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Market Insights & Updates

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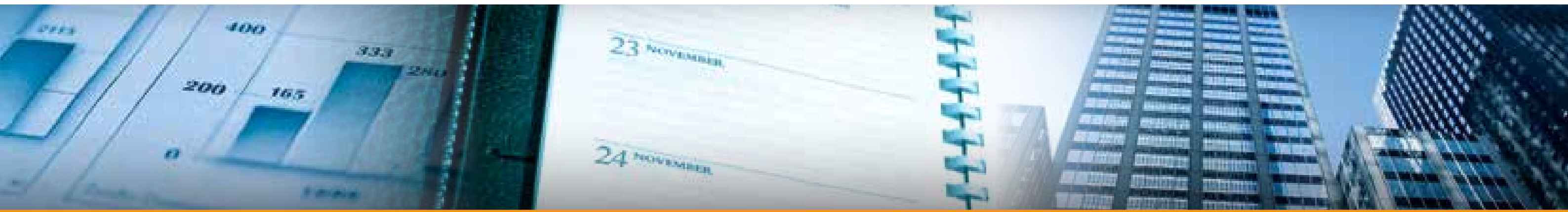

Summary

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European Covered Bond Council

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Harmonisation of Legal Frameworks: A Study

By Richard Kemmish, Independent Covered Bond Consultant, Richard Kemmish Consulting Ltd.

Last December the European Banking Authority (EBA) made some far-reaching proposals for the harmonisation of the covered bond market. Building on their earlier, 2014 proposals they both elaborated on and went beyond their 'Best Practice' principles for the covered bond market. In brief they proposed three steps to the legislation of covered bonds in Europe: step 1 defining basic principles of the product; step 2 as a measure of quality standards that bonds must meet in order to benefit from prudential treatment for investors; and step 3 constituting those aspects of the legislation which, on the principle of subsidiarity, are most appropriately legislated at a national, rather than a Union level. The (augmented) best practice principles and other measures, such as new liquidity and collateralisation rules are to define the first two steps.

Their intention is that this proposal should be the basis for legislation: possibly in the form of a Covered Bond Directive. Before embarking on legislative action the Commission must satisfy itself that the proposal is justified, that it works and that the benefits of harmonisation outweigh any costs, either transition costs or costs associated with changing the way in which successful, functioning covered bond markets work today.

Arguably it is an odd time to do this. With the covered bond market in robust good health and with market participants acutely aware of the specificities of each market in Europe, the potential costs of over-harmonisation seemingly outweigh any potential benefits. The answer of course is that legislation is not passed for today's conditions but for tomorrow's. Specifically, whilst the covered bond market sailed, more or less serenely, through the last crisis that is no guarantee that the next crisis will be the same or that the ability of the covered bond market to survive hasn't somehow been impaired by changes to regulation or to the structure or reach of the market since then. Sceptics have pointed to the changes to state aid rules, the introduction of covered bonds in lower rated banking systems and even changes to programme structures as potential sources of future threats.

At the same time the impetus for change comes from outside the market too. Covered bonds fund some of the best assets in the banking system, if the proven technology of our market could be applied to assets which are more difficult to finance, could they contribute to the wider objectives of Commission's Capital Markets Union initiative and help to provide much needed funding for other sectors of Europe's economy?

A STUDY

The European Commission, in an effort to assess the proposals and their costs and potential benefits commissioned a detailed study of the proposal. As part of this study representatives of 56 organisations in 14 Member States were consulted on their views. In addition, the study was able to draw on the results of the earlier public market consultation that Commission launched, and included a far reaching online survey and a review of existing analysis of the market from sources ranging from academic studies to rating agency analysis.

RESULTS

It will come as no surprise that the study concluded both that there is a strong case for greater harmonisation – this has been clear to many market participants for a long time – and that the EBA's proposals are an appropriate basis for this. Most of the EBA's specific proposals, such as the best practice principles are, quite frankly, 'no-brainers' – the benefits of harmonisation are clear (if sometimes difficult to quantify), the costs of harmonisation somewhere between zero and 'not very much'. So the below is a summary of the more controversial areas and the few areas where the study disagreed with the EBA.

CONTROVERSIAL PROPOSALS

The biggest area of contention in the overall proposal is the possibility of a 'two tier' covered bond market, existing covered bonds largely being the second tier but with an additional 'lower' tier of bonds, for example backed by other non-traditional asset classes. Whilst this clearly advances Commission's objectives of funding the real economy it also creates a contagion risk: what if one of the non-traditional asset class backed bonds defaults, will it damage the existing market? The study concluded: probably not. With appropriately distinct branding (such as "European Secured Notes" rather than "covered bonds") being used to describe 'step 1' bonds investors are sufficiently sophisticated to differentiate between the two products.

EBA have also proposed a harmonised, pan-European minimum over-collateralisation ratio, most likely 5%. Whilst this is an intuitive and straightforward concept it does run the risk of over-standardising. As we know all covered bond structures, issuers and cover pools are different. Is the simplicity of the concept undermined by the fact that my 5% over-collateralisation is different from your 5% over-collateralisation? This is of course a risk but one that is ameliorated by the greater investor confidence in the asset class that such a measure will introduce and by the prohibition of abuses of the over-collateralisation concept.

The study's disagreement with the EBA on this proposal was not on the concept of a pan-European level, or even with the 5% value but with the method in which it is calculated. The EBA would prefer a pan-European methodology. The study contends that the different national specificities in mortgage markets in Europe make it impossible to do this in a meaningful way and expresses a preference for the calculation methodology to remain in 'step 3' – a Member State competency.

Another area of controversy concerns liquidity buffers. The EBA would like to see issuers hold liquidity assets equal to net outflows on their programmes for the next 180 days. For many issuers this could be very expensive were it not for a potential mitigant – issuers of extendable maturity bonds (such as soft bullets) are exempt from holding liquidity against principle on its expected maturity date. As all extensions are for a period of greater than 180 days this in practice substantially eliminates the costs of this proposal.

But there is a twist. In order to avail themselves of this exemption the extensions must meet certain criteria laid down by the EBA including, most controversially that the issuer default is a pre-requisite for the extension provision. Roughly half of existing programmes do not meet this condition currently. It is a complex and detailed topic but, to cut to the chase, the study agreed with the EBA's proposal but recognised that this will be a significant irritant to many issuers. Anticipate disagreement.

There are too many topics covered in the study and not enough room here to give any more than a flavour of the more controversial aspects of the EBA's proposal and the study. It is all available online here.

NEXT STEPS

The Commission must now consider the EBA's proposals and the findings of the study. They will shortly announce whether there is a sufficient case for legislative action and if so what form it will take. That is not the end of the story, the European Parliament has launched its own proposals for legislation.

We cannot be sure of the details of the legislation and, realistically, it will be at least a couple of years before it is passed but it is clear that there will be legislation to harmonise the European covered bond market and equally clear that it will be beneficial. The devil is in the detail.

G20 Launches Energy Efficiency Investment Toolkit

By Peter Sweatman, Rapporteur for the G20 Energy Efficiency Finance Task Group and CEO of Climate Strategy

Launched in Hamburg on 4th May 2017, the G20 Energy Efficiency Investment Toolkit references the importance of Green Tagging and highlights the innovative energy efficiency mortgage initiative of the EMF-ECBC.

The growing energy efficiency market now represents USD 221 billion of opportunities delivering multiple benefits each year, yet further collaboration in G20 economies and beyond is identified by the G20 Energy Efficiency Leading Programme and needed to match the scale of the investment challenge.

The G20's Energy Efficiency Investment Toolkit[1] provides a set of voluntary options for policy makers to scale up energy efficiency policies and financing tools, and contains supportive statements and current practices from 122 banks, over USD 4 trillion of institutional investors, leading public financial institutions and insurance companies. The Toolkit was launched to the Energy and Sustainability delegations of the G20 countries at the G20 Energy Efficiency Forum in Hamburg in May to strong acclaim.

In its summary for G20 policymakers, the Toolkit highlights the need to increase visibility of asset energy performance as a key theme among core banks, as is having a bank-wide energy efficiency policy. It also notes that the real estate and consumer and corporate lending departments [of banks] should find ways to integrate the multiple economic benefits of energy efficiency for their customers into their regular finance products, thereby stimulating demand and enhancing their customers' creditworthiness and resilience to energy shocks.

122 banks from 42 countries have declared their signed intent to the G20's Energy Efficiency Finance Task Group to take eight steps towards integrating energy efficiency into their mainstream bank financing including, among other things, implementing bank-wide energy efficiency policies and giving increased visibility of their assets' energy performance. An EEFTG-UNEP FI survey underscores these activities and their impacts among these banks, and its results are included in the Toolkit chapter 2. Interestingly, these survey results reveal very similar thinking among these EEFTG banks as was also revealed by the EMF-ECBC's own preliminary findings from its February 2017 Energy Efficiency Finance Key Parameters survey[2].

The G20 Energy Efficiency Investment Toolkit has four segments that each provide a complimentary perspective on the overall up-scaling challenge, as there is no "silver bullet" to solve it:

1. An assessment of current energy efficiency investment by sector and region;
2. A showcase for good practice exchanges on (i) enabling national policy framework design and (ii) implementing the *voluntary Energy Efficiency Investment Principles for G20 participating countries*;
3. A report on "best in class" instruments and approaches to encourage and increase energy efficiency investments among different types of private sector financial institutions (banks, long-term investors and insurance companies);
4. A joint consensus among public banks and development institutions around "best in class" instruments and approaches to scaling up their energy efficiency activities.

The overall energy efficiency market has grown to USD 221 billion of annual investment which is integrated in buildings, transport and industry. Much of this is "invisible" to financial players, who tend to only identify "core" energy efficiency investments (such as the USD 24 billion of ESCO finance) as stand-alone projects where the delivery of energy savings is the lead driver of returns to the project owner. The actual energy efficiency opportunity is much larger, which points to the need for new business models and tools.

Energy efficiency investment opportunities, whether "self-financed" or externally funded, are often hidden in business areas. The trillions of US Dollars of energy inefficient assets will be increasingly opened up by combined policy and technological advancements. Triodos Bank, a member of UNEP FI's Global Steering Committee, mentioned that the G20 Toolkit, which includes the current positioning of banks surveyed on energy efficiency that are increasingly mobilised, is the groundwork for an enabling environment and future development by banks of what represents true positive impact finance.

Banks can clearly increase their use of "green tagging" as a mechanism to better track and make visible the energy and environmental performance of their assets, also giving them expanded access to new financing markets (like green bonds) and enabling greater levels of transparency and disclosure.

The Toolkit collects best practices and experiences from 15 participating G20 countries, led by France and Mexico, and is produced and drafted by the G20 Energy Efficiency Finance Task Group (EEFTG) with the support and input of multiple stakeholders led by IPEEC, UNEP FI and IEA. Santiago Creuheras, Director General for Energy Efficiency and Sustainability at the Ministry of Energy (SENER), Mexico co-chair noted that scaling up energy efficiency investments has been seen to deliver multiple benefits to the Mexican economy and is a central part of their Energy Transition as developed by our recently published Energy Efficiency Roadmap.

Mexico and France, are among the countries engaged in a domestic Energy Transition where increasing energy efficiency investments is an essential and strategic component of their national energy agendas. Their respective country teams are particularly pleased with the way the Toolkit facilitates cooperation between both public and private financial institutions and G20 countries to develop and deliver tools to mainstream energy efficiency.

For more information see:
www.climatesrategy.com; @ClimateSt

1 https://ipeec.org/newsroom/239-g20-energy-efficiency-investment-toolkit-launched-for-worlds-major-economies-to-.html

2 http://figbc.fi/wp-content/uploads/2017/02/2017-00008.pdf

Refinancing Local Public Sector Investments and Export Loans – A Key Role for Covered Bonds

By Ralf Berninger, Caisse Française de Financement Local

INTRODUCTION

The public sector covered bond market has witnessed a profound transformation over the past ten years. Overall outstanding volumes have steadily declined and at the same time, business has become more focussed on the core business of financing local government investments.

In another important development over recent years, covered bonds have started playing a more and more important role as funding tool for large export contracts. The refinancing of export loans benefitting from state guarantee or a guarantee provided by an export credit agency is more and more complementing the traditional local government lending business.

I. FINANINCING LOCAL GOVERNMENT INVESTMENTS

Eligibility under European covered bond regulation

Loans to local authorities or guaranteed by local authorities within the European Union are eligible as cover pool assets compliant with the definition provided by Article 129 CRR. A number of additional conditions apply for loans to local authorities outside the European Union:

1. *To be eligible for the preferential treatment ..., bonds ...shall be collateralized by any of the following eligible assets:*
   - *(a) exposures to or guaranteed by central governments, ESCB central banks, public sector entities,* ***regional governments or local authorities in the Union****;*
   - *(b) ... exposures to or guaranteed by ...***third-country regional governments or third-country local authorities*** that are risk weighted as exposures to institutions or central governments and central banks ... and that qualify for the credit quality step 1 ..., and exposures within the meaning of this point that qualify as a minimum for the credit quality step 2 ..., provided that they do not exceed 20 % of the nominal amount of outstanding covered bonds of the issuing institutions.*

Importance of local government for public infrastructure investments

Local and regional governments (LRGs) exercise a wide range of responsibilities across Europe. Important differences exist from one country to the other. However, the following areas are to a large extent under the responsibility of the local public sector in most of Europe:

> Local and regional infrastructure, including large parts of the local and regional rail and road network;

> Large parts of the primary and secondary education system;

> Basic services such as drinking water supply, sewerage, waste collection and treatment;

> Urban planning and development;

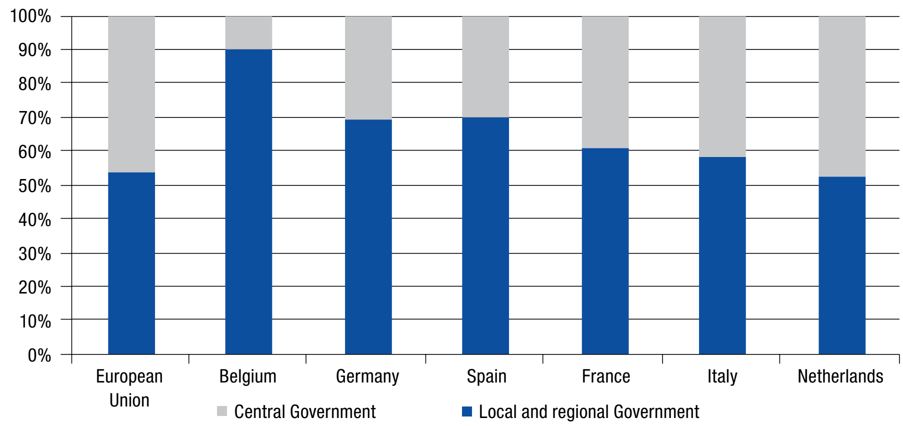
> Parts of the public health care system in some countries;

> Public order and safety, for example municipal police forces or fire-fighting services;

> Social housing in some European countries.

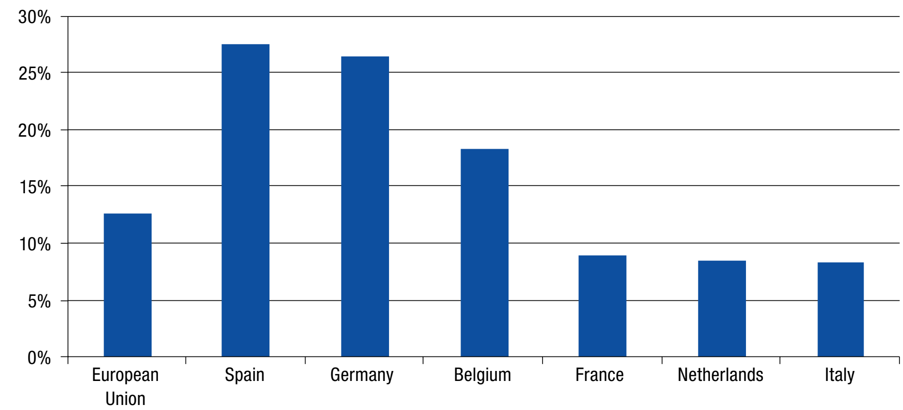
These responsibilities include key areas for public investments. As a consequence, local public sector investment expenditures exceed central government investments. On average local and state government contribute over 50% of total public sector investments across Europe.

Figure 1 ▶ Local and state government investments vs. central government investments 2015



Source: Eurostat

Figure 2 ▶ Local government debt as a percentage of GDP



Source: Eurostat

Important differences exist with respect to budget rules for the local public sector from one country to the other. However, the principle of the golden fiscal rule applies in one form or the other across most of Europe: local authorities are prohibited from running deficits to finance the operating section of the budget; new borrowing is only authorised to finance investments.

As a consequence of these strict budget rules, local and regional authorities only contribute a relatively small share to total public sector debt and deficits in Europe. Total European Union local public sector debt represents only 12.6% of GDP. Again, significant differences exist from one country to the other. At one end of the spectrum, local and regional governments (LRG) in countries such as Germany, Spain and Belgium with a high degree of decentralisation have also relatively high levels of debt compared to countries with a stronger centralisation of responsibilities. At the other end of the spectrum, local authority debt represents less than 10% of GDP for countries such as France and the Netherlands.

II. FUNDING SOURCES FOR LOCAL PUBLIC SECTOR INVESTMENTS

Direct bond issuance as source of funding for local authorities – only an option for large local authorities

Overall, local and regional authorities are able to raise significant amounts of funding via direct bond issuance with over EUR 300 billion outstanding bonds issued by European Union LRG issuers. Overall outstanding bonds represent close to a third of local authority debt in the European Union.

However, access to the bond market is limited to large entities with sufficient funding needs for regular bond issuance. As a consequence, German Länder represent close 80% of the European local and regional government bond market.

For large entities with regular funding needs, bond issuance represents an important source of funding. However, most local authorities are too small for regular bond issuance. For countries like France or the Netherlands, outstanding bonds represent less than 5% of local authority debt.

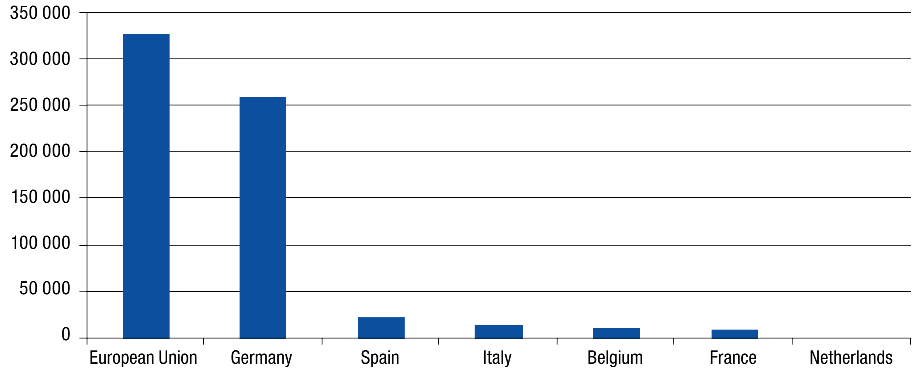
The loan market as key source of funding for local government investments

With access to the bond market only an option for regular issuers, most local authorities rely exclusively on the loan market as source of funding for public investments.

Funding provided by covered bond issuers

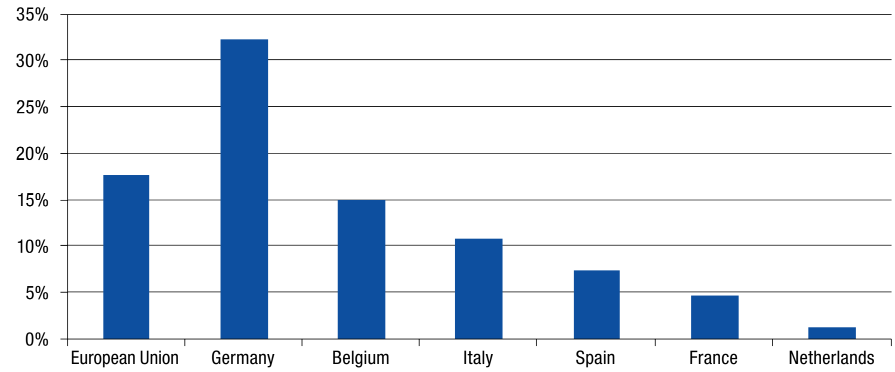
Banks in Germany, France, Austria, Spain, Belgium and Italy use covered bonds as refinancing tool for local authority loans. Germany and France are by far the largest markets in terms of issuance volumes. In addition, public sector covered bond markets exist in

Figure 3 ▶ Outstanding local and regional government bonds (EUR m equivalent)



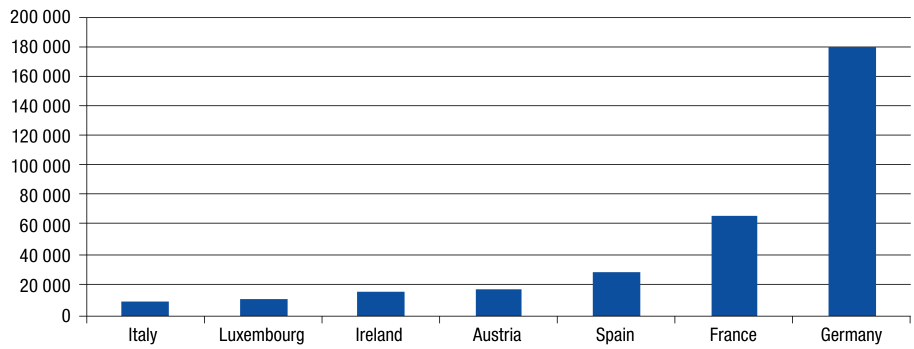
Source: Bloomberg and Eurostat

Figure 4 ▶ Outstanding bonds as percentage of total local and regional government debt 2015



Source: Bloomberg

Figure 5 ▶ Outstanding public sector covered bonds in EUR million as of 31 December 2015



Source: ECBC

Ireland and Luxemburg although local public sector funding needs in these two countries are small.

Covered bond issuers provide a significant source of funding for local and regional governments in Europe. Exposures by covered bond issuers to local and regional authorities in Germany amount to well over EUR 120 billion, based on the cover pool data provided by covered bond issuers. For France, with much less outstanding local authority debt, covered bond issuers provide above EUR 50 billion in loans and for Spain, the figure is still above EUR 30 billion.

Regional governments, often with important funding needs, have the capacity to access a wide range of funding sources, including direct bond issuance. Local governments on the other hand with smaller average funding needs depend to a large extent on bank loans to finance investments. As a consequence, a significant share of outstanding local government loans is provided by covered bond issuers. Looking at the cover pool data provided by issuers, loans by covered bond issuers represent over 40% of local government debt for France and Germany. For Spanish local authorities, loans by covered bond issuers still represent close to a third of local government debt.

Declining volumes in outstanding public sector covered

The outstanding volume of public sector covered bonds has witnessed a steep decline over the past 10 years. The volume of outstanding bonds has declined by over 50% to EUR 408 billion in 2014 compared to EUR 894 billion in 2005. However, public sector covered bonds can be used to refinance a wide range of public sector exposures and not exclusively local government loans.

Special factors like the cost of German re-unification and the end of guarantees for the German Landesbank sector contributed to an initial steep increase and to the subsequent decline in public sector covered bond issuance volumes over the past two decades. Looking at the volumes of outstanding public sector covered bonds the volume of outstanding public sector covered bonds actually increased for France (from EUR 43 billion in 2005 to EUR 68 billion in 2014) and Spain (from EUR 10 billion in 2005 to EUR 26 billion in 2014). However, growth in these markets only compensated a very small share of the reduction of the public sector Pfandbrief market down from EUR 735 billion in 2005 to EUR 207 billion in 2014.

The traditional lending business to municipalities has been much more stable than the overall issuance volumes suggest. For example, exposures of German Pfandbrief issuers to German municipalities stood at a total level of EUR 65 billion at the end of 2014, compared to a level of EUR 70 billion in 2008, i.e. a reduction by 7%. This compares to a decline by close to 50% in the public covered bond market over the same period and an even larger decline in outstanding German public sector Pfandbrief volumes.

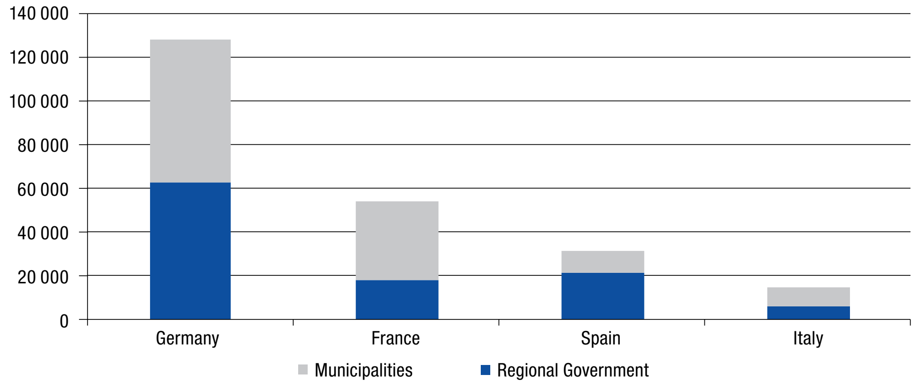
Declining volumes in outstanding public sector covered bonds do not necessarily indicate a decline in importance of covered bonds as refinancing instrument of local public sector loans. The refocusing of the public sector business has been a key factor leading to reduced volumes in public sector covered bond market.

III. PUBLIC SECTOR COVERED BONDS AS REFINANCING INSTRUMENT FOR EXPORT LOANS

Eligibility under European covered bond regulation

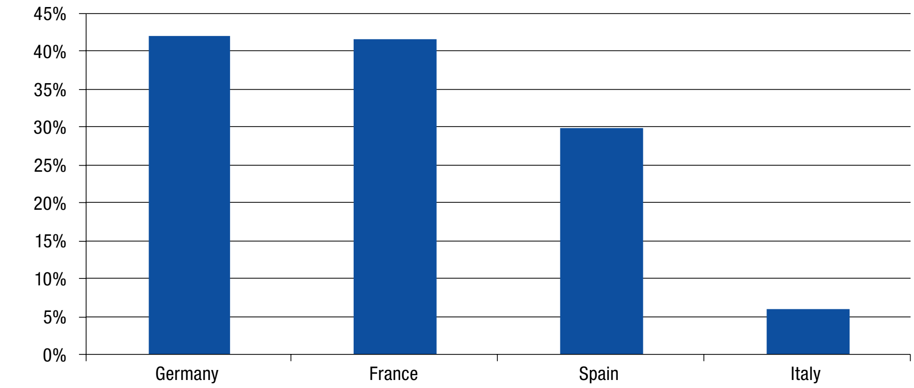
Export loans benefiting from a state guarantee or a guarantee provided by an export credit agency (ECA) are eligible for covered bond refinancing if the loans meet the criteria of 129.1 of the CRR:

Figure 6 ▶ Outstanding loans to local and regional government provided by covered bond issuers as of 31 December 2015 (EUR m)



Source: ECBC Covered Bond Label National Templates (BIIS, Caixabank, BBVA, CFF, CAFFIL, SG SCF, Arkéa SCF, BNPP SCF) and VdP

Figure 7 ▶ Estimated share of local government debt refinanced by covered bond issuers as of 31 december 2015



Source: ECBC Covered Bond Label Templates (BIIS, Caixabank, BBVA, CFF, CAFFIL, SG SCF, Arkéa SCF, BNPP SCF), VdP, Eurostat

1. To be eligible for the preferential treatment ..., bonds ...shall be collateralized by any of the following eligible assets:

*(a) exposures to or guaranteed by **central governments**, ESCB central banks, **public sector entities**, regional governments or local authorities in the Union'*

In addition, CRR requires that effective credit protection is provided for the export loan as defined by article 194.4:

4. Institutions may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where the lending institution has the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy – or other credit event set out in the transaction documentation – of the obligor and, where applicable, of the custodian holding the collateral

Market still relatively small compared to covered bonds backed by local government loans

Issuers in France and Germany make use of public sector covered bonds to refinance export loans with a state or ECA guarantee. Legal frameworks in France and Germany do not distinguish between covered bonds backed by local authority loans end ECA loans. In addition, Spain is implementing a legal framework for the issuance of covered bonds backed by ECA loans ('Cédulas de internacionalización') that will be separate from the framework for covered bond backed by LRG loans.

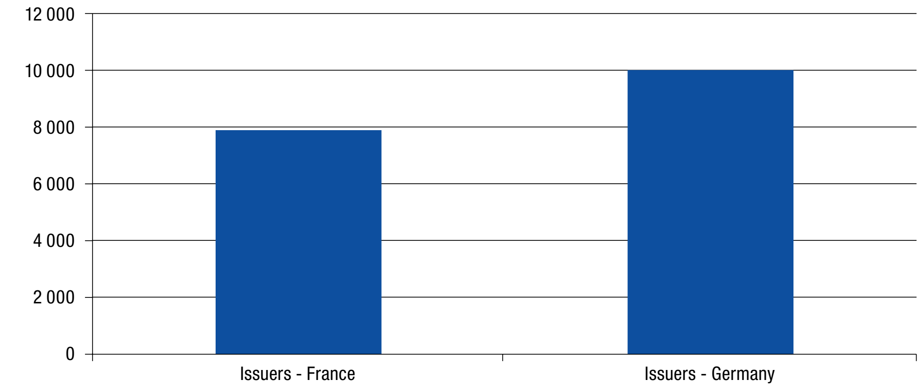
Overall, issuance linked to export loans is still relatively small compared to covered bonds backed by local authority loans. This can mainly be attributed to two reasons:

(1) The guaranteed export credit market is much smaller than the local authority loan market. For France, local government debt with a volume of EUR 196 billion at the end of 2015 represents roughly three times the volume of loans covered by French export credit insurance at EUR 66 billion.

(2) Use of covered bonds to refinance ECA loans has been a more recent development compared to the traditional local government financing business.

Overall, close to EUR 8 billion in export loans are currently refinanced via public sector covered bonds by French issuers. For Germany, the figure is just below EUR 10 billion.

Figure 8 ▶ Reported exposures linked to export credit business as of 31 December 2015



Source: ECBC Covered Bond Label Templates (CA SCF, BNPP SCF, SG SCF) VDP

New developments should lead to increased issuance

The share of ECA loans currently refinanced via covered bonds is still relatively low, compared to the share of local government loans refinanced via covered issuance. However, a number of factors should lead to increased issuance in the coming years.

Over recent years legal frameworks in France ('garantie rehaussée') and Germany ('Verbriefungsgarantie') have been adapted to the needs of covered bond issuers. In both cases, covered bond issuer can benefit from an unconditional and irrevocable state guarantee for exposures linked to the export credit activity.

Only a small share of export loans is currently refinanced via issuance of covered bonds. As a consequence, banks still have large volumes guaranteed export loans available for covered bond refinancing.

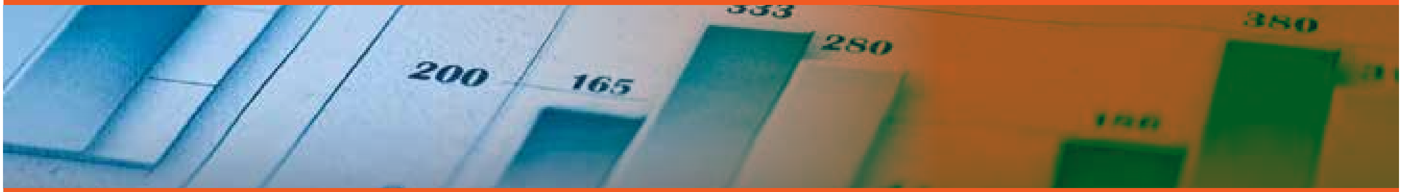
In addition, the implementation of a covered bond framework for the refinancing of export loans in Spain should be another factor leading to increased issuance.

CONCLUSION

The volume of outstanding public sector covered bonds has seen a significant decline over the past 10 years. However, the reduction in volumes has been linked to a reduction in the scope of business. The underlying local authority lending business has been much more stable. Public sector covered bonds remain a key pillar for public investments: local authorities in many countries rely to a large extent on loans provided by covered bond issuers.

Public sector covered bond issuance backed by export loans with a state or an ECA guarantee has been limited up to now. Nevertheless, new guarantee mechanisms, new legislation and a large pool of available eligible loans are likely to lead to increased issuance in the future.

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

ECB Publishes Comments on CMU Mid-Term Review

On 2 May 2017 the European Central Bank (ECB) published its comments to the European Commission's consultation on Capital Markets Union mid-term review 2017 (available here). In its review, among other things, **the ECB comments favourably on the three-step approach for the covered bond file**. Below is a summary of the comments from the ECB on the topic of covered bonds.

"While EU covered bond markets are well functioning, with many long-established national legal frameworks for covered bonds, they remain highly fragmented along national lines. Consequently, the ECB favours a high-quality and transparent EU covered bond market, and sees potential for harmonisation of some standards and practices across the EU*. Reduced market fragmentation (i.e. increased market integration) to this end would improve market liquidity and increase the resilience of the market (in the face of future crises). In addition, improved liquidity and reduced transaction costs (for investors) would improve pricing overall and further increase the attractiveness of covered bonds as a funding source. Such an approach should be sufficiently cautious and should avoid market distortions in a segment that proved to be relatively resilient throughout the financial crisis and for which a certain level of harmonisation across the specific national legal frameworks already exists.*

The ECB welcomes the EBA recommendations to the European Commission to further harmonise national EU covered bond frameworks as a tool to achieve these two objectives*. The three-stage approach proposed by the EBA recommendations is consistent with the ECB's view that a comprehensive covered bond legal framework at EU level is achievable over a medium to long-term horizon, following a harmonisation and convergence process.*

The proposed further harmonisation of several essential features of the national covered bond frameworks represents a significant step forward in increasing comparability between the national frameworks*. These features are: the definition of core concepts such as the dual recourse, the segregation of cover assets, the coverage requirement and the special supervision.* ***Moreover, the ECB also welcomes the proposed enhancements to the definition of those covered bonds that receive a preferential capital treatment****. The newly proposed minimum coverage requirement in particular represents a highly desirable improvement. As a common measurement of overcollateralisation, it would allow supervisors and investors to compare covered bonds more easily across Member States and issuers. It should also ensure that all covered bonds eligible for the preferential capital treatment provide investors with an additional layer of safety.*

The rapid development of innovative covered bond structures, whose features are not yet fully understood by all stakeholders, requires careful assessment, to ensure a sustainable market development*. Over the past few years new covered bond structures in which the scheduled maturity of the outstanding bonds can be extended by the issuer have been increasingly used. While these structures present certain advantages to the issuers compared with the traditional bullet structures, and are generally positively assessed by investors as an additional protection against a default of the issuer, the specific risks posed by them have not been sufficiently assessed by the prudential supervisors."*

EBA Publishes Final Guidelines on Credit Institutions' Credit Risk Management Practices and Accounting for Expected Credit Losses

On 12 May 2017 the European Banking Authority (EBA) published its final Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses (available here). These Guidelines aim at ensuring sound credit risk management practices associated with the implementation and on-going application of the accounting for expected credit losses. The Guidelines are part of the EBA's work on the implementation of IFRS 9 and its interaction with prudential requirements and build on the Guidance published by the Basel Committee on the same matter.

A significant number of credit institutions in the EU apply the IFRS standards, which for the accounting periods beginning on or after 1 January 2018 require the measurement of impairment loss provisions to be based on an expected credit loss accounting model (IFRS 9) rather than on an incurred loss accounting model (IAS 39). The EBA welcomes this approach on credit loss provisioning, as it should also contribute in addressing the G20's concerns about the issue of the 'too little, too late' recognition of credit losses and improve the accounting recognition of credit losses by incorporating a broader range of credit information.

The EBA final Guidelines set out sound credit risk management practices for credit institutions associated with the implementation and on-going application of the accounting for expected credit losses. High-quality and consistent application of the accounting standards is the basis for the effective and consistent application of the regulatory capital standards.

However, these Guidelines do not set out requirements regarding the determination of expected losses for regulatory capital purposes and would not prevent a credit institution from meeting the impairment requirements of IFRS 9.

These Guidelines build on the global guidance on credit risk and accounting for expected credit losses published by the Basel Committee on Banking Supervision (BCBS) in December 2015.

CGFS & FSB Publish Report on FinTech Credit

On 22 May 2017 the Committee on the Global Financial System (CGFS) and the Financial Stability Board (FSB) published a report entitled "FinTech credit. Market structure, business models and financial stability implications" (available here).

The report finds that platforms account for an increasing share of credit provision and policymakers must consider the opportunities and risks such activity brings.

The report analyses the nature of FinTech credit and finds wide variation in the business models of the electronic platforms involved. Platforms facilitate various forms of credit, including consumer and business lending, lending against real estate and business invoice financing. The profile of investors, which platforms match to borrowers, also differs across countries.

Although FinTech credit markets are currently small in size relative to traditional credit markets, they are growing at a fast pace. According to the report, potential benefits and risks of Fintech include:

- Lower concentration of credit provision from banks could help to diversify economies' credit channels and reduce the risks of credit upsets if bank lending is interrupted.
- FinTech platforms may increase competition and help consumers by pressuring banks to be more efficient.
- FinTech credit could lead to increased financial inclusion, but it could also lower lending standards in countries where credit markets are already deep.
- Incentive problems, caused by a reliance on fee income (an 'originate-to-distribute' model), could pose a problem at some platforms.
- FinTech credit provision could rise and fall with the business cycle, with the potential for a pullback of credit provision to certain parts of the economy, if there is a loss of investor confidence during times of stress.
- If FinTech growth leads to an erosion in bank profitability, it could encourage greater risk-taking by banks or generate broader stresses for the financial system, given banks provide a range of systemically important services.

The report touches upon real estate credit in several instances.

The report also notes that the availability of official data on FinTech credit is limited, so most analyses of these markets rely on non-official sources, such as academic surveys, industry bodies and financial disclosures by FinTech companies. As a result, data availability and quality may warrant increased attention from authorities as FinTech credit markets develop.

The FSB will publish a report, before the G20 Leaders' Summit in Hamburg in July 2017, on the financial stability implications of FinTech, identifying regulatory and supervisory issues that merit authorities' attention from a financial stability perspective.

ECB Publishes Working Paper on Capital Requirements, Risk Shifting and the Mortgage Market

On 15 May 2017, the European Central Bank (ECB) published a Working Paper on capital requirements, risk shifting and the mortgage market (available here). The paper examines the effect of changes to bank-specific capital requirements on mortgage loan supply with a new loan-level dataset containing all mortgages issued in the UK between Q2 2005 and Q2 2007. The paper finds that a rise of a 100 basis points in capital requirements leads to a 5.4% decline in individual loan size by bank. Loans issued by competing banks rise by roughly the same amount, which is indicative of credit substitution. Borrowers with an impaired credit history (verified income) are not (most) affected. This is consistent with origination of riskier loans to grow capital by raising retained earnings. No evidence for credit substitution of non-bank finance companies is found in the study.

EC Publishes Call for Evidence on Collective Redress in the EU

On 22 May 2017 DG JUST of the European Commission published a Call for Evidence (accessible here) regarding the Operation of Collective Redress Arrangements in the EU Member States.

As background information, the Commission adopted a topical Communication (available here) and Recommendation 2013/396/EU (available here) in 2013. More precisely, the Recommendation proposed that collective redress mechanisms, in areas where EU law grants rights to natural and legal persons such as consumer protection, financial services, personal data protection and competition, for instance, should be readily available in all EU Member States. During a recent DG JUST conference on the issue, the European Commission expressed its disappointment in the practices of banks, especially relating to consumer mortgage loans, indicating that *"clauses on early repayments as well as unilateral contract changes have caused much distress in ES and HU"*.

With the Call for Evidence at hand, the Commission would like to gather information on the state of implementation of the principles as outlined in the aforementioned Recommendation, which were supposed to be implemented at national level by 26 July 2015.

Further to that, the Commission will focus on:

- Identifying collective legal actions within the scope of the Recommendation, initiated after its adoption;
- Collecting quantitative and qualitative data concerning these actions;
- Identifying solutions in which collective action could have been appropriate but was not taken, and
- Obtaining views on the effectiveness and efficiency of collective actions.

The Call for Evidence is open for submissions until 15 August 2017.

EP Publishes Proposed Amendments to its Own Initiative Draft Report on Covered Bonds

On 28 April 2017 the European Parliament published the list of proposed amendments to the Covered Bonds' Own Initiative Draft Report (available here). The amendments are very comprehensive and touch upon many of the aspects of the original report (available here). Of particular relevance to the mortgage and covered bond industry are the ones connected to the nature of the covered bond (paragraph 3), the maturity extensions (paragraph 5) and the European Secured Note – ESN (throughout the document). In addition, it is worth noting the proposal of Sven Giegold MEP (Greens-DE) to exclude European Secured Notes and covered bonds from the calculation of the contributions to the Single Resolution Fund (Amendment 42). These amendments are scheduled to be voted upon in the ECON Committee on 19-20 June 2017.

EBA Publishes Final Technical Standards on Valuation in Resolution

On 23 May 2017 the European Banking Authority (EBA) published its final draft Regulatory Technical Standards (RTS) on valuation in resolution. These draft RTS (available here) are a crucial piece of regulation for the resolution framework as they aim to provide the independent valuer with common criteria for the valuation, which will inform the decisions made by resolution authorities, thus promoting a consistent approach to such valuations across the EU.

The Bank Recovery and Resolution Directive (BRRD) provides a comprehensive framework of powers for resolution authorities to intervene in failing banks to protect the public interest. To ensure that authorities exercise these powers in ways which reduce the risk of costs falling on the taxpayer, preserve value where possible, and respect the property rights of affected shareholders and creditors, the BRRD requires independent valuations to be carried out to inform decisions of the authorities. These valuations are required for several distinct purposes, either prior or after the resolution.

These final draft RTS specify the valuation principles that shall be followed before and after a resolution occurs.

Valuation before resolution is critical to the resolution process since it informs the resolution authority's decision as to whether the conditions for resolution are met and, if so, which resolution tools should be used. To conduct a valuation before resolution, the independent valuer is empowered to challenge the banks' management assumptions, data, methodologies and judgements on which the institutions prepare their financial statements.

The decision on which resolution tools to apply is informed by a fair, prudent and realistic valuation, based on the economic value of assets and liabilities.

Valuation after resolution is instrumental to establish whether the no-creditor-worse-off (NCWO) safeguard has been breached by the resolution action and whether any compensation has to be paid to creditors and shareholders by the resolution fund. Valuation after resolution is conducted by an independent valuer who should only rely on the information, facts and circumstances that existed and could reasonably have been known at the resolution decision date.

EBA Publishes Opinion on Own Funds in the Context of the CRD CRR Review Proposal

On 23 May the European Banking Authority (EBA) published an Opinion addressed to the EU institutions expressing its views on a number of aspects related to own funds in the context of the European Commission's proposal to amend the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD). In the Opinion (available here), the EBA calls, in particular, for a possible strengthening of the Authority's role in assessing issuances of CET1 instruments. In addition, the Opinion elaborates on restrictions on distributions in the context of capital conservation measures and suggests introducing a general anti-circumvention principle. The views expressed in this Opinion are not meant to be exhaustive and focus on the areas deemed to be the most significant ones.

The EBA has been monitoring CET1 instruments on a regular basis since the entry into force of the CRR. The EBA's monitoring of the quality of these instruments has been beneficial in the implementation of the CRR and the provisions laid down in the related Regulatory Technical Standards (RTS) on own funds and has resulted in enhancing the quality of EU banks' capital. The outcome of this monitoring is published today in a CET1 report accompanying the regular publication of a CET1 list of types of instruments for banks in the EU.

However, in the context of the current CRR, the final responsibility of evaluating whether issuances of CET1 instruments meet the eligibility criteria lies with competent authorities. In this context, the EBA is of the opinion that a reinforcement of its role when it comes to the evaluation of the compliance of CET1 instruments should be considered to ensure the enforceability of the CRR and RTS provisions for CET1 instruments for all institutions in the EU.

In addition, the Opinion elaborates on restrictions on distributions with regard to the Maximum Distributable Amount (MDA) and its definition, as well as on reduction, redemption and repurchase of capital instruments, the introduction of an anti-circumvention principle and of a point of non-viability criterion.

EBA Announces Details of 2017 EU-Wide Transparency Exercise

On 25 May 2017 the European Banking Authority (EBA) announced that it will publish data for its fourth annual EU-wide transparency exercise in December 2017 together with the Risk Assessment Report (RAR). Nearly 600,000 data points in total on more than 130 banks will be released, covering all key balance sheet items. The transparency exercise is part of the EBA's efforts to foster market discipline, improve the understanding of the EU banking system and ensures both a detailed snap shot and consistent time series.

Running a transparency exercise on an annual basis guarantees a wide coverage of disclosure in terms of banks and countries as well as continuity of the time series of semi-annual bank-by-bank financial information, which the EBA started in 2011.

The sample of banks for the 2017 exercise will be aligned with the one used in the 2017 EBA RAR and the exercise will be based exclusively on supervisory reporting data. Therefore, banks will not be required to report any additional data, which will significantly reduce the burden for them.

The data will refer to December 2016 and June 2017, keeping a semi-annual time series of data disclosure, and will show financial information on capital, leverage ratio, risk exposure amounts, profit and losses, market risk, securitisation, credit risk, exposures to sovereign, non-performing exposures and forborne exposures. Leverage ratio is a new item in 2017 as it is now available in supervisory reporting.

The exercise will be launched in September 2017, when the interaction with the banks in the sample for the verification of the data will start. The data will be frozen at the end of October 2017 and the EBA expects to publish it in early December 2017, together with the EBA 2017 RAR.

Rabobank Becomes the 90th Covered Bond Labelled Issuer

On 11 May 2017 the Covered Bond Label Foundation (CBLF) announced that **Coöperatieve Rabobank U.A.**, a Dutch based bank, had become the 90th issuer to join the Covered Bond Label, following which the total number of cover pools holding the Label stood at 106.

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

"The decision of Rabobank to join the Covered Bond Label confirms the willingness of core covered bond market participants to significantly enhance transparency by implementing the Harmonised Transparency Template (HTT). Rabobank's adhesion is all the more significant given that it is a new issuer of covered bonds, which demonstrates the role that the Covered Bond Label plays for new market entrants as the industry quality benchmark."

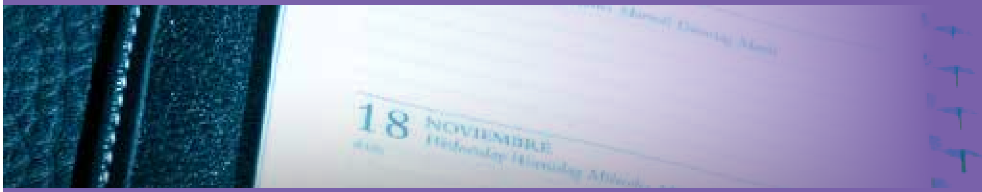
To recap, the Covered Bond Label is a quality Label, of which the primary purpose is to highlight to investors the security and quality of covered bonds, and to further enhance recognition of and trust in the covered bond asset class.

The Covered Bond Label is open to all covered bond programmes that are compliant with the Covered Bond Label Convention (available here) and disclose their data by publishing the Harmonised Transparency Template (HTT). More information on all labelled Issuers and the Label itself can be found on the Covered Bond Label website at www.coveredbondlabel.com.

Coming Up: EeMAP Stakeholder Meeting

On 9 June 2017, over 100 stakeholders and key supporters of the Energy efficiency Mortgages Action Plan (EeMAP) initiative, which is being led by the EMF-ECBC together with five other consortium partners (Ca'Foscari University of Venice, RICS, European Regional Network of Green Building Councils, E.ON and SAFE Goethe University Frankfurt), will convene in Rome for the 'kick-off' meeting of the project's pilot phase.

Further details on the EeMAP initiative can be found here and a dedicated EeMAP website will be launching shortly.



AGENDA

JUNE 2017

01/06 The ICMA CBIC & The Covered Bond Report Conference 2017 – Frankfurt

08/06 Covered Bond Label Foundation (CBLF) Label Committee Meeting – Rome

08/06 European Covered Bond Council (ECBC) Steering Committee Meeting – Rome

09/06 European Mortgage Federation (EMF) Executive Committee Meeting – Rome

09/06 Kick-Off Meeting for EMF-ECBC Energy efficiency Mortgages (EeMAP) Initiative Pilot Phase – Rome

16/06 vdp & WAVO Workshop Day on Long-Term Sustainable Value (L-TSV) and AVMs – Berlin

21/06 European Parliament Financial Services Forum (EPFSF) Event on Capital Markets Union: Pan-European Personal Product (PEPP) Chapter – Brussels

21/06 European Parliament Financial Services Forum (EPFSF) Ordinary General Meeting – Brussels

23/06 European Supervisory Authorities (ESAs) Joint Consumer Protection Day – Prague

JULY 2017

12/07 European Parliament Financial Services Forum (EPFSF) Event – Brussels