e.g. Donald Trump winning the US elections) will also become the new normal for 2017. The results of the 2016 referendum in Italy and the 2017 elections in France and Germany will be important European milestones in that context. It is still unclear whether the results will introduce stability

and certainty for the eurozone and its GDP growth, or amplify volatility and dampen growth prospects.

The persistent uncertainties, in combination with low growth prospects, make our issuance outlook bearish, and we expect that current volumes of outstanding covered bonds will stabilise – at best.

LOW INTEREST RATES UNLIKELY TO SPUR INNOVATION

A long-term funding market is not the most likely candidate for product innovation, and the ultra-low interest rates are even less conducive in this respect. As long as spread differentials between asset classes remain low, we do not believe incentives for issuers are high enough to establish new dual-recourse funding alternatives using the covered bond blueprint.

In 2016, we have not seen any repeat of a real covered bond for small and mid-sized enterprises (SMEs), and the concept of a covered bond like the European Secured Note (ESN) only remains a theoretical option. Also, the first-time issuance of the export-credit-based Cédulas de Internacionalización has not yet been repeated in Spain, and we do not think that structured covered bonds by Deutsche Bank will find followers in Germany.

We see merit in innovations that improve the credit quality of covered bond products but currently most innovations are driven by issuer-specific situations, and thus are unlikely to see a more widespread use. We hope that the EBA's harmonisation proposal, and the changes to the ECB's collateral policies do not discourage issuers from further improving the product or allowing banks to establish dual-recourse funding products with a high credit quality.

IMPROVING COVERED BOND FRAMEWORKS

Fundamental support factors, such as national legal frameworks that govern covered bond issuance, have great importance for a covered bond's credit quality. Changes to existing covered bond frameworks over the last two years have been cosmetic in nature and were not material enough to lead us to reassess the fundamental support we take into account in our covered bond ratings.

We expect the European Commission's harmonisation agenda to increase the number of changes to national

¹ The full covered bond outlook can be accessed [here](#)

² [European Banking Outlook for 2017 and Beyond: Balance Sheet Safety vs Profitability Challenges](#)

covered bond legislations – with first movers already starting to appear in 2017. While some legislation may only need subtle amendments, others might be forced into more fundamental changes when trying to translate the EBA's core covered bond principles into national frameworks. A full alignment across Europe will be a lengthy process and unlikely to be completed before the end of the decade.

DIFFERENCES IN LEGAL FRAMEWORKS HIGH-LIGHT NEED FOR HARMONISATION

In November 2016 the European Banking Authority (EBA) held a hearing on the harmonisation of covered bonds. They presented a legal framework analysis which illustrated that differences in the frameworks persist – also highlighting that investors need to be aware of these when investing on a pan-European basis.

In some European countries, e.g. Slovakia, the bankruptcy remoteness of the cover pool is not a given, and investors could face an acceleration of covered bonds upon the insolvency of the issuer. In others, e.g. Spain, the collateral provided in the cover pools might no longer comply with loan-to-value limits, as compliance is tested at origination and no cover pool revaluations based on house price development are required by law. Further, in most European covered bond countries investors have to rely on the voluntary disclosure of issuers, which can be infrequent and not comparable across countries, making it difficult for investors to compare the pools' resilience.

The EBA's November 2016 draft of their harmonisation proposal addresses many of these issues and provides a sound basis for the further development of this asset class. In contrast to the European commission's initial idea of a prescriptive 29th regime, the proposal provides a mix of core principles applicable to all covered bonds that seek regulatory recognition and allows some further voluntary convergence.

The European Commission is ultimately in the driver's seat to put harmonisation into practice. In our view, a lot of the EBA proposals will eventually be adopted by all the Member States. We believe investors will welcome the lower degree of divergence in the credit quality of covered bonds issued in the Member States, and harmonisation might even help encourage covered bond investment across borders, without the risk of surprises. However, harmonisation might also result in an underestimation of prevailing differences in risks: the diverging economic situation in Member States, diverging dynamics of bank fundamentals, as well as the dynamics driven by the management of risks between covered bond programmes of different issuers.

EBA'S HARMONISATION PROPOSAL TO IMPROVE MINIMUM CREDIT QUALITY

The EBA's covered bond harmonisation proposal addresses diverging practices in legal frameworks and will help to provide a clearer definition for the asset class in three steps:

'The cake'

To avoid a covered bond being affected by a potential restructuring of its issuer, the EBA proposes the following key features to establish a covered bond:

1. A clearly defined dual-recourse principle, the clear and valid segregation of cover assets, and the bankruptcy-remoteness of the covered bond
2. Requirements on the coverage of covered bond repayments, mitigation of liquidity risk, and cover pool derivatives
3. A more clearly defined system of special public supervision and administration
4. Transparency requirements for the issuer, including specific conditions for 'soft bullet'/conditional pass-through (CPT) covered bonds

From a rating perspective, we view positively the heightened awareness for a cover pool's inherent liquidity provision. In particular, we consider as credit-positive the requirement to provide liquidity for the first six months within the covered bond structure. It will reduce pressure for the cover pool administrator to sell parts of the cover pool at distressed prices – effectively destroying value.

Soft-bullet structures are likely to become the issuance format of choice for most issuers as they allow issuers to reduce the amount of 'liquid' assets held within the covered bond structure.

We understand that the enhanced clarity surrounding the special supervision and administration will provide investors with more clarity surrounding the worst case: a 'stand-alone' cover pool having to service outstanding covered bonds. We believe that enhanced transparency and homogeneity will be welcomed by investors. They often lack resources to commission legal opinions or engage in discussions with regulators or insolvency practitioners – elements that typically allow rating agencies to gain sufficient comfort on the cover pools status upon an issuer's insolvency.

We also view positively that the EBA positions covered bonds as a 'credit product'. Quarterly cover pool reporting will become obligatory for issuers highlighting that the evolution of risks needs to be regularly monitored by investors.

'The icing'

To achieve preferential risk weightings under the CRR/CRD IV as well as Solvency II, the EBA proposes to add: more-detailed credit measures into the regulation (including definitions for eligible cover assets); the requirement to keep the loan-to-value thresholds current; and a one-size-fits-all minimum overcollateralisation of 5%.

We believe the exclusive definition of eligible cover assets does not bode well for the acknowledgement that covered bonds are a credit product. From a credit-risk standpoint, we firmly believe that even

SMEs can support high credit quality instruments – in particular when originated in the normal course of business and maintained on the balance sheet of the issuer. The absence of a clear Europe-wide definition of what constitutes an SME, and the challenge to establish a similar, transparent credit-risk indicator for SME's (as e.g. the LTV for mortgages) currently does not facilitate the restriction of cover assets to the prime segment – for now. In light of the European Commission's Capital Markets Union (CMU), which aims to foster SMEs, and our view that markets might agree on comparable credit-risk indicators for SME's over time, we believe the final proposal should not rule out the widening of eligible assets to granular pools of assets with a predictable risk profile.

Further, an increased one-size-fits-all overcollateralisation creates a false sense of security for investors. Even within the same jurisdiction and within the limits of the same covered bond regime, the combination of and interaction between risks (credit risk, residual market risk and, notably, asset-liability mismatch risk) can significantly vary between issuers and their covered bonds. We do not believe that uniform requirements across issuers will provide the same credit protection. Similar to the Pillar II requirements in normal banking regulation, supervisors should have the ability to establish and publish individual overcollateralisation levels that allow a cover pool to withstand a pre-defined level of stress.

'The cherry on top'

The proposal highlights areas that national regulators could focus on to improve their frameworks, in order to foster investor acceptance. This includes the restriction to a single asset type or geographic focus, or the way and frequency that loan-to-value is measured (difference between market value and prudent mortgage-lending value).

We believe the additional stress-testing requirements, currently only part of the voluntary convergence, should become an integral part of preferential risk weightings.

THE ECB: A ROLE MODEL FOR INVESTORS?

As of end November 2016, the ECB was the single largest covered bond investor, with holdings of more than EUR 200bn accumulated during the third covered bond purchase programme (CBBP3). The ECB already holds 30% of eligible covered bonds on its balance sheet (up from about 18% a year ago), and its holdings in individual issuances can be as high as 70% of the outstanding volume. Any ECB action will have a significant impact on the market and liquidity of this asset class.

The CBBP3 has already had a significant impact on the covered bond market, resulting in a significant spread compression between 'core' and 'peripheral' markets. In the view of many investors the missing credit spread differentiation has converted covered bonds into a 'rates' product. The ECB has almost si-

phoned off primary and secondary markets and itself needed to reduce the volume of monthly purchases under the programme. Still, the programme has been extended by nine months, to end in December 2017.

Investors feel crowded out. They cannot replace maturing covered bonds as the ECB is active in primary and secondary markets. The end of the CBBP3 will have a significant impact on the covered bond market, and a well-timed and well-managed end is of crucial importance.

The ECB's annual update of the collateral framework seems simple as the changes are rather subtle, for example, to collateral haircuts. However, we believe the update provides something to consider for traditional covered bond investors. The ECB highlights two aspects that diligent covered bond investors should always monitor: 1. how does the credit quality of covered bonds evolve over time; and 2. what is the impact of maturity extensions (soft bullets, as well as conditional-pass-through covered bonds – CPTs).

The ECB's changes will make more information available to investors, who will then become able to validate their credit views. The enhanced transparency will benefit the market, as pricing will eventually again have to reflect credit differences rather than the current supply-demand imbalances.

1. New disclosure requirements for rating agencies

Regulators generally try to reduce reliance on ratings, but these still play a crucial role for the ECB's haircuts in the collateral framework. Forming an independent credit opinion for covered bonds is, in contrast to ECB-eligible securitisations, not really facilitated, as issuers do not provide a very high level of transparency on their cover pool risk structure. Regular and very detailed reporting is not required in most covered bond legal frameworks, and the industry has only recently made progress with the introduction of the ECBC's [Covered Bond Label](#) as well as a more standardised reporting format (the [Harmonised Transparency Template](#) – HTT).

Most investors rely on the credit assessment performed by credit rating agencies (CRAs), and the level of sophistication investors apply for their own assessments can vary significantly. Monitoring the composition of the cover pool is a starting point, but what matters is the impact of those changes on the covered bonds' credit quality. While CRAs might have diverging views on the level of credit risk and the impact of market risk, we believe that the regular provision of different views will give investors the needed insight into a covered bond programme's resilience against adverse shocks.

2. Consultation on the treatment of soft bullets and CPTs

The ECB also announced that in the second half of 2017, it will look into soft-bullet or conditional-pass-through covered bonds, including those issued at floating rates.

Retained covered bonds have been a lifeline for some banks in terms of providing liquidity, and we welcome that the ECB currently does not intend to go as far as the Swedish central bank, which disallowed the use of 'self-issued' covered bonds as collateral.

In terms of financial stability, we view positively that the use of such instruments will not become prohibited, and will only become an economically less-interesting liquidity option. At the same time, we view the widened application to publicly placed soft bullets or CPTs as a double-edged sword.

Soft bullets and CPTs allow a mitigation of liquidity risk, and we expect their use to become the new standard. We believe the ECB needs to find a well-balanced change to its haircut framework to facilitate the increased use of such credit-positive issuance formats.



A Closer Look At The Brazilian Covered Bond Framework

By Antonio Farina, Senior Director & Roberto Paciotti, Managing Director – Analytical Manager Covered Bonds, S&P Global Ratings



In October 2014, Brazil enacted Provisional Measure No 656, which outlined the framework for Brazilian covered bonds (letra imobiliária garantida; LIGs). This measure became Law No. 13,097 in January 2015.

S&P Global Ratings has reviewed this legislation. From the standpoint of the legal protection afforded to covered bondholders by the Brazilian framework in the event of the issuer's insolvency, we conclude that the new regime could allow a covered bond programme to be rated above the issuer credit rating (ICR). However, we also see several aspects that the law leaves unclear. We expect that secondary legislation, which the Brazilian Monetary National Council (CMN) should approve in 2017, will address these loose ends.

When assessing the underlying legal framework of a covered bond issuance, we focus primarily on the degree to which the cover pool assets are isolated from the risk of issuer bankruptcy and whether a bankruptcy is likely to have other detrimental effects on the timely and full satisfaction of the covered bondholders' claims.

We have reviewed five key aspects of Brazil's covered bond legislation:

1) Segregation of the cover pool assets and cash flows

We examine whether or not the cover pool assets are fully available to meet the obligations under the covered bonds. Law No. 13,097 qualifies the cover pool as a segregated portfolio subject to a fiduciary regime. This means that the cover pool assets are deemed legally separate and independent from the issuer's own assets. In particular, the cover pool and its underlying assets will not be available to any of the issuer's creditors other than the bondholders, except if the issuer commits fraud or illegal activities when it creates the cover pool.

Third-party execution risk. An LIG's cover pool is earmarked for the settlement of payment obligations of the issuer under the corresponding LIG. It cannot be seized, attached, or otherwise affected in case of default, intervention, extrajudicial liquidation, or bankruptcy of the issuer or because of any judicial lien resulting from the issuer's other obligations. The issuer is legally prevented from using, disposing, or encumbering any assets backing a cover pool.

Therefore, such underlying credit rights and remaining assets cannot be subject to any lien, burden, or encumbrance other than those related to the rights of LIG holders, and they shall only be released from the fiduciary regime upon the full payment of principal, interest, and other charges related to the LIGs.

Commingling risk. This refers to the possibility that collections received on the cover pool assets from the debtors fall into the general estate of the bankrupt issuer and are thereby either lost or frozen for the covered bondholders.

Since the cover pool assets are deemed legally separate and independent from the issuer's own assets, we understand that collection cannot be released from the cover pool until the issuer's obligations under the LIG are fulfilled. Thus, if the issuer defaults on its obligations under the LIG, any amounts arising from the collection of the assets – either under a pre-insolvency or a post-insolvency scenario – would belong to the bondholders.

Set-off risk. We consider the extent to which borrowers are entitled to set-off amounts owed to them by the issuer against their repayment obligations under the loans, in particular deposits that the borrowers may have with the issuer.

The amounts owed by the borrowers to the issuing bank are part of the segregated portfolio, specially created for the LIG's bondholders. Therefore, we understand that such assets should not be deemed as being part of the issuing bank's assets and should not qualify for set-off risk.

Eligibility criteria and replacement of ineligible assets.

The issuer is authorised to replace the assets backing a cover pool on a revolving basis upon fulfilment of certain replacement criteria that are yet to be promulgated by the CMN. The CMN has yet to implement a rule on eligibility criteria, portfolio composition, sufficiency, term, cover pool liquidity requirements, and the conditions for the replacement of assets that become ineligible.

The law does not clarify whether or not an asset that becomes ineligible should be maintained, excluded, or replaced from the pool of assets, under either a pre-insolvency or a post-insolvency scenario. We expect future regulations to address these issues.

2) The risk of acceleration of payments to bondholders, a payment moratorium, or forced restructuring

Acceleration of payments. Notwithstanding the issuer's default, intervention, extrajudicial liquidation, bankruptcy, or the acknowledgement of the issuer's insolvency by the Brazilian Central Bank, acceleration of the LIGs is forbidden as long as the cover pool is "solvent," as defined according to the criteria to be implemented by the CMN. Consequently, it is still not possible to determine how and when the cover pool shall be deemed "solvent" or "insolvent" and who should do so and if the acceleration risk is effectively mitigated.

Moratorium and forced restructuring. The pool will not be directly or indirectly available to satisfy any other issuer obligations, no matter how privileged they might be, until the full payment of the amounts due for the LIG holders. Therefore a moratorium or forces restructuring would not be imposed upon the cash flows from the cover pool assets.

3) Limits to the amount of overcollateralisation

Law 13,097 provides for minimum overcollateralisation thresholds for the cover pool and related credit enhancement mechanisms. However, the law does not regulate how any overcollateralisation – above the minimum threshold – should be treated in terms of replacement. Third parties may question this overcollateralisation, especially if, for any reason, the parties are not able to prove that the overcollateralisation ratio chosen is reasonable for the relevant programme. We expect future regulations will clarify the treatment of overcollateralisation over the legal minimum.

4) Treatment of hedging arrangements

The cover pool may contain derivatives contracted through a central counterparty acting as guarantor (for example, stock exchanges or clearing houses), while over-the-counter derivatives are not eligible for the cover pool. Swaps contracted through a central counterparty acting as guarantor are subject to the specific rules issued by the respective stock exchange or any other central counterparty acting as guarantor, especially for insolvency and termination-related issues. Such roles might not

follow our criteria and could limit our ability to give credit to derivative agreements included in the cover pool. Notwithstanding the above, the CMN could authorise over-the-counter derivatives to be eligible for the cover pool pursuant to Article 66, Item IV, of Law No. 13,097.

5) Access to funding after the issuer's bankruptcy

Law 13,097 establishes that in case of default, intervention, extrajudicial liquidation, or bankruptcy of the issuer, the trustee shall be vested with powers to manage the cover pool assets, pursuant to the conditions and duties to be further regulated by the CMN. The cover pool assets cannot be subject to any lien, burden, or encumbrance other than those related to the LIG holders' rights, so they would be freely transferable. In this sense, the trustee is empowered to raise liquidity. Upon the adjudication of an insolvency estate, the trustee shall convene a general bondholders meeting, with the author-

ity to take any appropriate measure regarding the management of the asset pool.

Any and all actions taken by the trustee require prior approval by the committee of general bondholders in order for the trustee to call upon the issuer's insolvency and decide how the pool of assets should be managed. However, this may cause liquidity issues if a bondholders' meeting cannot be held before the maturity date of the covered bonds. We will consider if this risk is mitigated in the secondary legislation.

A Preliminary Assessment

At this stage, the views we've outlined remain preliminary, particularly because we have not yet seen the secondary legislation.

We believe that new legislation could allow a covered bond programme to be rated above the issuer's ICR, but we also note several aspects that the law still

leaves unclear. Among other things, we look forward to seeing if and how secondary legislation will:

- Further clarify the concept of cover pool solvency and mitigate acceleration risk;
- Define the eligibility criteria for the cover pool assets and their inclusion in the cover pool once those criteria are not met;
- Clarify the treatment of voluntary overcollateralisation; and
- Mitigate the liquidity risk arising from the fact that the trustee must call an investors' meeting before managing the cover pool.

We also note that the current definition of eligible derivative agreements may prevent S&P Global Ratings from giving credit to swap agreements in our analysis.



Liquidity and Trading Volume in the EU Covered Bond Market

By Steffen Dahmer, JP Morgan, Moderator of the ECBC Liquidity Task Force and Chairman of the ECBC Market Related Issues Working Group, Michael Weigerding, Commerzbank AG, Joost Beaumont, ABN AMRO BANK N.V., Jonny Sylven, Association of Swedish Covered Bond Issuers & Kaare Christensen, Association of Danish Mortgage Banks

INTRODUCTION

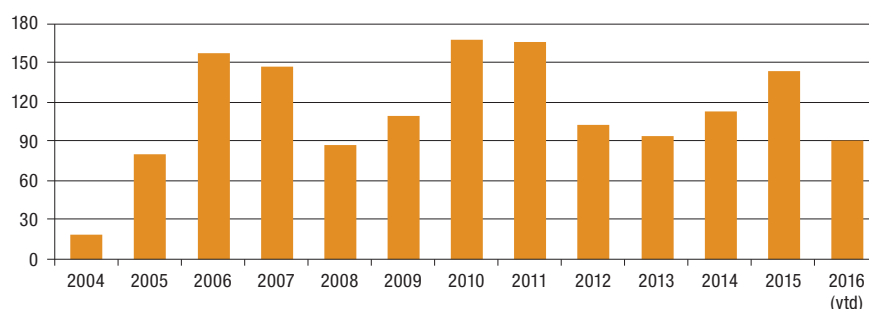
The international covered bond benchmark segment which started as interbanking market-making (head to head) market in the 1990's, transformed during the crisis into a pure client (investor) market-making market. This makes the covered bond market very much comparable to the supranational, sub-sovereign and agency (SSA) and sovereign market. A functional Repo market increases constantly the liquidity of the covered bond market, as consequences the covered bond benchmark market can be named as one of the most liquid market segments. There are still two camps, one which views covered bonds thanks to the nature and the rating as part of the rates world, and the other which clearly see credit elements and would value it as strongest product of the credit world.

As any other market in the rates or credit world, the covered bond market faces regulatory requirements which result in a more prudent approach by trading books in terms of balance sheet allocation. In sum, bank inventories have gone down and often only axed trading books are able and willing to show competitive prices and sizes to investors.

We continue to see the trend that EUR 500 m is becoming more and more the standard benchmark size for issuers, although issuers with larger annual funding appetite still favouring a EUR 1 bn deal or larger. In the US \$ market the 1 bn and even larger is the standard however a few examples in the last 1-2 years did also proof the acceptance of a USD 500 m benchmark. The Swedish or Danish Kroner covered benchmarks are often significant by size and therefore far larger than the Euro or Dollar benchmarks. Obviously smaller benchmark volumes lead often to smaller secondary turnovers given that the various covered bond markets are dominated by a majority of buy and hold investors. Furthermore, redemptions have also been at rather high levels in the past few years, resulting in negative net supply. This implied that the covered bond market shrank in 2013, 2014, and 2015. This year gross issuance has been roughly in line with redemptions so far. New jurisdiction such as Singapore, Turkey, Korea and others helping to lighten the net issuance reduction but were still not enough to stop the trend.

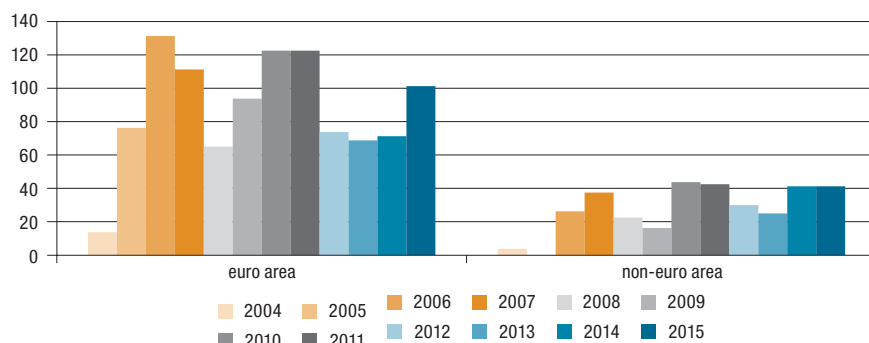
In sum, lower net supply, new deal size developments, a change of regulatory requirements and

Figure 1 ► Gross supply of euro benchmark covered bonds (EUR bn)



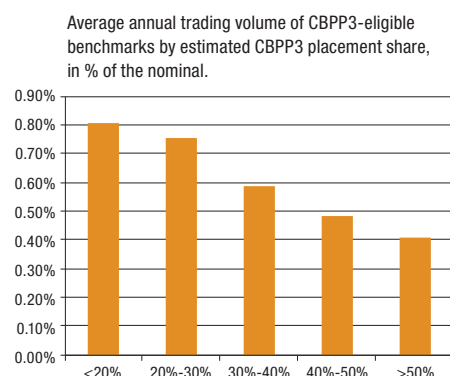
Source: Bloomberg, ABN AMRO

Figure 2 ► Gross supply of euro benchmark covered bonds by region (EUR bn)



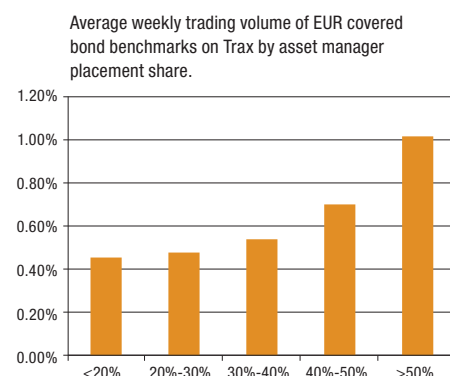
Source: Bloomberg, ABN AMRO

Figure 3 ► Higher CBPP3 share dampens market turnover



Source: Trax, Commerzbank Research

Figure 4 ► Asset managers trade more frequently



the nature of the investor base have a direct impact on secondary liquidity.

Gross supply of euro benchmark covered bonds has clearly increased in recent years. After gross issuance declined in 2012 and 2013, it has started to rise again in the past few years. In 2014, the rise was mainly driven by an increase in both the number of new issuers as well as a rise in the amounts issued from jurisdictions outside the euro area. However, last year, the rise in gross supply of euro benchmark covered bonds was merely due to increased issuance from banks located within the euro area. This is related (at least partly) to the Eurosystem's third covered bond purchase programme (CBPP3), which has made it increasingly attractive for banks to issue covered bonds. At first sight, this should have supported liquidity. However, the rise in gross supply from euro area issuers was fully offset by primary allocation to the EUR central banks under CBPP3. As a result, CBPP3 allocation has dampened turnover and reduced liquidity, the size of the traded volume drop is remarkable. Although many other traditional investors have also become mainly long term investors for various reasons, the below graphs clearly indicate a higher placement share with fund managers or a high oversubscription level usually go hand in hand with greater trading activity on the secondary market. In sum, the CBPP3 purchases, of course, seem to have impacted covered bond's trading volume.

Meanwhile, the number of benchmarks outstanding in the Markit iBoxx euro covered bond index has steadily increased in recent years. In June 2016, the iBoxx included 733 benchmarks, which was 100 more than at the end of December 2014. Thus, the number of flavours that investors can choose from has risen, which in the end should support liquidity.

Let us again look at the evolution of investor base as an angle for liquidity. If the share of buy-and-hold investors has risen in the past few years, this should have reduced liquidity of covered bonds. Figure 6 below shows the average share per investor type in new euro benchmark deals. The graph clearly illustrates the crowding out impact of CBPP3. The share of central banks/SSAs has risen sharply, actually tripling from around 10% in 2012 to some 30% in 2016. This has come at the expense of other investors, such as banks, asset managers and institutional investors. However, asset managers have seen the biggest drop in their share, followed by institutional investors. As these can be regarded as the most active portfolio managers, it seems fair to conclude that the change in the investor base in recent years has not supported liquidity of covered bonds.

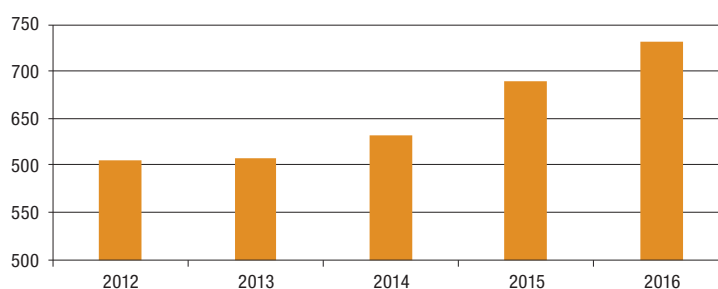
Finally, the larger the issue size, the better the liquidity. But also in this case, it seems that recent developments point in the direction of a reduced liquidity. Figure 7 below depicts the number of new deals broken down by issue size. The number of deals with an issue size below EUR 1 bn increased strongly in recent years. Whilst only two deals had

a size smaller than EUR 1 bn in 2008, 96 deals had such a size in 2015. In contrast, no new issues had a size above EUR 2 bn in the past two years. Meanwhile, the number of deals sized between EUR 1 bn and EUR 2 bn rose again during 2014 and 2015, although the total remains still below that seen in 2010 and 2011. Therefore, also from an issue-size perspective, it seems that liquidity has deteriorated rather than improved in recent years.

TURNOVER ON THE EUR COVERED BOND MARKET HAS STEADILY DECREASED FOR MONTHS

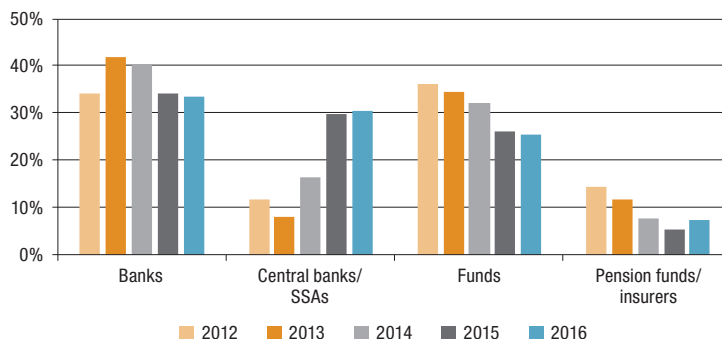
On first glance, trading volume from Bloomberg, the largest on e-platform for covered bonds, was relatively stable since 2014: The aggregated covered bond turnover (including non-benchmarks) from January to April 2016 amounted to EUR 58 bn, which compares to EUR 59 bn over the same period 2014. However, the turnover captured might have been

Figure 5 ► Number of isins in iBoxx euro benchmark covered bond index



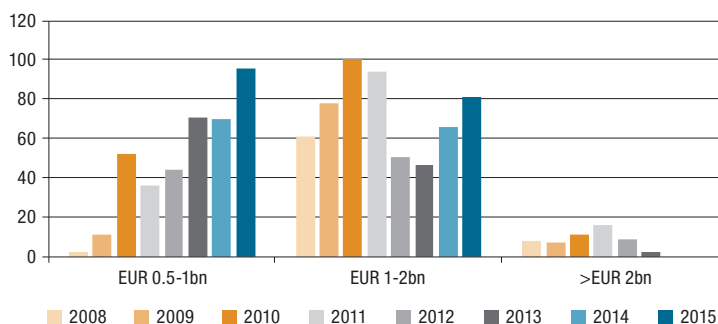
Source: iBoxx (Markit)

Figure 6 ► Average share by investor type in new issuance of euro benchmark covered bonds



Source: Bloomberg, ABN AMRO

Figure 7 ► Number of new euro benchmark covered bond deals, broken down by size



Source: Bloomberg, ABN AMRO

supported by the fact that e platforms have gained importance, not least due to CBPP3's order process. After adjusting for a shift from voice to e trading¹ the total covered bond trading volume estimated from the largest e-platform data tells a different story: Total turnover in 2016 actually decreased by around a third compared to two years earlier.

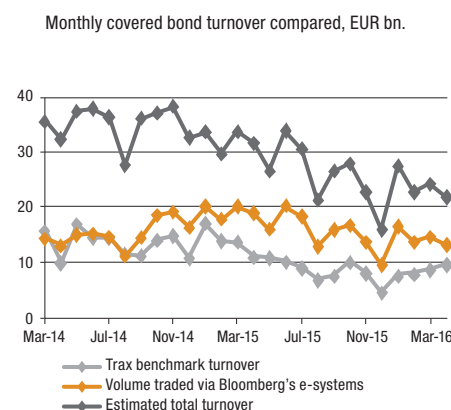
Direction and scope of this change are confirmed by MarketAxess' Trax turnover volume. Trax statistics compile turnover figures from banks using the company's post-trade services. As the data capture both voice and e-trading they are not biased by a shift in the latter's importance. Additionally, the weekly Trax data show how trading activity has decreased for individual instruments: From February to April 2016, e.g., c. 8% of EUR benchmark covered bond have not been traded at all. Two years ago, that percentage was below 2%. The share of benchmarks traded less than every other week has doubled from 30% to 60% from 2014 to 2016. Usually, weekly turnover does not exceed EUR 5 m per bond. Although Trax data does not cover all trades in the market, these figures give an impression of the magnitude of the volume drain on the covered bond market.

The density of turnover driven by private investors has, of course, fallen by a higher amount. After all, one has to adjust the total turnover for the CBPP3 secondary market purchases. This first requires some mathematical adjustments to the monthly figures reported by the ECB (as they are based on amortised costs rather than nominal levels etc.). On balance, in our model calculation CBPP3 purchases account for around a fifth of overall secondary market turnover.

FURTHER DRIVERS OF TRADING VOLUME AND LIQUIDITY ON THE COVERED BOND MARKET

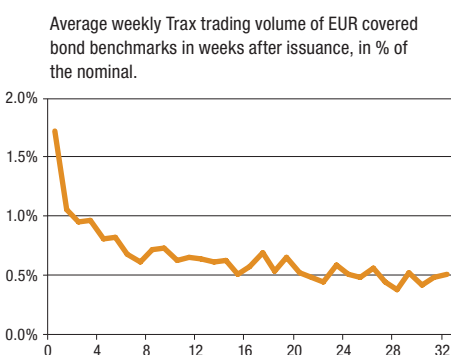
While the turnover reduction appears substantial, its causes are not that clear cut. As it is accompanied by the EUR central banks' quantitative easing (QE) measures, the idea that CBPP3 has supported the activity drain seems plausible at first glance, as it has crowded out other investors (please see above). However, it is difficult to isolate the influence of this factor on the trading volume of EUR covered bonds and to estimate its magnitude. After all, volume has several other determinants and many of them apply to other covered bond or fixed-income segments as well, i.e., do not negatively affect the relative liquidity of EUR benchmarks. One of the most important turnover drivers is, of course, the volume outstanding: Around two-thirds of the turnover in EUR benchmarks is made up of covered bonds from Spain, Germany, France and Italy. This is predominantly due to the size of these segments as EUR benchmarks in jumbo size, e.g., have on average double the trading volume than benchmarks with less than EUR 1 bn of nominal outstanding. When adjusted for size, the difference between both seg-

Figure 8 ► Covered bond turnover has lost ground since 2014



Source: Bloomberg, Trax, Commerzbank Research

Figure 10 ► Trading volume dropping rapidly after issuance

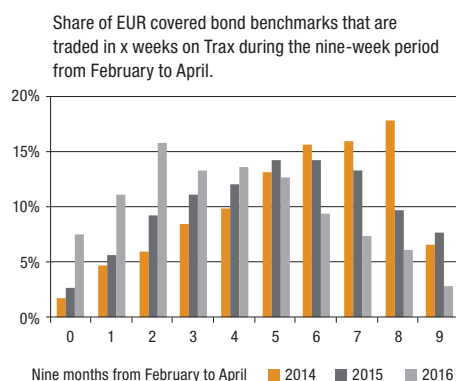


Source: Trax, Commerzbank Research

ments wanes. Therefore, the steadily decreasing size of new EUR benchmarks over recent years seems to have had a negative impact on volume.

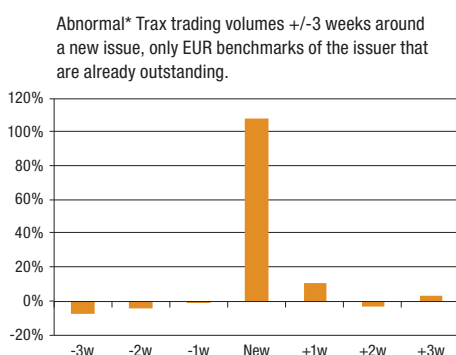
Another important turnover factor is the primary market. For one, a bond's age determines its trading volume. A new benchmark loses three quarters of its initial trading volume in the first four weeks after issuance. Thereafter, weekly turnover only amounts to 0.5% of the nominal volume on average, with a declining tendency. A lively primary market that limits the average age of the outstanding bonds therefore is positive for a market's trading volume. For another, switching interest induced by new issues is one of the most important turnover driver particularly for segments that lack a genuine trading activity. Roughly speaking, Trax trading volumes of an issuer's covered bonds outstanding² on average doubles in the week where the bank launches a new benchmark. Trading volumes of other covered

Figure 9 ► Trading activity decreasing from year to year



Source: Trax, Commerzbank Research

Figure 11 ► A new issue is a major turnover driver for bonds on the issuer's curve



* deviation from the six-week average around new issuance
Source: Trax, Commerzbank Research

bonds in the issuer's country climb by around one fifth. Individual examples show that the switching interest may even set in as soon as several weeks before the actual pricing of a new deal, in case there is a roadshow ahead. Hence, the lively issuance activity since autumn 2015 should have spurred the trading activity on the covered bond market.

Trading volume is also influenced by factors that are not directly liquidity-related. For instance, higher-beta covered bonds tend to feature higher trading activity. Trax turnover of benchmarks featuring a single A as second-best rating, for instance, came in around twice as high as for AAA rated instruments, relative to their volume outstanding. Multi Cédulas also register higher relative trading volumes than Single-name Cédulas. Moreover, turnover is greater in bonds with a longer remaining maturity and thus higher duration. Among other things, this beta bias should be due to the fact that, since the sovereign

1 We have incorporated an increase of the e-share from 40% to 60% from September 2014 to January 2015 in our data (see Pfandbrief Weekly, 24 September 2015).

2 In our analysis, new benchmarks have been stripped out for nine weeks.

debt crisis ebbed, active investors have relied to a greater degree on volatile names to generate outperformance while buy-and-hold clients prefer stable qualities.

THE SWEDISH COVERED BOND MARKET

The Swedish market for covered bonds is of great importance for the domestic capital market. Before Sweden implemented a law for covered bonds in 2003, there was a liquid market for mortgage bonds that had been around since the beginning of the more modern capital market in Sweden in the 1980's.

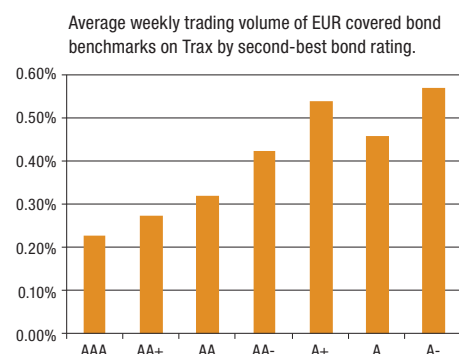
The outstanding volume of covered bonds in SEK was EUR 165.7 bn at year-end 2015. That was nearly twice as much as outstanding volume of government bonds. The Swedish bond market investors appreciate liquidity. Because of these the larger issuers issue their bonds as benchmarks which mean that large amounts (SEK 3 billion and more) are issued and that a number of dealers, under normal circumstances, show both bid and offer prices. Also, only benchmarks are deliverable in the future contracts. When a new benchmark-loan is issued, the issuers make sure that the amount issued meets the requirements for a benchmark sized deal. After the initial day of issuance the issuer can, without further notice, issue "on tap" the size he requires to match the lending. Sweden has a liquid and smoothly operating repo market with almost all banks and broker firms involved in the trading. Mortgage companies offer their market makers a repo-facility in their own bonds. The repo transaction is viewed as a 'sell-buy back' or 'buy-sell back' deal and the ownership of the security has to be transferred.

Overall this system has been working throughout a long period of time. The new regulations with higher capital requirements, larger information requirements (MiFID II) and other potential obstacles like leverage ratio, structural reforms and so on will have a negative impact on liquidity in a small market like the Swedish. The Swedish central bank (Riksbanken) has been aggressive in its QE- policies and is aiming to buy 1/5 of outstanding government bonds, this year. Riksbanken is not going to buy covered bonds. Activities in the market will although suffer. This far turnover is not significantly lower and the local Financial Supervisory Authority has performed a study³ of the liquidity in the covered bond market. The result of that study is that the liquidity is still good.

THE DANISH COVERED BOND MARKET

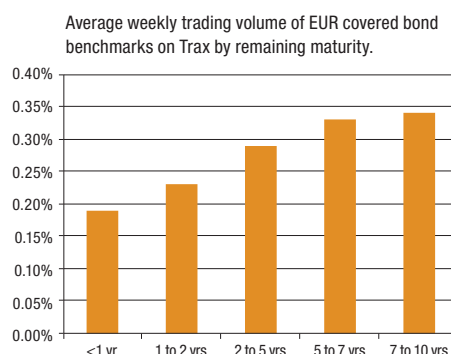
With an outstanding volume of EUR 378 bn, Denmark has Europe's largest covered bond market funding mortgage loans. After the German Pfandbrief market, the Danish covered bond market is the second largest market in Europe when including covered bonds backing other assets such as public loans and ship loans. The total Danish covered bond market stands at EUR 383 bn, including EUR 5 bn covered bonds financing ships.

Figure 12 ► Weaker ratings featuring higher trading volumes



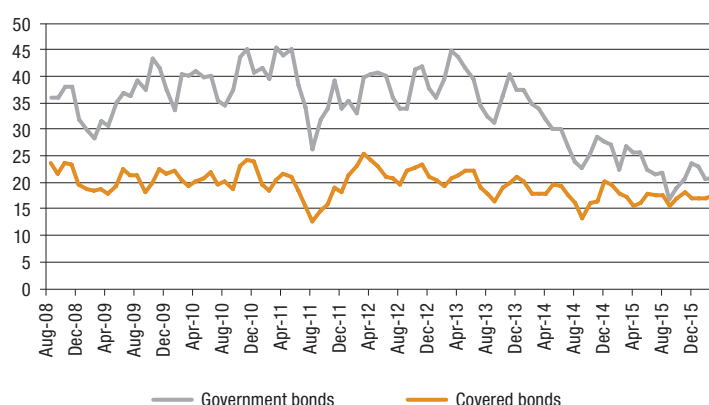
Excluding Multi-Cédulas;
Source: Trax, Commerzbank Research

Figure 13 ► Higher turnover in longer-dated benchmarks



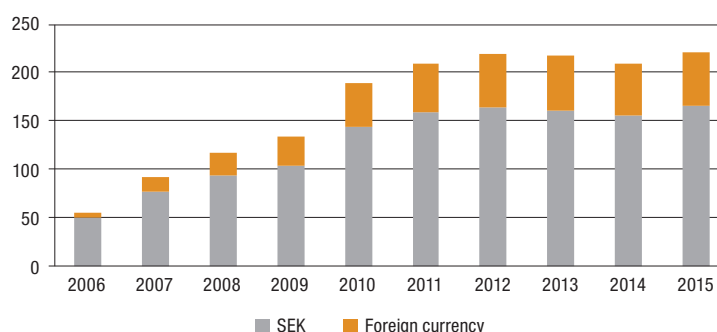
Source: Trax, Commerzbank Research

Figure 14 ► Daily turnover of government and covered bonds, 3M moving average, without repos, bn SEK



Source: Riksbanken

Figure 15 ► Outstanding volume of covered bonds, bn EUR



Source: ASCB

The Danish covered bond market is approximately five times the size of the Danish government bond market. The penetration of covered bonds as the primary funding tool in the private sector in Denmark is further emphasised when comparing covered bond funding with other funding tools, such as bank lending

or corporate debt issuance. Excluding stock issuance, covered bonds backed financing makes up more than half of total financing to the private sector in Denmark.

Danish mortgage covered bonds are issued by six specialised mortgage banks, Nykredit/Totalkredit,

³ Just in Swedish: <http://www.fi.se/Tillsyn/Rapporter/Listan/forordrad-likviditet-i-marknaden-for-sakaerstallda-obligationer/>.

Realkredit Danmark, Nordea Kredit, BRFKredit, DLR Kredit and LR Kredit and one universal bank, Danske Bank. Meanwhile, Dansk Skibskredit, is the only issuer of ship covered bonds. The type of bonds making up the Danish covered bond market fall into three major segments: callable bonds, bullet bonds and floater with or without a cap. All bonds are UCITS compliant and the vast majority are CRD compliant.

Turnover in Danish covered bonds

Reported trades in mortgage covered bonds to the Danish stock exchange, Nasdaq OMX Nordic, including over the counter trades and excluding repos, show no sign of diminished turnover in 2015 compared to recent years. Average monthly turnover in the period 2011 – 2015 has come in at close to DKK 550 bn (app. EUR 73.7 bn). In 2015, average monthly turnover was DKK 555 bn (app. EUR 74.4 bn), cf. Figure 16, or approximately 19% of the outstanding volume, which is on par with previous years.

Turnover in 2015, was propelled by massive early repayment activity in the first half of the year. Hence, issuance in the primary market of callable bonds has been a driver for turnover in 2015. Meanwhile, as covered bonds issued outside the Euro are not eligible for purchase under the ECB CBPP3, the Danish covered has not been directly affected by the most recent quantitative measures by the ECB. However, an indirect effect cannot be ruled out. As intended, ECB purchases have depressed yields on euro covered bonds, sending investors searching for higher yields. Foreign investors have extended their ownership share of Danish covered bonds from an average of 19% over the year in 2014 to 21.5% in 2015.

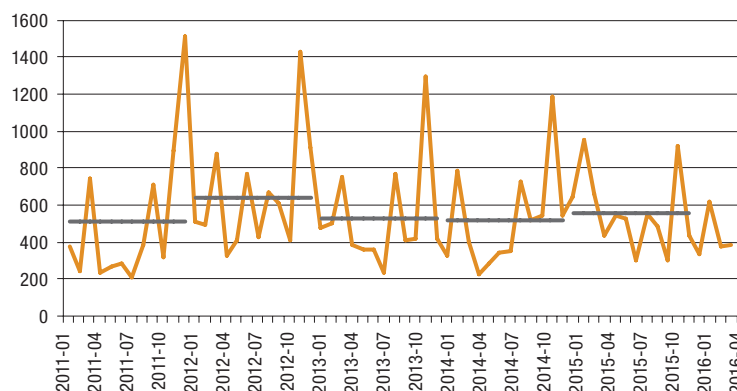
Previously, the data was characterised by high turnover around the time of the November/December refinancing auctions of bullet bonds financing adjustable rate mortgages. Over the years, the spike has somewhat diminished as mortgage banks have spread the refinancing auctions from one to four annual settling periods.

Danish specifics affecting turnover in Danish covered bonds

Pass through, tap issuance, quarterly refinancing auctions and frequent early repayment activity notably in fixed rate mortgages are all characteristics of the Danish covered bond market, which among other more universal factors affect the level of market turnover.

The strict balance principle, deployed to by Danish mortgage banks, incorporates pass through and means that mortgage covered bonds are tapped on the go, in sync with demand for mortgage loans. Following the initial tap issuance, mainly bullet bonds and to an extend floaters are refinanced by the issuance of new bonds at refinancing auctions over the life of the loan.

Figure 16 ► Turnover in danish mortgage covered bonds, monthly turnover in DKK bn



Source: Nasdaq OMX Nordic

Note: Data is for nominal value Non Repo Mortgage Bond transactions including over-the-counter. Shares are average monthly turnover to outstanding amount. Horizontal lines indicate yearly averages MiFID transaction reporting, compiled and analysed by the Danish central bank show, that transaction activity is intact in large as well as small series. Also, transaction volume in trades of no less than EUR 250 m per trade remain level with previous years.

Another specific influencing liquidity in the Danish covered bond market is borrowers' early repayments. Any Danish covered bond can be bought back by the borrower at the current market price and delivered to the issuing mortgage bank – the buyback option. This is option is primarily used when interest rates rise, as borrowers with fixed rate mortgages can reduce their loan balance. This type of early redemption activity gives rise to an increase in transaction both when bonds are bought back, and when new bonds are issued. However, yet another early repayment option exist on the fixed rate mortgage (fixed to maturity – primarily 30 years). The product is financed by callable bonds with a matching maturity. Borrowers in fixed rate mortgages retain an early repayment option, securing the right to buy back the bonds at par. The option is priced into the product by the market when the bonds are initially sold. Hence, borrowers do not have to pay an early repayment fee (which is sometimes the case in other markets) to investors, if they chose to prematurely opt out of the loan. It is not the early repayment in itself that adds to turnover, as the existing bonds are merely cancelled. However, turnover is elevated due the issuance of new bonds, as was the case in 2015, when fixed 30 year rates hit a low of 2%, igniting high early repayment activity.

Challenges to liquidity in the Danish covered bond market

Whereas, transaction activity in the Danish covered bond market remains on par with previous years, the external forces currently shaping the financial sector are altering the role of market makers. Due to tap issuance, the market maker function of universal banks is handed a central role already in the early stages of the Danish liquidity system. As profes-

sional investors are mostly unwilling to buy in small batches, market makers pool newly issued bonds in palatable bites. Onwards, market makers remain the main source of liquidity in the Danish covered bond market. However, higher capital charges, liquidity rules and the low interest rate environment have put pressure on the profitability of market making. Increasingly, market makers will to a lesser extent be providers of market liquidity, but instead be match makers between buyers and sellers in the market. In 2015, the Central Bank of Denmark (Danmarks Nationalbank) found evidence, that the five largest universal banks in Denmark have reduced their net positions available for market making by DKK 100 bn since mid-2014⁴. On the receiving end has been among others institutional investors which could lead to lower turnover going forward.

Although approximately 80% of the outstanding volume of mortgage covered bonds are in series sizes above EUR 500 m, giving rise to an LCR classification of Level 1B for the AAA rated Danish covered bonds, the new liquidity rules do create a challenge managing smaller series sizes. Issuers need to bulk up series size to secure competitive prizes, while maintaining an attractive product selection to mortgage customers. If investors are unsure if a bond series will reach the critical mass – as bonds are tap issued – to qualify as Level 1B- or Level 2A-assets under the LCR, the pricing of the specific series may be negatively affected. Already, the number of covered bond series in circulation have been reduced over the past years, but the new legislation is driving issuers to explore the possibility for further reduction.

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](#).

⁴ Financial Stability Report H2 2015, Danmarks Nationalbank.



NEWS IN BRIEF

European Commission Proposal for a Directive on Insolvency

On the 22nd of November 2016, the European Commission published its proposal (available [here](#)) for a directive on preventing restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures.

Overall, the Commission's initiative on insolvency is considered as a key deliverable in the Capital Markets Union Action Plan and Single Market Strategy. It is intended to contribute to removing important barriers to the development of capital markets in the EU by providing legal certainty to cross-border investors and companies operating across the EU. It is also expected that it will foster financial stability since efficient restructuring procedures will prevent businesses from defaulting on their loans to the banks and will help addressing the issue of high levels of non-performing loans in parts of the EU banking sector. As a result, it is anticipated that banks will be able to lend more to consumers and businesses.

The Commission's proposal for a directive focuses on the following **three key elements**:

- Common principles on the **use of early restructuring frameworks**, which will help companies continue their activity and preserve jobs.
- Rules to allow **entrepreneurs to benefit from a second chance**, as they will be fully discharged of their debt after a maximum of three years.
- Targeted measures for Member States to **increase the efficiency of insolvency**, restructuring and discharge procedures. This is expected to reduce the excessive length and costs of procedures in many Member States, which results in legal uncertainty for creditors and investors and low recovery rates for unpaid debts.

As a result, the new rules are expected to observe the following **key principles** in order to ensure insolvency and restructuring frameworks are consistent and efficient throughout the EU:

- Companies in financial difficulties, especially SMEs, will have **access to early warning tools** to detect a deteriorating business situation and ensure restructuring at an early stage.
- **Flexible preventive restructuring frameworks** will simplify lengthy, complex and costly court proceedings. Where necessary, national courts must be involved to safeguard the interests of stakeholders.
- The debtor will benefit from a so-called time-limited "breathing space" of a **maximum of four months from enforcement action** in order to facilitate negotiations and successful restructuring.
- Dissenting minority creditors and stakeholders will not be able to block restructuring plans but their **legitimate interest will be safeguarded**.
- **New financing** will be specifically protected increasing the chance of a successful restructuring.
- Throughout the preventive restructuring procedures, workers will enjoy **full labour law protection** in accordance with the existing EU legislation.
- **Training, specialisation of practitioners and courts**, and the **use of technology** (such as the online filing of claims, notifications to creditors) will improve the efficiency and length of insolvency, restructuring and second chance procedures.

The EMF-ECBC will monitor the evolution of this file very closely, in particular the transmission of the file to the European Council and European Parliament and keep readers informed of developments.

SRB Holds Fourth Industry Dialogue Meeting & Publishes 2017 Work Programme

On the 28th of November 2016, the Single Resolution Board (SRB) held its **Fourth Industry Dialogue Meeting** in Brussels. The meeting was divided into several sessions focused on, amongst other things, the SRB resolution planning for 2017, the MREL state of play and the contributions to the Single Resolution Fund (SRF) for 2017. More information on the meeting is available via the SRB's website [here](#).

In addition, on the same date, the SRB published its **Work Programme for 2017**, which can be accessed [here](#). Its key focus is on resolution planning and resolution readiness, and on ensuring that the significant and cross-border banks of the Euro area are resolvable with minimum impact on the real economy and on the public finances of the participating Member States. The main priorities for 2017 relating to the SRF will be the development of the contribution mechanism, development and implementation of the investment policy and continuation of work with respect to the funding options.

Overall, the Work Programme identifies the following four main areas that the SRB will focus on in 2017:

- Resolution readiness by sound resolution planning
- The Single Resolution Fund
- Policy and cooperation
- SRB resources in human resources, finance, procurement and information technology

European Commission's "Energy Efficiency Finance Market Place"

The European Commission is organising an "[Energy Efficiency Finance Market Place](#)" in Brussels on 18th and 19th of January 2017. 200 participants are expected from the financial sector, ESCOs, project developers and public authorities. The event will be a mix of plenary discussions and breakout sessions with a focus on practical experiences and projects involving private finance, looking at four thematic tracks: standardisation and benchmarking, innovative financing schemes, aggregation of public assets, and aggregation of private assets.

The EMF-ECBC will be participating in the event where it will present its **Energy Efficiency Mortgage Initiative**, further details about which can be found [here](#).

Green Bonds: New Study Shows Extraordinary Growth and Signals Potential in Financing Europe's Climate and Environment Goals

A study released by the European Commission on the 2nd of December 2016 (available [here](#)) shows that green bonds have enjoyed extraordinary growth, since they were first issued in 2007.

The study on the potential and functioning of green bond markets also identifies key bottlenecks and measures to overcome them so they can fulfil their huge potential. The study was published two days after the Commission's "Clean Energy for All Europeans" package which finds that an extra EUR 177 billion is needed annually from 2021 onwards to reach the 2030 climate and energy goals. New innovative funding and investment mechanisms will be essential to achieve this. Green bonds will also be on the agenda of the High Level Expert Group on sustainable finance that the Commission established in late October 2016.

Vice-President Valdis Dombrovskis, responsible for the Euro and Social Dialogue, also in charge of Financial Stability, Financial Services and Capital Markets Union, said: *"Promoting long-term and green finance is one of the priorities of the Capital Markets Union Action Plan. Green bonds are an important instrument to raise capital market finance for environmentally-friendly and more sustainable investments. The new High Level Expert Group on sustainable finance will help define steps towards greener capital markets."*

Commissioner for Environment, Maritime affairs and Fisheries, Karmenu Vella, said: *"EU has positioned itself well, to allow companies and municipalities to be among the frontrunners in the expanding green bond market. We must double our efforts to eliminate existing bottlenecks. This will allow green bonds to help on investment needed to move towards a circular economy and fulfil our energy and climate commitments."*

In 2012 USD 2.6 billion of green bonds were issued globally. By 2015 total issuance had multiplied to USD 41.8 billion. It rose to USD 74.3 billion by end of November 2016. European and Chinese issuers make up largest share of the climate-aligned bonds market globally. In Europe, France and UK are the biggest issuers. In light of the global commitment to shift to a low carbon economy, the green bond market is likely to continue to grow, attracting more diverse issuers and investors. It can be an additional source of long-term green financing next to bank lending and equity financing.

The study identifies the lack of green project pipelines as well as the absence of a green bond definition and framework as holding back development. But there are many good practices in EU Member States and beyond to overcome these and other limitations. Examples of public sector measures range from 'soft measures' such as raising awareness and capacity building to more stringent approaches such as mandatory disclosure of green indicators for bond issuances and investments.

The study also looked into standardisation. Many stakeholders stress the importance of standards to ensure that the proceeds from green bonds are used for genuinely green projects with clear and measurable environmental objectives. Market-led initiatives are developing strongly in this area. The study advises supporting a common European Green Bonds Standard building on existing market-led initiatives.

Today, green bonds mainly finance projects in renewable energy (45.8% of the issuance globally in 2015), energy efficiency (19.6%), low carbon transport (13.4%), sustainable water (9.3%), and waste & pollution (5.6%). Green bonds are thus one important financing instrument to deliver on the ambitions of the Energy Union Package "Clean Energy for all Europeans", published on the 30th of November 2016.

EBA Publishes Final Guidelines on Revised Pillar 3 Disclosure Requirements

On the 16th of December 2016 the European Banking Authority (EBA) published its final Guidelines on regulatory disclosure requirements following an update of the Pillar 3 requirements by the Basel Committee on Banking Supervision (BCBS) in January 2015. These Guidelines, available [here](#), represent a significant step forward in the EBA's effort to improve and enhance the consistency and comparability of institutions' regulatory disclosures.

Following the release by the BCBS of a revised version of the Pillar 3 framework (RPF) in January 2015, the EBA published its own initiative Guidelines to ensure the harmonised and timely implementation of the RPF in the EU. These Guidelines, while not changing the requirements of the regulatory disclosures defined in Part Eight of the CRR, provide further guidance and support to institutions in complying with both the CRR and the RPF requirements.

In particular, the Guidelines cover the entire content of the RPF, with the exception of securitisation requirements, which are currently under discussion at EU level following the finalisation of a revised securitisation framework at the international level, and other disclosure requirements in Part Eight of the CRR for which there are already EBA Delegated or Implementing Regulations or guidelines, such as own funds and leverage ratio.

The Guidelines apply to Globally and Other Systemically Important Institutions (G-SIIs and O-SIIs). Competent authorities may still require institutions that are neither G-SIIs nor O-SIIs to apply some or all the guidance provided for in these Guidelines when complying with the requirements of Part Eight of the CRR.

Nonetheless, proportionality is embedded in the different disclosure templates and tables. Therefore, smaller, less sophisticated or less complex institutions are expected to have a lower risk profile and will not be subject to all the disclosure requirements. In addition, the concept of materiality allows institutions to tailor the granularity and the frequency of their disclosures.

The Guidelines will apply from the 31st of December 2017, but G-SIIs are encouraged to comply with a subset of those Guidelines as soon as the 31st of December 2016.



ESMA to Provide Free Credit Ratings Information to Public

On the 1st of December 2016 the European Securities and Markets Authority (ESMA) launched its new database, the [European Ratings Platform \(ERP\)](#), to provide access to free, up-to-date information on credit ratings and rating outlooks. The ERP is an important element of ESMA's work, following the financial crisis, to increase transparency around credit ratings and help investors make informed decisions.

The benefits of the new ERP include:

- allowing investors and other users of ratings to easily compare all credit ratings that exist for a specific rated entity or instrument;
- lowering information costs by centralising information; and
- helping smaller and new credit rating agencies gain visibility in the market.

Since July 2011, the ESMA has been solely responsible for the supervision, and registration, of credit rating agencies (CRAs) in the European Union (EU). The ERP holds all individual credit ratings and rating outlooks issued by CRAs registered and certified with ESMA except for those issued under the investor-pays model. Users can also access rating history details from 1 July 2015 onwards, press releases accompanying the rating issuances and research reports for sovereign ratings.

The rating information in the ERP is collected and published on a daily basis allowing for one daily update of the ERP to ensure it remains up-to-date. In providing granular information on specific rated entities and instruments, the ERP complements the statistical data on CRAs' rating activities and rating performance which ESMA already publishes via its central repository database (CEREP).

The ERP is part of a suite of registers and data available on ESMA's website which provide information to market participants, regulators and the general public.

EBA Launches Qualitative Survey on IRB Models

On the 16th of December 2016 the European Banking Authority (EBA) launched a qualitative survey (available [here](#)) on internal ratings-based (IRB) models to analyse the impact of the EBA draft Guidelines on the estimation of risk parameters for non-defaulted exposures, namely of the probability of default (PD) and the loss given default (LGD), and on the treatment of defaulted assets (Guidelines hereafter), which are currently under consultation. These Guidelines are part of the broader review of the [IRB approach](#) that is carried out by the EBA to reduce the unjustified variability in the outcomes of internal models, while preserving the risk sensitivity of capital requirements. Institutions are invited to submit their responses to this survey by the 27th of January 2017.

This qualitative survey is addressed to all institutions which use the IRB approach for credit risk. It contains detailed questions about banks' modelling practices for estimating PDs, LGDs, LGD in-default and expected loss best estimate (ELBE). The main objective of the survey is to assess the impact of the Guidelines in terms of expected amount and severity of model changes.

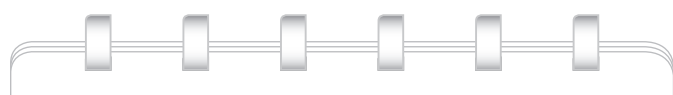
All institutions using the Internal Ratings Based (IRB) approach for credit risk are invited to participate in the survey.

To ensure that the EBA gains insight into modelling practices across all exposure classes (both high- and low-default portfolios) and receives feedback from a representative sample of models, institutions are invited to fill in the survey for at least their three main PD and LGD models.



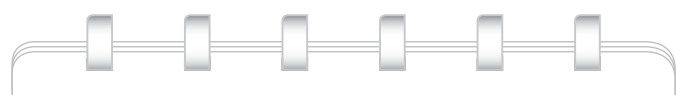


AGENDA



JANUARY 2017

- 18/01** Fifth Energy Efficiency Financial Institutions Group (EEFIG) Workshop – Brussels
-
- 18-19/01** European Commission's Executive Agency for Small and Medium-Sized Enterprises (EASME) Conference on Energy Efficient Finance Market Place – Brussels
-
- 25/01** European Parliament Financial Services Forum (EPFSF) Event on Capital Markets Union (CMU): Insolvency Law Chapter – Brussels
-



FEBRUARY 2017

- 01/02** European Covered Bond Council (ECBC) Technical Issues Working Group & European Covered Bond Council (ECBC) EU Legislation Working Group Joint Meeting – Brussels
-
- 02/02** Crédit Foncier de France Annual Conference on Real Estate Markets – Paris
-
- 02/02** European Covered Bond Council (ECBC) Statistics and Data Working Group & European Covered Bond Council (ECBC) Fact Book Working Group Joint Meeting – Brussels
-
- 07/02** MEP Jeppe Kofod Breakfast Event on the process, status and the consequences of regulating covered bonds in Europe and, in particular, the role of covered bonds in microfinance, innovation and job creation – Brussels
-
- 07/02** 15th Annual European Financial Services Conference – Brussels
-
- 16/02** Second European Mortgage Federation – European Covered Bond Council (EMF-ECBC) Roundtable on Energy Efficient Mortgages – Brussels
-
- 28/02** European Parliament Financial Services Forum (EPFSF) Event on the Capital Requirements Regulation and Directive (CRR/CRD) – Brussels
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DISCLAIMER

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