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EMF Quarterly Review – Q3 2016

By Daniele Westig, Economic Adviser, EMF-ECBC



INTRODUCTION

In light of mounting political uncertainty both within and outside Europe, the third quarter of 2016 has provided an aggregate housing and mortgage market picture which is in line with the previous quarters. In the EU¹ house prices continued their upwards trend, on an aggregate level, while the outstanding mortgage lending figure in our sample, after having reached the peak at the end of 2015, slightly contracted by

1.9% since then. Interest rates continued their downward path as well and the unweighted average rate of our sample dropped by 19 bps year-on-year (y-o-y) and lies for the first time below 2.5%.

In this latest quarterly review a number of updates and new charts have been added in order to improve the effectiveness of the document. First of all, the thresholds and the timeline of the depicted charts have been updated in

order to better focus on more recent developments. Moreover, considering the chart on the evolution of the House Price Index (HPI), the data has been switched from a quarter-on-quarter (q-o-q) to a year-on-year (y-o-y) representation in order to focus on longer dynamics. The q-o-q dynamics of the HPI will be represented with a new box plot chart which depicts the distribution of the HPI within the sample. In this way the reader has an insight as to where the HPI is headed in the short-term.

¹ In Q3 2016 the sample of the proxy for the amount of total outstanding mortgage lending in the EU28 included BE, CZ, DE, DK, ES, FI, FR, HU, IE, IT, NL, PL, PT, RO, SE and UK. (i.e. around 95% of the total outstanding mortgage lending in the EU28 in 2015). Please, note that at the date of publishing, Q3 2016 data for NL was not yet available and the most recent observations (from Q4 2015) has been used.

MORTGAGE LENDING

In Q3 2016 mortgage lending at an aggregate level shows an ongoing slightly decreasing path, which started at the beginning of 2016. Also the aggregate gross mortgage figure, though it increased by 1.7% from last quarter, reached around EUR 281 bn, which is around 11% less than the peak of nearly EUR 316 bn of Q2 2015. However, national peculiarities together with both market and non-market factors sketch a very heterogeneous picture across the continent.

An important reason for increased mortgage lending is a favourable economic climate, together with imbalances of high demand and low supply. For these reasons mortgage lending in **Sweden** is still rising but it seems that the pace has decreased to 7.8% y-o-y (from 8.2% the previous quarter). In **Ireland** Q3 2016 saw a buoyant growth in drawdowns, which increased y-o-y in volume by 13.7% and in value by 16.7% to EUR 1.6 bn. Looking at the year-to-date figures ending September 2016, approval and value volumes continued to increase in line with the yearly figures. Increasing household debt is heavily debated in Sweden and amortisation rules were imposed in June 2016 following different measures to cool down mortgage lending and house prices. Likewise in the **UK**, notwithstanding the ongoing political uncertainty due to the referendum in June 2016, the latest data on economic growth and unemployment shows a relatively favourable environment. The Bank of England aimed at supporting the domestic economy with a significant monetary stimulus in August as well as a new scheme to influence borrowing rates and to help lenders pass on interest rate cuts to household and firms. With this in mind, the UK housing market fared better than many had expected with increased mortgage lending (in GBP terms) compared to both the previous quarter and to the same quarter of the previous year. In Q3 2016 mortgage lending showed a lending market driven principally by re-mortgaging rather than by new house purchases. Elevated house prices, tight supply in the secondary housing market, tighter affordability criteria and upcoming tax changes in 2017 are factors dampening demand. As a result, the mix of lending has moved towards re-mortgaging activity which accounted for over 40% of lending compared to a third in the previous years. This trend is likely to continue in the near future. A surge in re-mortgaging activity can also be seen in **Denmark** due to declining long-term rates in the third quarter, which increased the proportion of fixed rate mortgages to 64% of gross lending compared to 45% the previous quarter. Overall gross residential lending increased by around 50% both q-o-q and y-o-y, while the level of total outstanding residential mortgage loans continued steady growth of 2.4% y-o-y.

On the contrary, re-mortgaging plummeted in **Spain** by 83.3% y-o-y in Q3 2016 to EUR 649 mn, which

represents nearly 8.5% of gross residential lending, down from 39% in Q3 2015. In parallel, the figures for outstanding mortgages also continued their downwards trend and gross figures showed a decrease both y-o-y and q-o-q. This is the result of the effects of non-market factors, such as the shutdown in the official registry of new mortgage loans as a consequence of a Supreme Court ruling regarding interest rates on arrears. In contrast, in **Belgium** the unusually high re-mortgaging activity of 2015 caused the y-o-y figure of overall new lending contracts of Q3 2016 to be slightly lower by around 1.17%, while the evolution in the amount shows a slight increase of 1.31%. If re-mortgaging is not taken into account, both the number of contracts and the volume of lending increased by more than 5% and 10% respectively. The motivations for credits granted in Q3 2016 show a surge in purchases (+6%), in construction (+18%) and in purchase cum renovation (+6%), with only renovation (-2%) and refinancing (-20%) declining. Overdue contracts are continuing their downward path since the peak in 2015. In **Portugal** outstanding residential loans have been declining by 3.8% y-o-y, an ongoing trend since Q4 2011. Nevertheless, gross residential mortgage lending showed a growing trend reaching EUR 1.5 bn in Q3 2016, which reflects the improved economic household conditions and the low interest rates on deposits.

In Central and Eastern Europe the latest data gives quite a heterogeneous picture. On the one hand, in the **Czech Republic** new mortgages increased by almost 22% in the first three quarters of 2016, which represents a new record. The average amount of a mortgage loan also increased by 8.6%. In **Hungary**, whilst at a q-o-q level gross residential lending remained constant compared to the same period of the previous year, it shows an increase of 8.5% y-o-y. In Q3 2016 the construction industry also showed signs of vitality with an increase of 140% y-o-y in the issuance of new building permits. Several housing projects are in the pipeline, but the effect on completions is expected by mid-2017, which will reflect the VAT reduction for new-build homes which was introduced at the beginning of 2016. Starting from Q2 2017, Hungarian Commercial Banks have to fund at least 15% of their mortgage loan portfolio with mortgage bonds. Most of these banks entered into refinancing agreements with mortgage banks and by October 2018 the Mortgage Funding Adequacy Ratio is expected to increase from 15% to 20%. In **Romania** outstanding mortgages continued to increase in Q3 2016 but at a decreasing pace of around 2% q-o-q. The Non-Performing Loan (NPL) ratio of mortgage loans reduced by 1 pp to 7.8%, mainly due to a decrease in the volume of loans more than 90 days overdue. The Bank Lending Survey showed an easing in credit standards for the first time in half a year due to the lack of the surge of closing loans followed by the law on debt discharge of April 2016, as only a marginal number of mortgage debtors requested to close their loans.

On the other hand, in Q3 2016 **Poland** experienced the biggest decline of new residential loans over the last five years. The number of new loans granted in Q3 2016 decreased by c. 13%, while the value of newly granted loans diminished by nearly 9%. This decline can be explained by the unusually high lending results of the first half of the year due to the "Flat for Youth" Housing scheme. Moreover, it is important to highlight that credit standards for housing tightened for the fifth time in a row in Q3 2016, which comes as a result of restrictions on trade in agricultural properties, additional collateral requirements and updates in the assessment of creditworthiness. It is interesting to highlight that in this quarter new lending in Warsaw decreased for the first time in several years, but which still represents around 40% of the last quarter's new lending volume. The construction of new dwellings also declined slightly in this quarter.

Moving to **France** housing and mortgage markets continue to be quite active. Outstanding residential mortgage lending grew by 3.1% y-o-y and the level of gross loans increased by 1.8% y-o-y, while credit production for existing homes remained stable at around EUR 79.7 bn. Housing activity also increased and at the end of October 2016, over a period of 12 months 843,000 existing homes were sold, namely 9% more than in October 2015 over the previous year. In **Italy** both outstanding and gross residential mortgage loans continued to grow by 1.8% and 5% respectively with regards to the same quarter of last year.

HOUSE PRICES

Nearly all countries of the sample report an increasing trend in terms of house prices. Besides a large variability across countries there are also distinct patterns within countries, with cities and capitals generally showing larger price increases than the surrounding countryside, mostly due to a mismatch in the supply and demand of housing, the very low interest rate environment and the improved disposable income of households. Looking at the new boxplot chart, the q-o-q median growth in Q3 2016 stands at 1.48%, a decrease from the 2.01% growth of the previous quarter, but in line with the 1.40% of the same period of last year.

In the **Czech Republic** large cities show an increase of house prices in the double-digit range. Besides the above mentioned reasons, here the implementation of new residential projects is quite lengthy, thus exacerbating the supply shortage. In **Hungary** house prices in Q2 2016, the latest quarter for which data is available, grew in aggregate terms by 1.4% q-o-q, which is a significant deceleration with respect to the previous quarters. Budapest and the surrounding area registered the highest increase, while less dynamic regions depicted also significantly lower prices. In **Poland** prices remained generally stable in Q3 2016, while in **Romania** house prices rose by more than 3% q-o-q.

Germany continued to witness increasing residential property prices. In the cities the situation remained tense as living space is scarce and, despite increases in construction activity, current demand in these areas outpaced supply. New lease rentals for residential use grew by 4% y-o-y and owner occupied housing by 6.4% over the same period, while prices for condominiums grew by 6.0% and single-family and semi-detached houses by 6.5%. In **Sweden** house prices increased by a healthy 8.7% in Q3 2016, though it seems that the pace has peaked and the first signs of a deceleration can be observed, considering that the increase in the same period last year was around 11%. The same trend is also seen with respect to apartments which increased by 'only' 6.3% in Q3 2016 compared to 19% in Q3 2015. Construction figures continued to increase in 2016 and the National Board of Housing expects that construction figures might soon reach the record levels of the 1990s. Despite this, strict building standards coupled with a worsening undersupply for the construction workforce will not result in a balance here for several years to come. In **Portugal** the house price increase of 7.6% y-o-y in Q3 2016 marked the largest jump in the available series and follows a positive trend of six consecutive quarters. This recovery can be explained by the government programmes to attract new investors, with special permits to boost the residential sector. The increase in house prices was also helped by a slight increase in the demand for loans by individuals for the purchasing of housing. **Ireland** also saw property prices growing by 7.3% in September 2016 y-o-y, with Dublin increasing by 5.4%, while the rest of the country rose by 11%. Rents continued to grow faster than house prices with a geographic pattern but the gap narrowed markedly in Q3 2016. The Banking & Payments Federation Ireland (BPF) pointed out that a major issue in the Irish economy is the lack of available housing, especially of suitable family accommodation. Notwithstanding the increase in building activity with housing completions up +17.5% y-o-y and building starts up +15.9%, meeting the demand for 25,000 new homes per year is still far away. Based on the figures obtained from Daft.ie, a property listings website, the number of properties listed for sale and rent dropped significantly during the last year.

In **Denmark** the growth in house prices was positive overall, with single house prices rising by 1.1% q-o-q and 4.4% y-o-y, while owner occupied flats increased by 0.4% q-o-q and by 7.2% y-o-y. Home sales slightly decreased in Q3 2016 with respect to the same period of the year before by 1.8% for single family houses and by 4.0% for owner

occupied flats. The slowdown can be explained by the peak in transaction activity reached in 2015. Similarly, in **France** the price of existing homes continued to grow but by a smaller amount of around 1%. Since 2012, on average new houses have been fluctuating between EUR 3,750 and EUR 3,650 per square meter for collective housing and between EUR 238,000 and EUR 260,000 per unit. **Spain** showed an increase of 1.6% y-o-y in house prices and an average per square meter price is around EUR 1,500; however, this is still far below the peak registered in 2007. **Belgium** also witnessed an increase in house prices in the different housing categories, with a 2.5% increase in the official house price index for existing houses and a nearly 4% increase for newly built ones. Prices for houses and villas increased on average by 2.3% and 2.7% respectively while apartments became 1.3% cheaper.

In **Finland** house prices show a mixed pattern. On the one hand existing dwellings showed an increase of 1.4% y-o-y, which can be broken down into +2.8% in Helsinki and +0.2% in the rest of the country. On the other hand, new dwellings and multiple flats dwellings fell by 1.9% countrywide, with a 0.6% decrease in Helsinki and a 3.3% decrease elsewhere. In **Italy** house prices decreased by 0.9% y-o-y and stayed virtually unchanged with respect to the previous quarter. The price of new dwellings in particular fell by 2.1% y-o-y, while the existing dwellings decreased by a marginal 0.6%.

INTEREST RATES

Overall the countries of the analysed sample show a very low and in the majority of cases also decreasing interest rate landscape following the expansive monetary policies of the various central banks of the continent. Moreover, in most countries there is a rising trend of entering a mortgage contract with longer initial fixed periods, in order to lock into the benefits of current interest rates, which will have difficulty to fall much lower. Nonetheless, there are some national peculiarities which are described here.

Notwithstanding the persistent downwards trend, in the **Czech Republic** it is expected that this dynamic will be reversed by the end of 2016 as a new legislation on the provision of loans to clients will enter into force. In **Finland** and in **Portugal**, interest rates have reached their lowest ever levels with 1.12% and 1.76% respectively. These can be explained by the fact that in these countries a majority of housing loans are linked to the Euribor, which currently is at very low levels. In the **UK** mortgage rates fell to their historic lows in

nearly all measures following the accommodative monetary policy of the Bank of England coupled with the high level of competition among lenders to attract new customers. In **Hungary** mortgage holders are increasingly choosing more fixed rate loans. The most typical loan has a variable interest rate which is linked to the three month BUBOR, the Budapest Interbank rate. A similar dynamic has been seen in **Spain** over recent quarters where loans with an initial fixed period represented more than half of the market in Q3 2016, while they were around 38% just a year ago. This preference amongst Spaniards for a more fixed interest rate environment is reflected in the slight increase in interest rates over the last quarter. A similar picture is seen in **Italy** where new loans with initial fixed periods are continuously increasing and accounted for more than 63% of the total in Q3 2016. Italians also saw the interest rates of all different initial fixation periods decrease. In **Ireland** the new fixed rate mortgages taken out since Q1 2015 accounted for, on average, around 30% - 40% of the total, while the long-term average is around 20%. Mortgage rates on outstanding loans are heavily influenced by the European Central Bank's (ECB) base rate because about 49% of mortgages outstanding were on tracker rates, which average 1.03% for private dwelling home mortgages and 1.06% for buy-to-let mortgages.

In **Denmark** there were only small variations in the representative interest rate, which for the first time since a year showed a minor fall, enabling households to take out a loan at 1.2% with an initial fixed period of one year. Long-term and medium-term fixed rate loans also decreased marginally by 0.2 pps and 0.07 pps respectively. Short-term interest rate fixation saw a marginal increase of 0.05 pps. Equally, in **Sweden** rates changed only marginally in the reference period. Variable mortgage rates and those with an initial fixed period of one to five years remained stable, while mortgage rates with an initial fixed period of more than five years dropped 0.5 pps to 1.9%.

In **Germany** interest rates continued to be persistently low, as was also the case in **France**, with low interest rates stimulating the granting of loans where in Q3 2016 the average rate fell to 1.46% from 1.69% during the previous quarter. In **Belgium** the most representative interest rate of an initial long-term fixed period, which represent around 92% of the overall market, decreased to from 2.05% to 2.01%.

Contrastingly, in **Romania** the representative interest rate increased by 0.24 pps over the previous quarter to 3.56%.

Chart 1a ► Countries where gross residential lending has remained below 80% of 2007 levels

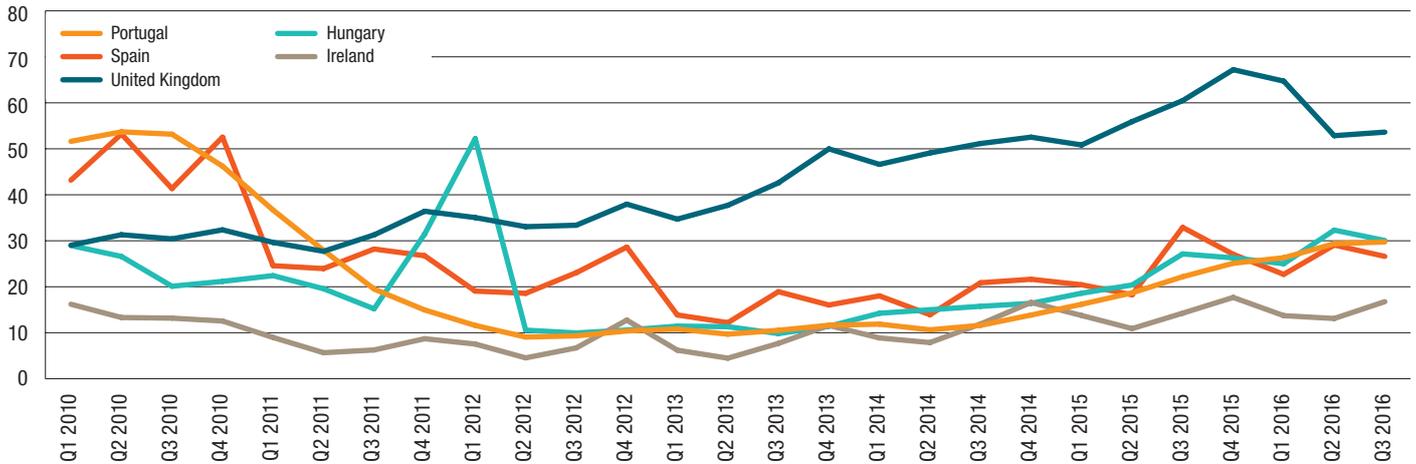


Chart 1b ► Countries where gross residential lending has remained between 80% and 120% of 2007 levels

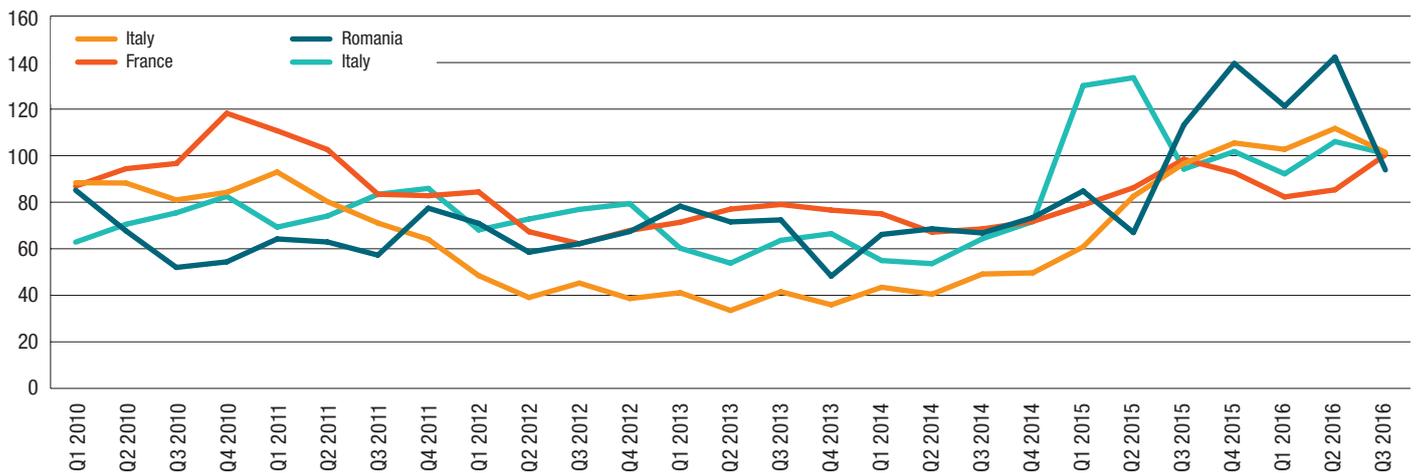
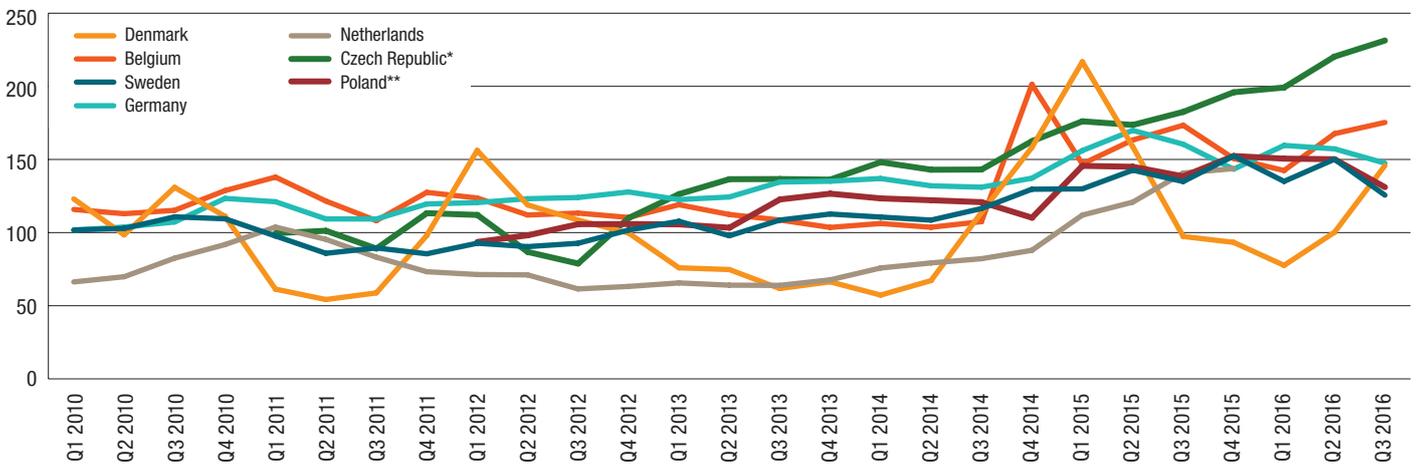


Chart 1c ► Countries where gross residential lending has risen above 120% of 2007 level



Note: Following countries submitted data explicitly including remortgaging figures: Belgium, Denmark, Ireland, Romania, Spain, United Kingdom
 * 2011 = 100
 ** 2012 = 100
 The time series have been seasonally adjusted by regressing the gross domestic lending of each country on quarter dummies and a constant, and adding the residuals to the sample means. STATA econometric software has been used.

Chart 2a ► Countries where house prices have increased at most 2% y-o-y (base year 2007)

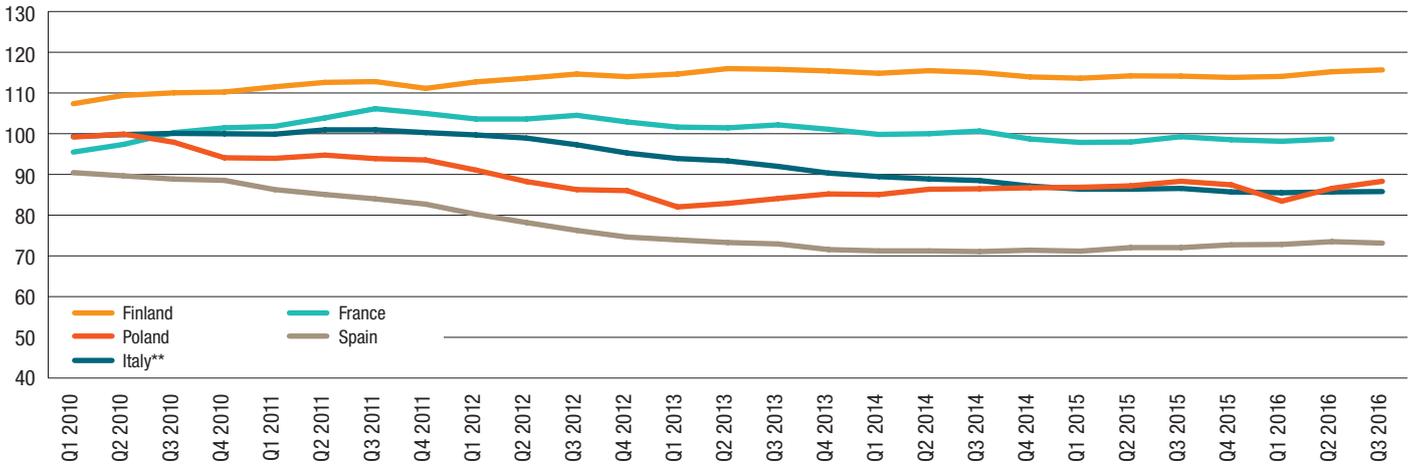


Chart 2b ► Countries where house prices have increased between 2% and 5% y-o-y (base year 2007)

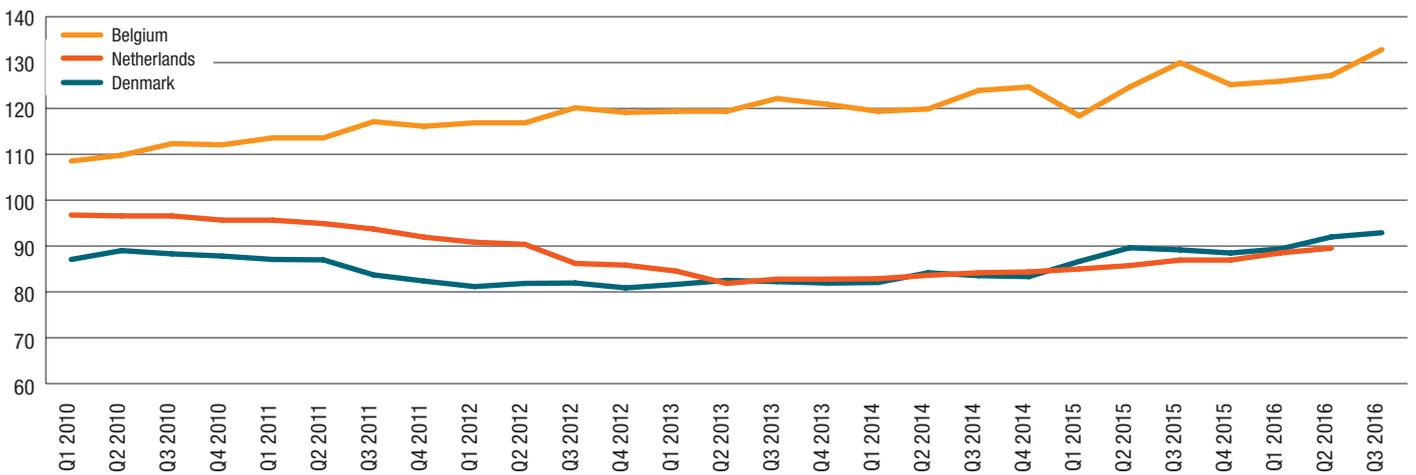
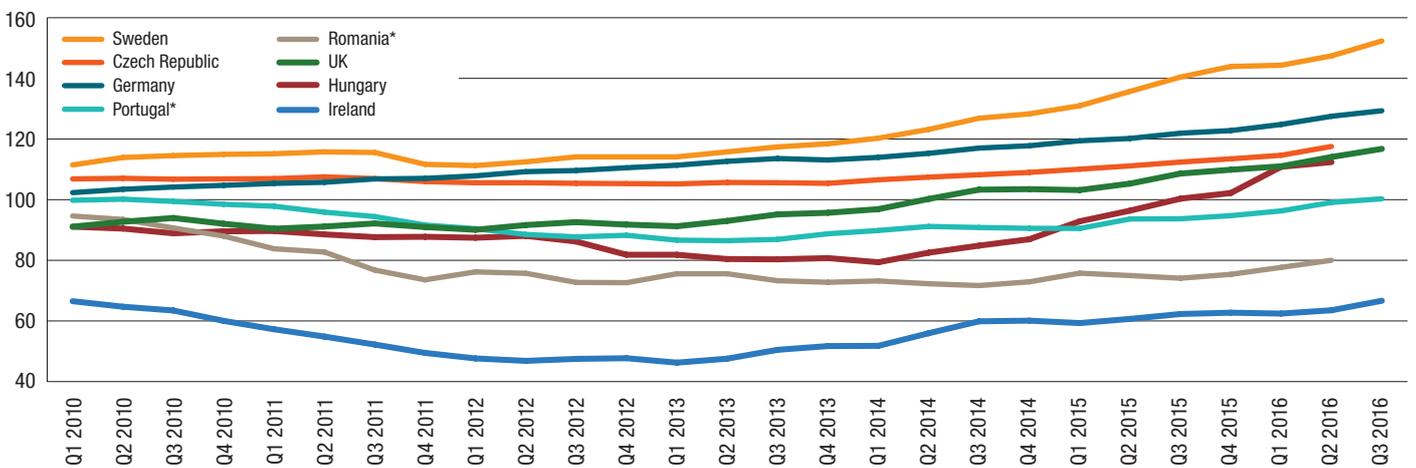
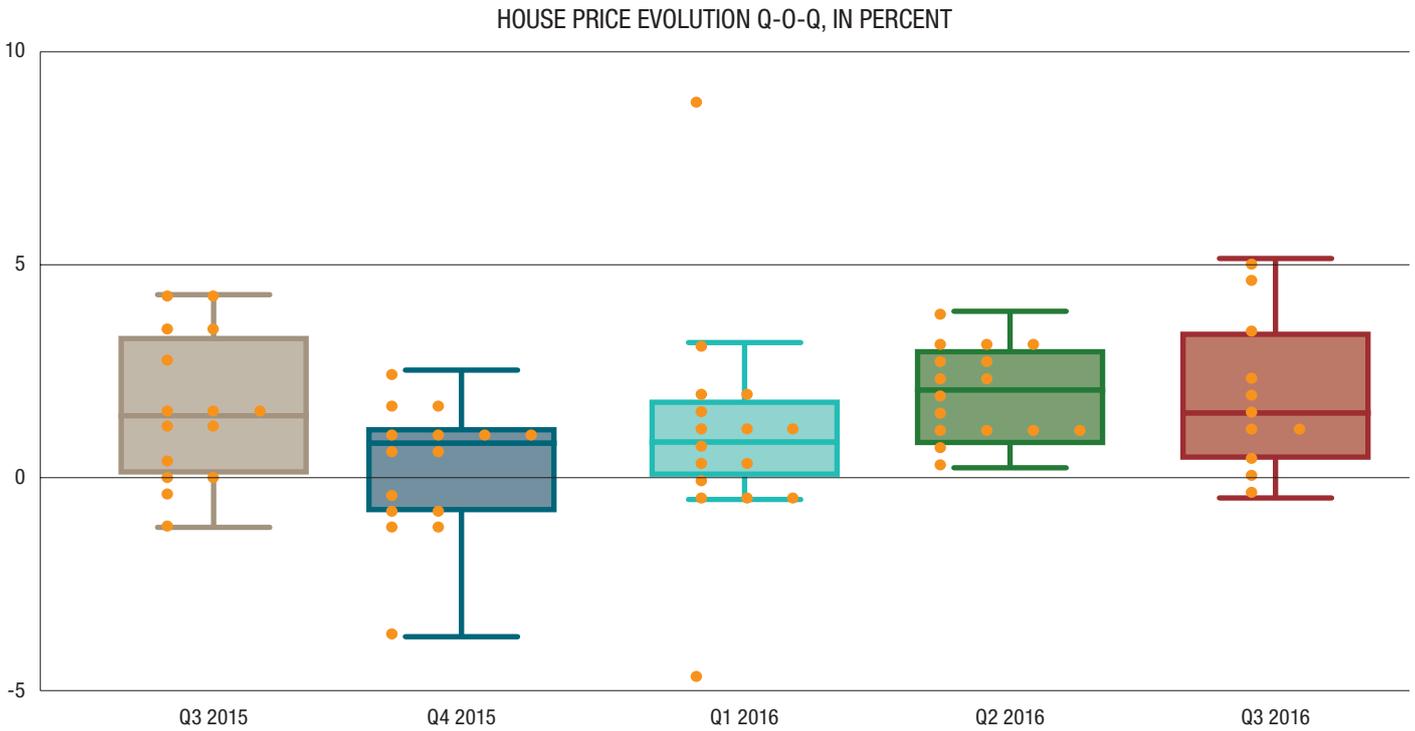


Chart 2c ► Countries where house prices have risen by at least 5% y-o-y (base year 2007)



Note:
 * 2009 = 100
 ** 2010 = 100

Chart 3 ► Box Plot of the House Price Evolution in the EU with respect to the previous quarter



Notes:
 Boxplots depict intuitively the distributional characteristics of a dataset, in this case the q-o-q House Price Index evolution of the country sample. The rectangle represents the second and third quartile of the data and the central horizontal line indicates the median value Q2, i.e. the value that splits the sample in two equal halves. The Horizontal lines below and above the box indicate respectively the lower and the upper quartiles. Eventual

'outliers' are depicted as points if they are more than 1.5 times the Interquartile distance – the height of the box – away from respectively Q1 or Q3. This is the case for Q1 2016.

The data set shows the q-o-q growth figures of the country sample. In Q3 2016 the data points are 11 instead of 16 as in 5 countries the latest House Price Index available was that of Q2 2016.



Unlocking Private Investment to Deliver Building Renovation and Clean Energy for All

By Ulrich Bang, Senior Director, Public Affairs & Corporate Responsibility, VELUX Group



Last year the VELUX Group celebrated its 75th anniversary – three quarters of a century creating better living environments with daylight and fresh air. Our main product consists of energy-efficient roof windows, together with a range of other products such as blinds, roller shutters and remote controls. The VELUX Group has manufacturing and sales operations in more than 40 countries, with the EU being our most important market.

Improving energy efficiency in buildings is an important topic for the VELUX Group. It represents a huge, untapped potential, not only in terms of using resources in a smarter way, but also in terms of boosting economic activity, growth and jobs. In the EU, buildings are responsible for 40% of total energy consumption and 36% of CO₂ emissions. As 75% of existing buildings are not energy-efficient, it is easy to see why energy renovation is a key target area.

VELUX's particular contribution to increasing energy efficiency and reducing greenhouse gas (GHG) emissions in buildings is through the installation or replacement of highly energy-efficient windows. Nevertheless, there are general barriers to building renovation, especially when it comes to financing and unlocking private investment. Many homeowners leave energy renovation projects at the idea stage, as they imagine them to be both complex, with multiple providers required to carry out the project, and also overly expensive.

THE BETTERHOME INITIATIVE – A WAY OF OVERCOMING BARRIERS TO RENOVATION

To overcome this, the VELUX Group has teamed up with three other global companies within the building industry who also provide energy-efficient solutions¹ and in April 2014 launched a new initiative called BetterHome. The idea with this concept is to provide a service which simplifies the process of an energy renovation project for homeowners. By visiting BetterHome's [webpage](#), homeowners can get an overview of the energy saving potential of their renovation project, and see concrete examples of different energy-efficient solutions depending on how much they want to invest.

Through the BetterHome webpage, it is also possible to get in contact with accredited local installers who are part of the BetterHome initiative. The installer will provide guidance around the required improvements, the energy saving potential and also financing options. The concept is that the installer will be the homeowner's single point of contact for the whole renovation process – therefore making it simpler and more convenient. Banks and mortgage institutions in Denmark are supporting partners in the BetterHome initiative, and they provide guidance and help to secure the correct financial services, thereby reducing uncertainty.

BetterHome provides further peace of mind by showing ways in which the investment will increase the value of the property due to improved comfort, energy savings and living conditions.

A "Pick and Click" approach to selecting approved providers and services puts the customer centre stage, and the approach has given positive results so far. The BetterHome initiative reached its targets in Denmark and has been subsequently extended to Sweden in 2016.

THE VELUX GROUP AND THE EMF-ECBC ENERGY EFFICIENT MORTGAGE INITIATIVE

One of the principal barriers preventing homeowners from renovating is financing – even though energy renovation has a positive impact on property value, while savings on energy bills increase disposal income. Therefore, the VELUX Group is also interested in the new Energy Efficient Mortgages Action Plan announced by European Mortgage Federation – European Covered Bond Council (EMF-ECBC). This aims to help the market recognise and price in the value of energy efficient homes. We believe that the EMF-ECBC initiative has the potential to further increase the renovation rate and thereby contribute towards greater energy efficiency in the EU.

It is clear that we need cooperation across sectors and industries if we are to unlock private investment in European home renovation. As a responsible company, we have to step up to the challenge.

¹ Danfoss, Grundfos and ROCKWOOL.

MREL & TLAC: The Consequences of Bail-In Requirements for Covered Bonds

By Alexandra Schadow, LBBW & Maureen Schuller, ING Bank

RESOLUTION ONLY POSSIBLE WITH ENOUGH BAIL-IN-ABLE INSTRUMENTS

The Bank Recovery and Resolution Directive (BRRD) has applied to all EEA states since it was implemented in national law in 2015. At the same time, the BRRD is also embedded in the European Banking Union's single Rulebook, which also comprises the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), whereby the two latter mechanisms initially apply only to the member states of the European Monetary Union. The goal of the BRRD is the harmonisation of the recovery and resolution instruments for banks subject to the premise that potential losses are initially borne by the shareholders and then by the creditors according to a prescribed ranking. This is governed by the "no-creditor-worse-off" principle, which ensures that no creditor may incur greater losses than it would have under normal insolvency proceedings. However, there are liabilities that are explicitly barred from a possible bail-in by the regulations of Article 44(2) BRRD. These also include covered bonds that are UCITS compliant (Article 52 (4) of Directive 2009/65/EC). Only one restriction is formulated that allows a bail-in for covered bonds if the liabilities from the covered bond exceed the corresponding collateral in the cover pool and the resolution authority believes a bail-in for this "uncovered" part is appropriate. This would, however, correspond to a cover shortfall.

Basically, if resolution is necessary, four instruments are available: sale of businesses, bridge institutions, asset separation and bail-in. Within the framework of the bail-in, the resolution authority can exercise write down and conversion into equity powers in order to absorb losses and to carry out recapitalisation measures. This approach presupposes all banks have adequate "bail-in eligible" capital. Article 45 BRRD stipulates a special requirement for this: the *minimum requirement for own funds and eligible liabilities (MREL)*. The same idea is behind the *total loss absorbing capacity (TLAC)* requirement, which is applied via the Financial Stability Board (FSB) to the Global Systemically Important Banks (G-SIBs). The goal of both requirements may well be the same, but there are several differences in their content. We therefore provide a comparison of the most important components of MREL and TLAC.

Figure 1 ► Comparison MREL and TLAC

KEY FEATURES	MREL	TLAC
Scope	All banks within the scope of BRRD	G-SIBs only
Timeline	Effective from 1 January 2016 Appropriate transitional period	Effective from 1 January 2019
Calculation	Own funds + eligible liabilities Own funds + total liabilities (total assets)	Total capital + TLAC eligible liabilities Risk weighted assets (RWA) and Tier 1 capital Exposure measure
Determination	Case-by-case for each institution including Pillar 1 and Pillar 2	Common Pillar 1 requirement: 1 January 2019 16% of RWA/6% of Basel III leverage ratio 1 January 2022 18% of RWA/6,75% of Basel III leverage ratio Pillar 2 requirement case-by-case possible
Capital buffers	Included	Excluded
Subordination requirement	No	Yes
Priority	<ul style="list-style-type: none"> not a precondition in the BRRD 	<ul style="list-style-type: none"> structural subordination, e.g. holding company statutory subordination contractual subordination
Eligible instruments	Own funds = Tier 1 capital + Tier 2 capital Eligible liabilities: <ul style="list-style-type: none"> liabilities and capital instruments that do not qualify as CET 1, AT 1 or T 2 instruments and that are not excluded from the scope of the bail-in tool by virtue of Article 44(2) issued and fully paid up not owed to, secured or guaranteed by the institution itself not arising from a derivative not arising from a preferred deposit remaining maturity of at least one year 	Total capital = Tier 1 capital + Tier 2 capital TLAC eligible liabilities: <ul style="list-style-type: none"> liabilities that can be effectively written down or converted into equity without giving rise to material "no creditor worse off" claims be paid in and be unsecured not subject to set off or netting rights minimum remaining maturity of at least one year not be redeemable by the holder not insured deposits not sight and short term deposits not liabilities arising from derivatives not liabilities which are preferred to normal senior unsecured creditors under the relevant insolvency law not any liabilities that are excluded from bail-in by law

Sources: BRRD, EU Commission, FSB, LBBW Research

MINIMUM REQUIREMENT FOR OWN FUNDS AND ELIGIBLE LIABILITIES (MREL)

Article 45 (2) BRRD mandates the European Banking Authority (EBA) to propose to the EU Commission a Regulatory Technical Standard (RTS) that is intended to provide the basis for determining the minimum requirement for MREL. After publication of the Consultation Paper in November 2014, the EBA submitted its final proposal in July 2015 (EBA/RTS/2015/05). Then, in November 2015,

the EU Commission announced its intention to amend the EBA's proposal. The EBA responded promptly in February 2016 with the rejection of the major amendments made by the EU Commission. Ultimately, the EU Commission got its way and the Delegated Act was published on the 23rd of May 2016 with two major amendments regarding the setting of an MREL ratio and the transitional period for fulfilment of the requirement. Unlike the EBA, which proposed a minimum requirement of 8%, the EU Commission insisted that the MREL should be set on a bank-specific basis and did not set a minimum ratio. The EU Commission

replaced the transitional period originally set at a maximum 48 months by the EBA with an appropriate period that can be set by the resolution authority. The EBA and the EU Commission agree with regard to the basic approach for determining the MREL: the MREL is calculated from three components: the loss absorption amount (LAA), the recapitalisation amount (RCA) and the possible adjustments caused by the corresponding Deposit Guarantee Scheme (DGS).

- The LAA takes account of a bank's capacity to absorb losses. The LAA is determined on the basis of the regulatory capital components (8% of RWA), which have to be fulfilled at least in compliance with the Capital Requirement Regulation (CRR; Regulation 575/2013), the combined buffer requirements and additional Pillar 2 requirements (bank-specific) under the Capital Requirement Directive (CRD IV; Directive 2013/36/EU). These provide the basis for determining the first component. But the pertinent authority may deviate from this on the upside or on the downside if it deems this to be necessary due to certain conditions (e.g. business model, funding model and risk profile).

- The second component, RCA, is defined as the recapitalisation that is necessary after a resolution. This initially entails the fulfilment of the regulatory capital requirements, which are obligatory for the licensing of the bank. The CRR's regulatory capital requirements (8% of RWA) including the Pillar 2 requirements of the CRD IV are the starting point here. In addition, at this point potential business sales and other measures taken as part of the implemented resolution strategy are also taken into account. Any additional requirements to obtain the market's confidence in the bank after the resolution are also taken into account. If a bank is classified by the resolution authority as not systemically important, it would be liquidated immediately in the event of a default. In this case, the RCA component would be equal to zero.

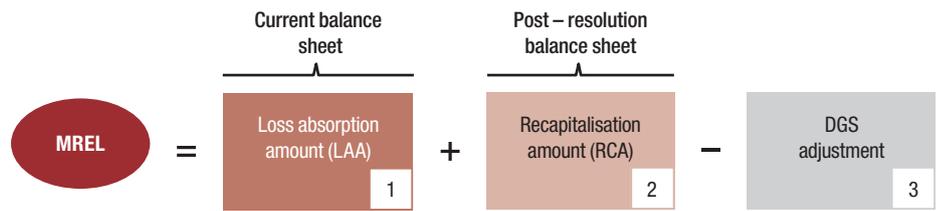
- Possible contributions of a DGS as part of a resolution may be deducted. This is in turn mainly determined by the size of the covered deposits of an individual bank and the capacity of the DGS. The compensation that is to be expected here in the wake of a resolution can lead to a lower MREL requirement.

Thus the basic approach is fixed by the Legal Act. Implementation is planned for 2016 and it has been carried out and is being carried out in parallel, depending on the country, via the SRB (European Monetary Union) or at the national level in very different ways. This has also been reinforced by the discussion about TLAC, which is ultimately supposed to serve the same purpose.

TOTAL LOSS-ABSORBING CAPACITY (TLAC)

After the consultation paper of November 2014, the FSB also formulated a requirement in November

Figure 2 ► Determination of MREL requirements



Source: SRB, LBBW Research

Figure 3 ► Preferred option for implementing TLAC into EU law

MAIN ISSUES	OPTION FOR A HARMONISED IMPLEMENTATION OF MREL+TLAC	KEY QUESTIONS
Scope of application	Split of MREL into minimum Pillar 1 requirements and firm-specific Pillar 2 requirements Pillar 1 requirement = TLAC for G-SIBs	Extension to other banks Implementation in CRR
Level of application	Introduction of the concept of resolution entity/group in the EU MREL currently on a individual and consolidated basis	External/internal TLAC in the context of SPE/MPE Considering EU as one jurisdiction
Calibration of the requirement	Denominator of MREL should be RWA and exposure measure (like TLAC) MREL denominator currently own funds and total liabilities Additional Pillar 2 requirements only if reasonable and necessary	Criteria for Pillar 2 requirements
Eligibility of instruments	Introduction of the subordination concept for MREL Amendment of Tier 2 eligibility criteria in CRR for compliance with TLAC	Same eligibility criteria for MREL, TLAC and Tier 2 Same eligibility criteria for Pillar 1 and Pillar 2
Supervisory regime	Consequences of breaching the MREL/TLAC requirements	Trigger restrictions for a breach in Pillar 2 (dividends, coupons, etc.) Split of requirements in hard and soft ones
Deduction of cross-holdings	Loss-absorbing instrument held by another bank should be excluded	Deduction from the Tier 2 capital

SPE = Single Point of Entry / MPE = Multiple Point of Entry

Sources: European Parliament, LBBW Research

2015 calling for a minimum loss-absorbing capacity (TLAC) for Global Systemically Important Banks (G-SIBs). This is mainly intended to make it possible to absorb losses and carry out recapitalisation measures in the case of resolution in order to put an end to the "too big to fail" (TBTF) problem. In the final standard the TLAC ratios were amended: as of January 2019 G-SIBs must have a TLAC corresponding to the higher of 16% of RWA or 6% of the Basel III leverage ratio (previously: 18% and 6%). As of 2022, these ratios increase to 18% and 6.75% respectively (previously: 20% and 6%).

Within the framework of the minimum Pillar 1 TLAC requirement there is a limitation to the Basel 3 minimum capital requirements; unlike in the MREL capital buffers are ruled out explicitly. In addition, the TLAC eligible liabilities are also recognised, whereby these must account for at least 33% of the TLAC. The question now is which liabilities are TLAC eligible. Decisive here for the FSB is that an explicit

subordination must exist. Three possibilities are proposed for this. First **structural subordination**: the TLAC-eligible liabilities may not be ranked the same as or senior to any excluded liabilities. This can best be achieved by issuing bonds at a holding company level, which is then placed structurally and organisationally right at the top of the resolution entity. Second, **contractual subordination**: here bonds become TLAC-eligible in that they are made subordinate on a contractual basis. These would then occupy a position between the normal senior unsecured bonds and T2 bonds. The third possibility is **statutory subordination** in which bonds are allocated a statutory subordinated status in the order of creditors that is junior to all excluded liabilities.

WHERE ARE WE AT THE MOMENT?

In our view, the parallel appearance of the MREL requirements, on the one hand, and the TLAC, on the other have given rise to confusion especially

among investors in bank bonds. At the same time, in those countries with G-SIBs the national implementation of the BRRD has been used above all to make the Global Systemically Important Banks fit for TLAC. While the TLAC requirements were already relatively concrete, the concrete implementation requirements of MREL were still in the process of being drafted. As a result, the requirements were often mixed, whereby the individual countries went down very different roads especially with regard to subordination or have not yet decided it. The motivation is and was very different: for example, the protection of private investors, the creation of new bail-in eligible capital or the funding-cost strategy with regard to new instruments. The need to make the two concepts compatible with each other has been acknowledged. At the end of 2015, the EU Commission already announced it intended to put forward a draft bill for the implementation of the TLAC requirement in European supervisory legislation in 2016. After the press had been informed in January 2016 that the EU Commission was publishing a Working Paper with three options for the harmonisation of MREL and TLAC, in April 2016 the EU Commission presented a further Working Document with several proposals for the coordinated implementation of the two requirements whereby it narrowed the range of choices from three to one option (preferred option). Figure 3 highlights the most important points.

The report on the implementation of MREL that the EBA must submit to the EU Commission under Article 45 (19) BRRD by 31 October 2016 could also prove helpful here as this report in turn forms the basis for a possible draft bill for the harmonised application of MREL to be put before the European Parliament and the Council of the EU by the EU Commission. At this stage, it will be possible to take up points such as the consideration of different business models when setting MREL or the adjustment of

certain parameters. Attention will focus here on the identification of the business models and the adequate minimum MREL requirements that are suitable for these business models. But issues such as the method of calculation, the appropriate transitional periods or the suitability of the concept for banking groups are also to be examined here. With regard to the business models MREL already provides for special treatment of mortgage banks. However, there is one exception in the BRRD regarding mortgage banks financed by covered bonds. If they are not allowed to receive deposits the resolution authority can exclude them from the MREL requirement. This, in turn, is only possible in the case of a realisable winding-up according to national insolvency proceedings or other types of measures in accordance with the resolution tools in the BRRD and within the resolution objectives. But in our view this does not cover by far the diversity of the business models in which covered bonds play an important role in refinancing.

With regard to MREL and TLAC we believe we are currently going through a transitional phase that will, however, probably end up in the medium term in a harmonisation of the two instruments. The outcome is already partly anticipated and the banks are trying to prepare for it at an early stage – despite all open points. In our view, it is clear that the requirements will have serious repercussions on the banks’ liabilities structure. Depending on which road is embarked on with regard to subordination, certain asset classes will be favoured in order to fulfil the required MREL and TLAC ratios. Covered bonds are excluded here. We believe this harbours positive and negative aspects. On the one hand, this important and crisis-proof funding tool for the banks enjoys explicit protection against a bail-in. This is likely to keep the costs of funding through covered bonds attractive on a permanent basis. On the other hand, the bail-in exception for covered bonds in combination with very high requirements

on MREL and TLAC could lead – for fear of holding inadequate loss-absorbing capital resources – to the covered bonds being given increasingly less scope. A sort of asset encumbrance would be prevented through the backdoor. In our view, therefore, much depends on the consideration of the different business models combined with the risks and their funding structure. The dilemma between creating a level playing field for all banks and achieving an unnecessary levelling down must be resolved here, not least in the interest of investors who are currently confronted with the fact that they should include ever more bank-specific components in their investment decisions while the information required for this is often not adequately transparent. There follows an attempt to cast some light on the different liabilities structures of issuers and their repercussions on covered bonds.

SYSTEMIC IMPORTANCE HAS BECOME A SUPPLY NEGATIVE FOR COVERED BONDS

Significant developments in the field of solvency capital instruments and financial institution resolution protocols, including scope for the use of so-called “bail-in” tools, have ramifications for the covered bond market. These stretch beyond the simple exclusion of the covered bond product from the scope of a hypothetical bail-in. A discernible more opportunistic use of covered bonds within the overall funding decision of a given banking entity has been one of the side effects of the new regulatory terrain. The importance of covered bonds in the diversified funding mix of global systemically important institutions (G-SIBs) is nowadays a token of what it once was. In 2015, European G-SIBs issued a little over EUR 30 bn in covered bonds, 14% of their aggregate funding print (Figure 4 and 5). Non G-SIBs attracted almost 40% of their funding

Figure 4 ▶ Funding developments for European banks

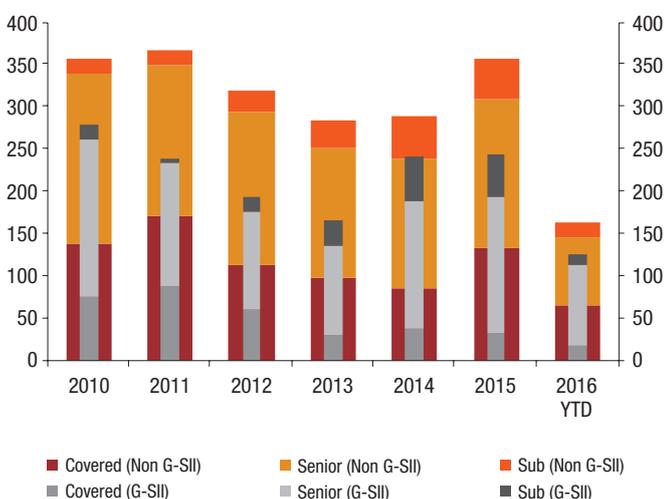
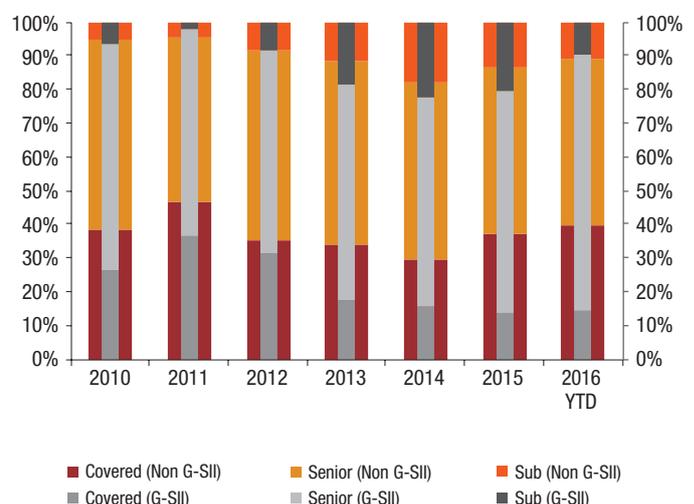


Figure 5 ▶ Funding source distribution European banks



Source: Dealogic, ING

via covered bonds. G-SIBs continue to have a comparatively stronger focus on subordinated funding, and this is a trend that is likely to persist in light of the stricter capital and expected loss absorption requirements for these institutions. Further clarity on the treatment of senior unsecured debt instruments in the loss absorption resolution hierarchy will only, in our view, reinforce the emphasis on the issuance of debt instruments eligible for loss absorption at the expense of fresh covered bond product.

INTEGRATING MREL AND TLAC

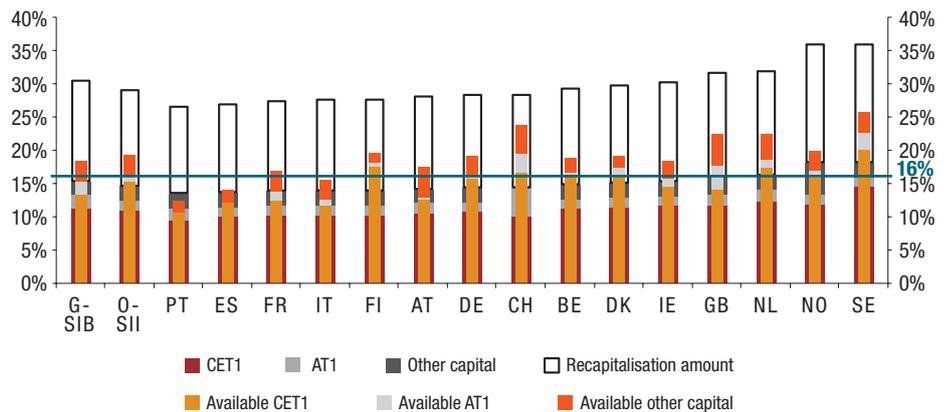
As described hitherto in greater detail, the Delegated Act published by the EU Commission in May 2016 concretised first efforts in harmonising MREL and TLAC requirements.

- The MREL will be determined as a percentage of the *total risk exposure measure* (i.e. risk-weighted assets), or as a percentage of the *leverage exposure measure*. This aligns the denominator approach to determining the MREL and TLAC. However, the calculated MREL will be expressed as a percentage of own funds plus total liabilities of the institution.
- The MREL's loss absorption amount and *recapitalisation amount* both take the higher of the 8% capital ratio or 3% leverage ratio as a basis. Resolution authorities will ultimately determine the MREL for banks on an individual basis and may decide not to apply the recapitalisation amount in full. However, aggregating the basis loss absorption and recapitalisation amounts provides for an indicative MREL "loss absorption minimum" of 16% of the risk exposure measure or 6% of the leverage exposure measure. This matches the minimum TLAC requirements for G-SIBs as per the 1st of January 2019 (18% and 6.75% respectively by the 1st of January 2022).

■ In the case of MREL, the default definitions for the *loss absorption and recapitalisation amounts* add the additional own funds requirements and combined buffer requirements for banks to the aforementioned indicative loss absorption minimum. Resolution authorities may decide to partially apply these additional requirements when setting a bank's MREL. This brings the MREL into line with TLAC. In the case of TLAC the capital buffer requirements must be met in addition to the 16% TLAC minimum. The unadjusted default setting for the MREL (adding the additional own funds requirements and combined buffer requirements twice should this also include the minimum capital requirement) is higher however than the TLAC requirement (adding in the capital buffer requirements only once).

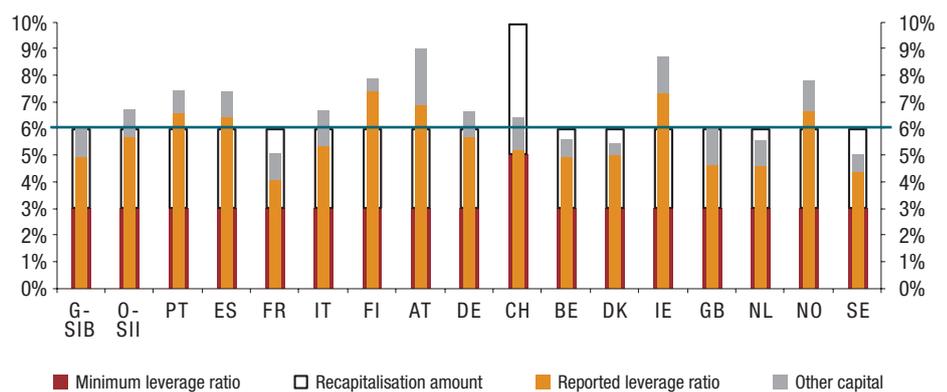
Figure 6 gives an indication of the average default MREL requirements for 55 European covered bond issuers that have been identified as systemically important institutions. The loss absorption amount matches the expected fully phased in capital require-

Figure 6 ▶ Potential loss absorption requirements vs. available capital buffers (2015 YE, % risk exposure amount)



Source: Issuer reports, SNL, ING

Figure 7 ▶ Potential loss absorption requirements vs available capital buffers (2015 YE, % LR denominator)



Source: Issuer reports, SNL, ING

ments of the banks and the recapitalisation amount is set equal to the loss absorption amount (i.e. including the additional own funds and combined buffer requirements twice). The figure suggests the somewhat higher expected MREL requirements for G-SIBs compared to O-SIBs. Nordic banks may also face stricter loss absorption requirements than, for instance, Southern European banks.

The calculated loss absorption requirements are compared with the average capital ratios of the banks at the end of 2015. The O-SIBs seem better positioned than G-SIBs to meet a larger proportion of their loss absorption requirement with capital. The figure also illustrates that most banking sectors already meet the 16% loss absorption floor with solvency capital. To avoid exposing senior unsecured bondholders to loss absorption risk, only the Southern European banks would have to attract further capital to meet the (indicative) 16% loss absorption floor.

The list of banking sectors with capital loss absorption shortfalls expands if the minimum leverage ratio

requirements are taken as a reference (Figure 7). The minimum leverage ratio is 3%, equating to a 6% minimum loss absorption requirement as a percentage of the leverage exposure measure. Switzerland applies a 5% minimum leverage ratio equating to a 10% minimum loss absorption requirement. The UK regulator intends to apply a countercyclical leverage ratio buffer (CCLB) and an additional leverage ratio buffer (ALRB) for its systemically important institutions (initially only for G-SIBs) on top of the 3% minimum. This illustrates that ultimately the loss absorption requirements based upon the applicable leverage ratio can be higher than 6%. The French, Belgian, Danish, Dutch and Swedish banking sectors do not yet fully meet this 6% loss absorption minimum with capital instruments. The Finnish, Austrian, German, Irish, UK and Norwegian banking sectors, on the other hand, have sufficient capital under both approaches, and may consequently be among the less active issuers of eligible loss absorption instruments. When existing senior instruments are included in these calculations most banking sectors appear to be in decent shape vis-à-vis fulfilling loss absorption requirements.

SUPPLY AND SPREAD IMPLICATIONS

That said, building loss absorption buffers with subordinated debt or (structurally, statutorily or contractually) subordinated senior unsecured paper will remain an important driver for bank funding decisions. Figure 8 plots the share of covered bonds in the supply aggregate of European banks in 2015 and 2016 YTD. The average leading loss absorption buffer shortfalls or surpluses (based on capital instruments only) are depicted on the right hand side as a percentage of the banks' total assets. Jurisdictions with higher shortfalls, such as Spain, France or the Netherlands, indeed tend to see less supply activity in covered bonds and more issuance in subordinated debt. The opposite trend holds for Norway and Germany where more covered bond product is issued versus subordinated paper.

The impact of loss absorption buffer shortfalls on covered bond spreads is less straightforward. Although lower loss absorption buffers coincide with lower supply pressure in covered bonds, they are also broadly indicative of lower bank capitalisation levels. Figure 9 compares 5yr equivalent covered bond spreads (over sovereign) with the estimated buffer shortfalls. The figure indeed suggests that loss absorption buffers have limited impact on covered bond spreads. However, larger buffer shortfalls do tend to coincide with wider senior unsecured over covered bond spreads, reflecting the higher potential loss implications for the senior bonds in the case of a bail-in scenario.

GOING CONCERN RESOLUTION PROSPECTS ARE SPREAD POSITIVE

Higher loss absorption buffer requirements compel stronger bank capitalisation levels and support

credit ratings. These coincide with lower covered bond supply pressure. Therefore, it would appear that a bank's systemic significance corresponds with observable funding cost advantages. Figure 10 illustrates the durable spread premium of systemically less important institutions versus those with heavier systemic importance for a selection of core Eurozone countries. These wider spreads indeed partly reflect weaker issuer credit ratings. We refer to figure 11 for an overview of average 5yr equivalent covered bond spreads for both systemically important institutions and those less so, by average issuer credit ratings. However, worth noting is that in a jurisdiction such as Austria, where the average issuer credit ratings of institutions with less systemic significance are negligibly different from the ratings of the pillar systemic banks, spreads are wider.

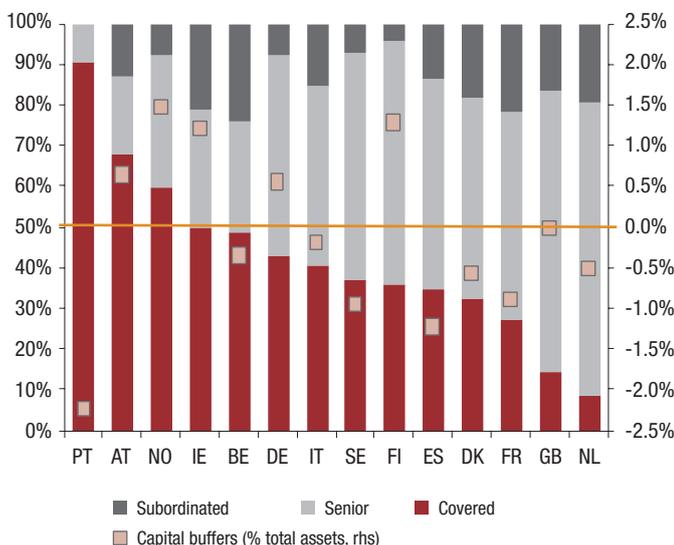
Systemically important banks have stronger going concern prospects. Smaller institutions on the other hand may be more at risk of insolvency and resolution protocols, and consequently have less need for loss absorption buffers that would facilitate complete recapitalisation in case of failure. For covered bonds, insolvency proceedings together with the segregation and a standalone administration of the cover pool are likely to result in more timely payment uncertainty for bondholders than a going-concern resolution strategy involving a bail-in of unsecured creditors. This can have covered bond rating implications. Moody's for instance, suggested in May that it may reconsider applying the existing covered bond anchor for minor European banks that are likely to have a resolution strategy of insolvent liquidation, and where the covered bonds are likely to remain with the bankruptcy estate. However, the prospects of selling assets or transferring a covered bond programme to another bank entity are, in our view, stronger for smaller institutions than for larger

programmes. The perceived systemic importance of covered bonds in a jurisdiction remains an important consideration in this regard. That said, differences in systemic significance are not necessarily the only driver of these observed spread discrepancies. Smaller size, less frequent issuers also typically have a confined and limited investor base to take up their covered bond product.

THE IMPACT OF DIFFERENT LOSS ABSORPTION MODELS

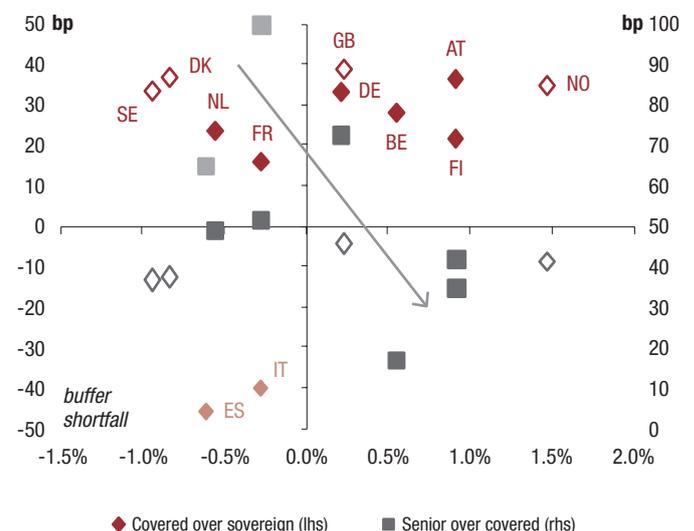
While the systemic importance and buffer requirements of a given bank will impact funding decisions and costs, so too will the applicable loss absorption model. Whether the hierarchical loss absorption protocol is contractual, structural or statutory will translate to different results to different banks in terms of the expected loss and supply consequences for (existing legacy) unsecured and secured bondholders. Figure 12 depicts the relationship between the 5yr equivalent covered bond and senior unsecured spreads of a selection of SIs that (may) issue eligible loss absorption paper from a resolution entity that does not have any excluded liabilities on its balance sheet, i.e. a holding company (**structural subordination model**) versus their less systemically important comparables (LSIs). The chart confirms the significant (expected loss) premium for holding company senior unsecured paper, qualifying for loss absorption, versus senior unsecured paper issued from operating companies. For systemically important institutions, the credit risk perception reflected by the covered bond spreads is approximately linear to the credit risk priced in by the senior unsecured bonds (both OpCo and HoldCo). Systemically less significant institutions (non HoldCo) are quoted wider than systemically significant institutions in both covered bonds and in senior unsecured. However,

Figure 8 ► Buffer shortfalls and funding mixes



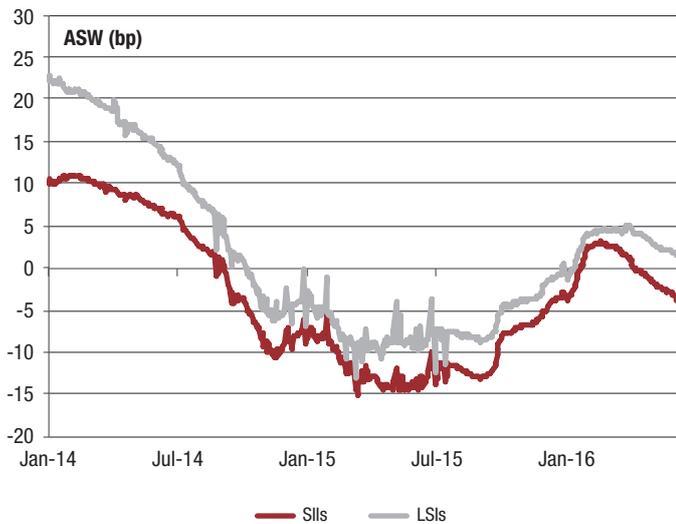
Source: Dealogic, SNL, ING

Figure 9 ► Buffer shortfalls and spread levels



Source: Markit iBoxx (31 May 2016), SNL, ING

Figure 10 ▶ Systemic vs. non-systemic bank spreads



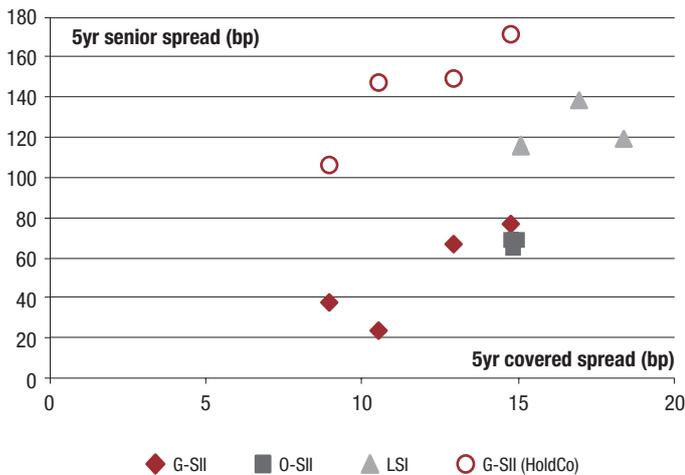
Source: Markit iBoxx, ING

Figure 11 ▶ Covered bonds of LSIs trade wider than SIs



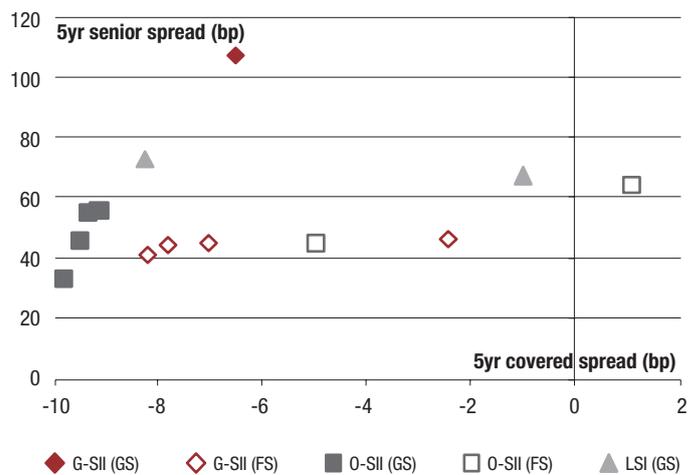
Source: Markit iBoxx (31 May 2016), ING

Figure 12 ▶ Senior-covered spreads (structural solution)



Source: Markit iBoxx (31 May 2016), ING

Figure 13 ▶ Senior-covered spreads (statutory solution)



Source: Markit iBoxx (31 May 2016), ING

the expected loss premium is comparatively higher versus (OpCo) senior instruments of SIs than the covered bond product of SIs.

Figure 13 plots a similar relationship for two different **statutory loss absorption solutions**. Under the German solution (GS), all existing senior unsecured bonds rank statutorily ahead of other unsecured claims in a bail-in scenario. In the case of the advocated French solution (FS) the outstanding existing senior unsecured bonds are expected to obtain “preferred” status over a lower ranking “non-preferred” senior unsecured asset class within the loss-absorption hierarchy. The figure confirms the roughly linear relationship between covered bonds and senior unsecured bonds under the German

solution, irrespective of the systemic significance of the institution. This relationship is notably steeper than observed for the advocated French solution. This illustrates the different expected loss assessment for senior unsecured paper made statutorily eligible for loss absorption purposes, versus senior unsecured debt receiving preferred status in the loss absorption hierarchy. The latter is likely to become a scarcer debt instrument and represents a better yielding alternative to covered bonds with (ultimately) moderate loss absorption risk.

CONCLUDING REMARKS

As loss absorption frameworks and resolution strategies take further shape, charting and navigating

this regulatory terrain will remain an important analytical dimension for covered bond investors. This extends well beyond the specific exclusion of covered bonds from any bail-in solution and may indeed prove to be something of a turbulent way forward with harmonisation efforts likely to remain challenging in light of the existing institutional and country specific differences.

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](#).



NEWS IN BRIEF

EBA Recommends Retaining Risk-Sensitive Framework for Banks' Regulatory Capital

On the 22nd of December 2016 the European Banking Authority (EBA) published its Report on cyclical capital requirements (available [here](#)) aiming at clarifying whether risk-sensitive bank capital requirements as laid down in the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD) create unintended pro-cyclical effects by reinforcing the endogenous relationships between the financial system and the real economy. This report, which has been drafted in close cooperation with the European Systemic Risk Board (ESRB) and the European Central Bank (ECB), is in response to a request by the European Commission to understand whether CRDIV/CRR requirements exert significant effects on the economic cycle and, if so, whether any remedial measures are justified. In addition, this Report may inform the European Commission's currently ongoing reviews of the EU micro- and macro-prudential frameworks and could serve as a valuable complementary contribution to the global discussions about the bank capital regulatory framework.

Increased risk-sensitivity of the bank capital regulatory framework raises the concern whether resulting regulatory capital requirements tend to be pro-cyclical, e.g. contribute to mutually reinforcing feedback loops between the financial system and real economic developments.

Findings

Against the background of considerable challenges to empirically identify with sufficient certainty the relationship between risk-sensitive regulatory capital and the amplitude of the economic cycle, the key conclusions of the Report are the following:

- Banks' capital requirements, since 2008, appear to have developed relatively stable and series on banks' IRB risk parameters (Probability of Default, Loss Given Default, default ratio) do not show a particularly cyclical pattern.
- The surprising lack of a strong correlation between the economic cycle and banks' risk-weighted assets (RWAs) and underlying parameters is evident in various regression specifications at bank and portfolio level.
- Higher capital requirements due to CRD/CRR could have exerted some restricting impact on banks' loan supply, but in the period observed (after 2008), results indicate that it is likely that broader macroeconomic and financial factors had a predominant impact on banks' lending decisions.
- Further econometric analysis provided only limited evidence of any significant pro-cyclical effect induced by the regulatory framework on the real economy.

Recommendations

Against the background of the weak evidence on the existence of pro-cyclical effects due to the CRDIV/CRR framework, this Report recommends that the EU retains its current risk-sensitive framework for bank regulatory capital. If pro-cyclical risks were to become more material, the EU financial regulatory framework has various tools at its disposal, which could in principle be used.

For that purpose, the impact of the EU bank regulatory framework on the economic cycle should be monitored regularly and the potential impact, effectiveness and efficiency of counter-cyclical instruments be further analysed.

EBA Publishes Risk Dashboard for Q3 2016

On the 13th of January 2017, the European Banking Authority (EBA) published its periodical update of its Risk Dashboard (available [here](#)) summarising the main risks and vulnerabilities in the EU banking sector by a set of Risk Indicators in Q3 2016. Together with the Risk Dashboard, the EBA published the results of a Risk Assessment Questionnaire, which was conducted among banks and market analysts between October and November 2016.

In Q3 2016, EU banks' ratio of common equity tier 1 (CET1) reached new highs, increasing by 50 bps to 14.1%. This effect is simultaneously explained by the growth in capital (mainly driven by higher 'retained earnings') as well as a decrease in RWAs.

The ratio of non-performing loans (NPLs) was 5.4%, 10 bps below Q2 2016 and suggesting that supervisory efforts are bearing fruit, albeit slowly. Looking forward, the Risk Assessment Questionnaire shows that more than half of the banks plan to increase their volumes of corporate and SME financing portfolios, as well as residential mortgage and consumer loans.

Profitability remained squeezed, and the annualised return on equity (RoE) decreased to 5.4%, one percentage point (p.p.) below the third quarter last year. The RoE was still significantly below banks' Cost of Equity (CoE), which is estimated to be between 8% and 10% by nearly half of the institutions in the Risk Assessment Questionnaire. Furthermore, the cost-to-income ratio increased to 63.0%, three percentage points (p.p.) above the third quarter of the last year.

The loan-to-deposit ratio decreased to 120.1%, compared to 120.5% in the former quarter and the asset encumbrance ratio further increased to 26.5% (25.5% in the previous quarter).

ECB Publishes Results of the January 2017 Euro Area Bank Lending Survey

On the 17th of January 2017 the European Central Bank (ECB) published the results of its euro area bank lending survey (BLS) for the month (available [here](#)). According to the BLS, credit standards (i.e. banks' internal guidelines or loan approval criteria) for loans to enterprises tightened somewhat in net terms in the fourth quarter of 2016 (a net percentage of 3%, compared with 0% in the previous quarter), driven mainly by developments in the Netherlands. This was the first net tightening since the fourth quarter of 2013 and was broadly in line with expectations in the previous survey round. Banks' lower willingness to tolerate risk was the main factor behind the slight net tightening of credit standards on loans to enterprises. Credit standards on loans to households for house purchase remained broadly unchanged (a net percentage of 1%, compared with -4% in the previous quarter). For the first quarter of 2017, banks expect a net easing of credit standards across all loan categories.

The net easing of banks' overall terms and conditions on new loans (i.e. the actual terms and conditions agreed in the loan contract) continued across all loan categories, mainly driven by a further narrowing of margins.

Net demand continued to increase across all loan categories. The low general level of interest rates, merger and acquisition activity and debt refinancing remained the main contributing factors to net demand for loans to enterprises in the fourth quarter of 2016. Net demand for housing loans was driven by the low general level of interest rates, continued favourable housing market prospects and consumer confidence.

Euro area banks continued to adjust to ongoing regulatory and supervisory changes in the second half of 2016 by further strengthening their capital positions and reducing their risk-weighted assets. At the euro area level, banks reported a broadly neutral impact of regulatory or supervisory action on credit standards and credit margins.

Regarding the targeted longer-term refinancing operations (TLTROs) conducted by the Eurosystem, 37% of the euro area BLS banks reported that they had participated in the third TLTRO-II operation. Participation was driven by profitability motives, reflecting the attractiveness of the TLTRO-II. Banks continued to indicate that the main effect of the past TLTROs on loan supply was an easing of terms and conditions, but the easing impact on credit standards also increased.

The BLS, which is conducted four times a year, was developed by the Eurosystem in order to improve the understanding of banks' lending behaviour in the euro area. The results reported in the January 2017 survey relate to changes in the fourth quarter of 2016 and expectations of changes in the first quarter of 2017, unless otherwise indicated. The January 2017 BLS was conducted between 7 and 27 December 2016. With 139 banks (out of 141 sample banks) participating in the survey, the response rate was 99%.

EBA and ESMA Call to Clarify Margin Requirements between CRR and EMIR

On the 18th of January 2017 the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) published their joint report (available [here](#)) on the functioning of the Capital Requirements Regulation (EU) No 575/2013 (CRR) with the European Market Infrastructure Regulation (EU) No 648/2012 (EMIR). The report calls for the requirements for credit, market, and counterparty credit risk in the CRR to be clarified. This clarification should ensure that only risks not already covered by specific financial resources for activities not related to clearing are to be covered by CRR requirements. This exclusion should also be extended to activities covered by interoperability arrangements.

In the Report, the EBA and ESMA have focused their analysis on a list of specific issues concerning the mandate of article 515(1) of the CRR, and in particular with regard to institutions operating a central counterparty (CCP). The recommendations included in the Report aim at avoiding duplication of requirements for derivative transactions and thereby avoid increased regulatory risk and increased costs for monitoring by Competent Authorities. In particular, the following topics have been addressed in the Report: (a) Capital requirements for CCPs holding a banking licence; (b) Leverage and liquidity for CCPs; (c) Large exposures; (d) Difference in MPoR application; (e) Clients' exposures to clearing members.

European Commission Launches Public Consultation on the Capital Markets Union Mid-Term Review

On the 20th of January 2017 the European Commission launched a public consultation on the Mid-Term Review of its Capital Markets Union (CMU) initiative. This consultation (accessible [here](#)) offers an opportunity for stakeholders to provide targeted input to complement and advance actions put forward in the CMU Action Plan.

Launching the consultation, European Commission Vice-President **Valdis Dombrovskis**, responsible for Financial Stability, Financial Services and Capital Markets Union, said: *"We have built good momentum behind the Capital Markets Union project and we are well on our way to completing the first wave of measures. Now, we want to move faster and be more ambitious. This mid-term review consultation will help shape the next phase of our work to build a single market for capital in Europe."* European Commission Vice-President **Jyrki Katainen**, responsible for Jobs, Growth and Investment, said: *"Progress towards building a Capital Markets Union is crucial to strengthen the third pillar of the Investment Plan for Europe. It will contribute to creating an investment friendly environment and make it cheaper and more interesting for insurance companies and banks to invest in long-term infrastructure projects. We are determined to deliver on our commitments and the mid-term review will allow us to ensure that the Capital Markets Union Action Plan remains relevant in a changing political, economic and technological context."*

The results of this consultation will feed into the mid-term review of the CMU Action Plan that the Commission aims to publish in June 2017. The review will seek to strengthen the current policy framework for the development of capital markets by updating the proposed actions and integrating complementary measures in response to key challenges.

Respondents are invited to provide evidence-based feedback and specific suggestions by the 17th of March 2017 through the [online questionnaire](#). A [Q&A](#) is also available online.

Green Covered Bond Pioneer Berlin Hyp AG Joins ECBC

Berlin Hyp

The European Covered Bond Council (ECBC) is pleased to announce that the German real estate and mortgage bank **Berlin Hyp AG** has become the latest member to join the ECBC. As of January 2017, the ECBC represents over 100 members across more than 30 active covered bond jurisdictions globally.

Berlin Hyp was the first lender to issue a covered bond backed by green mortgages in April 2015, and is an active stakeholder in the recently launched pan-European [Energy Efficient Mortgages Initiative](#).

Commenting on Berlin Hyp's decision to join the ECBC, **Luca Bertalot**, EMF-ECBC Secretary General said:

"We are delighted to have the pioneer of Green Pfandbriefs on board the ECBC. Berlin Hyp's experience with green issuances and expertise in selecting and classifying green building data will make an important contribution to the European Energy Efficient Mortgages financing initiative, which will be one of the ECBC's main areas of focus in 2017."

Sven Schukat, Head of Treasury at Berlin Hyp commented:

"The ECBC is the well-recognised think-tank and international voice of the covered bond industry. We look forward to contributing to their important work on various upcoming regulatory and market-related covered bond issues. Moreover, we are especially excited about the collaboration with other market participants and stakeholders in the European Energy Efficient Mortgages financing initiative."

Compagnie Européenne de Garanties et Cautions Joins EMF as an Observer Member



COMPAGNIE
EUROPÉENNE
DE GARANTIES
ET CAUTIONS

The European Mortgage Federation (EMF) is pleased to announce that the French multi-disciplinary surety insurance company, **Compagnie Européenne de Garanties et Cautions (CEGC)** has become the latest organisation to join the EMF

as an Observer Member. As of January 2017, the EMF represents 17 Full Members organisations across 14 European Union (EU) Member States and four Observer Members across three EU Member States.

CEGC is a subsidiary of NATIXIS – BPCE – the number two in French retail banking – and it is the second largest insurance company in France in terms of the market for guaranteed loans for housing. At the end of 2015, CEGC was responsible for guaranteeing outstanding home loans worth over €114 billion, with new business representing €31.8 billion. In 2015, CEGC's amount of earned premium for home loans guaranteed was over €374 million. For the company, the shareholders' equity stands at €406 million and the amount of technical provisions is €1,429 million. The company employs 277 members of staff.

Royal Bank of Canada First North American Issuer to Join the Covered Bond Label

The Covered Bond Label Foundation (CBLF) welcomes **Royal Bank of Canada (RBC)** as the first North American Issuer to join the Covered Bond Label. As such, RBC becomes the 82nd Issuer to hold the Label and brings the total number of labelled pools to 98.

Due to RBC's accession, Canada becomes the 16th jurisdiction to be represented in the Covered Bond Label. This expansion to another new continent – following Asia (Singapore) earlier this year – further strengthens the Label's reach beyond European markets.

Commenting on this development, **Luca Bertalot**, Covered Bond Label Foundation (CBLF) Administrator, stated:

"We are delighted to welcome Royal Bank of Canada on board. The support of the Canadian covered bond community for the Label shows that there is strong demand for transparency and convergence in covered bond markets in Europe and beyond, and underpins the global importance of the Covered Bond Label Initiative."

The Covered Bond Label is a quality Label which responds to a market-wide request for improved standards and increased transparency in the covered bond market. The primary purpose of the Label is to highlight to investors the security and quality of covered bonds, and to further enhance recognition of and trust in the covered bond asset class. On the Covered Bond Label [website](#), investors can retrieve key information, such as LCR eligibility, on over 4,200 different covered bonds.

Furthermore, the introduction of the Harmonised Transparency Template (HTT) requires the labelled issuers from all covered bond jurisdictions to disclose their cover pool information in a standardised way, regardless of their jurisdiction. As of the 1st of January 2017, all labelled issuers have to comply with the requirements of the 2017 Covered Bond Label Convention (available [here](#)), which entails disclosing their data by publishing the HTT.



Royal Bank



COVERED BOND
L A B E L

EMF-ECBC Energy Efficient Mortgage Initiative: Second Stakeholder Meeting – Brussels, 16th of February 2017



In September 2016, the European Mortgage Federation - European Covered Bond Council (EMF-ECBC) launched a ground-breaking mortgage financing initiative (see [here](#)) to support energy efficiency improvements in buildings, representing the first time a group of major banks and mortgage lenders, as well as businesses and organisations from the building and energy industries have come together to address the concept of energy efficient mortgages. The EMF-ECBC believes that **the mortgage industry can play a game changing role in providing long-term financing for energy improvements to the existing European housing stock**. Considering that buildings constitute the largest single energy

consumer in the EU, and that the value of the European mortgage market is close to 50% of the EU's GDP, there is huge potential for unlocking the benefits of mortgage financing to support energy efficiency. A pan-European initiative in this area will help to coordinate market interventions, which will reduce the public resources necessary to boost households' energy savings.

In this context, on the **16th of February 2017**, the EMF-ECBC will host the **Second Stakeholder Meeting of the EMF-ECBC Energy Efficient Mortgage Initiative** at the **Bibliothèque Solvay** in Brussels where around **50 key stakeholders** engaged in the initiative will convene to discuss progress to date and the next steps to be taken. We are delighted to announce that both **Jyrki Katainen**, European Commission Vice-President for Jobs, Growth, Investment and Competitiveness, and **Paul Hodson**, Head of Unit, DG Energy, have confirmed their participation in our event, which is kindly being supported by **European DataWarehouse**.

ECBC Events in Singapore – 6th-8th of March 2017

Following on from the success of previous years' events, we are pleased to announce that the ECBC will be returning to **Singapore** on the **8th of March 2017** in order to host the fourth 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.

As in previous years, this event will be preceded on the 7th of March 2017 by the **Euromoney/ECBC Asian Covered Bond Forum**, which will also be held for the fourth 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 third meeting of the **ECBC Global Issues Working Group** will also take place in Singapore on the 6th of March and will be kindly hosted by the **Association of Banks in Singapore (ABS)**. A **Welcome Dinner** for all participants in the Roundtable meeting will also be hosted on the evening of the 7th of March with the kind support of **BNP Paribas, DBS** and **UOB**.

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

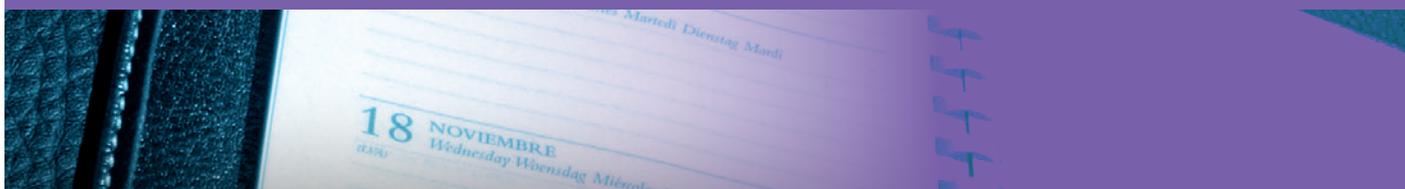
25th ECBC Plenary Meeting – Oslo, 6th of April 2017

We are delighted to confirm that registrations are now open for the **25th ECBC Plenary Meeting**, which will take place in **Oslo**, Norway on the **6th of April 2017** with the kind support of **Finance Norway** and **The Norwegian Covered Bond Council**.

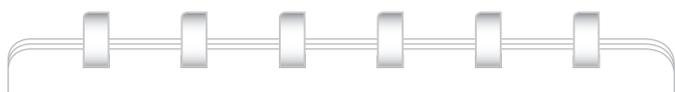
To register for the event, click [here](#) (*registrations are open until the 30th of March 2017*).

Please note that this event is only open to ECBC members and guests invited by the EMF-ECBC Secretariat. For further information, please contact us at ecbcinfo@hypo.org.





AGENDA



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

- 01/02** Fourth Meeting of the CEN-CENELEC Working Group on “Energy Efficiency Financing Tools” – 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

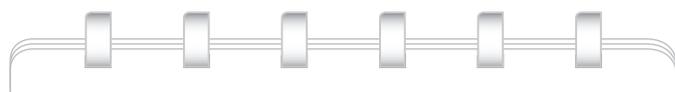
- 07/02** MEP Jeppe Kofod Breakfast Event on the process, status and the consequences of regulating covered bonds in Europe and, in particular, the role of covered bonds in microfinance, innovation and job creation – Brussels

- 07/02** Meeting of the Advisory Group of the Sustainable Energy Investment Forums – Brussels

- 07/02** 15th Annual European Financial Services Conference – Brussels

- 16/02** European Mortgage Federation – European Covered Bond Council (EMF-ECBC) Energy Efficient Mortgages Initiative Second Stakeholder Meeting – Brussels

- 28/02** European Parliament Financial Services Forum (EPFSF) Event on the Capital Requirements Regulation and Directive (CRR/CRD) – Brussels



MARCH 2017

- 06/03** European Covered Bond Council (ECBC) Global Issues Working Group Meeting – Singapore

- 06/03** 2017 Climate Bonds Conference – London

- 07/03** Euromoney/European Covered Bond Council (ECBC) Asian Covered Bond Forum 2017 – Singapore

- 08/03** European Covered Bond Council (ECBC) Asian Covered Bond Investor Roundtable 2017 – Singapore

- 09/03** 11th LBBW European Covered Bond Forum – Mainz

- 17/03** European Mortgage Federation (EMF) Economic Affairs Committee Meeting – Brussels

- 23/03** European Commission Conference: #FinTechEU – Is EU regulation fit for new financial technologies? – Brussels

- 24/03** European Mortgage Federation (EMF) Legal Affairs Committee – Brussels

- 28/03** European Parliament Financial Services Forum (EPFSF) Event on the Action Plan on Retail Financial Services – Brussels

- 30/03** European Mortgage Federation (EMF) Statistics Committee Meeting – Brussels

- 31/03** European Mortgage Federation (EMF) & European Network for Housing Research (ENHR) Seminar – Brussels

DISCLAIMER

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