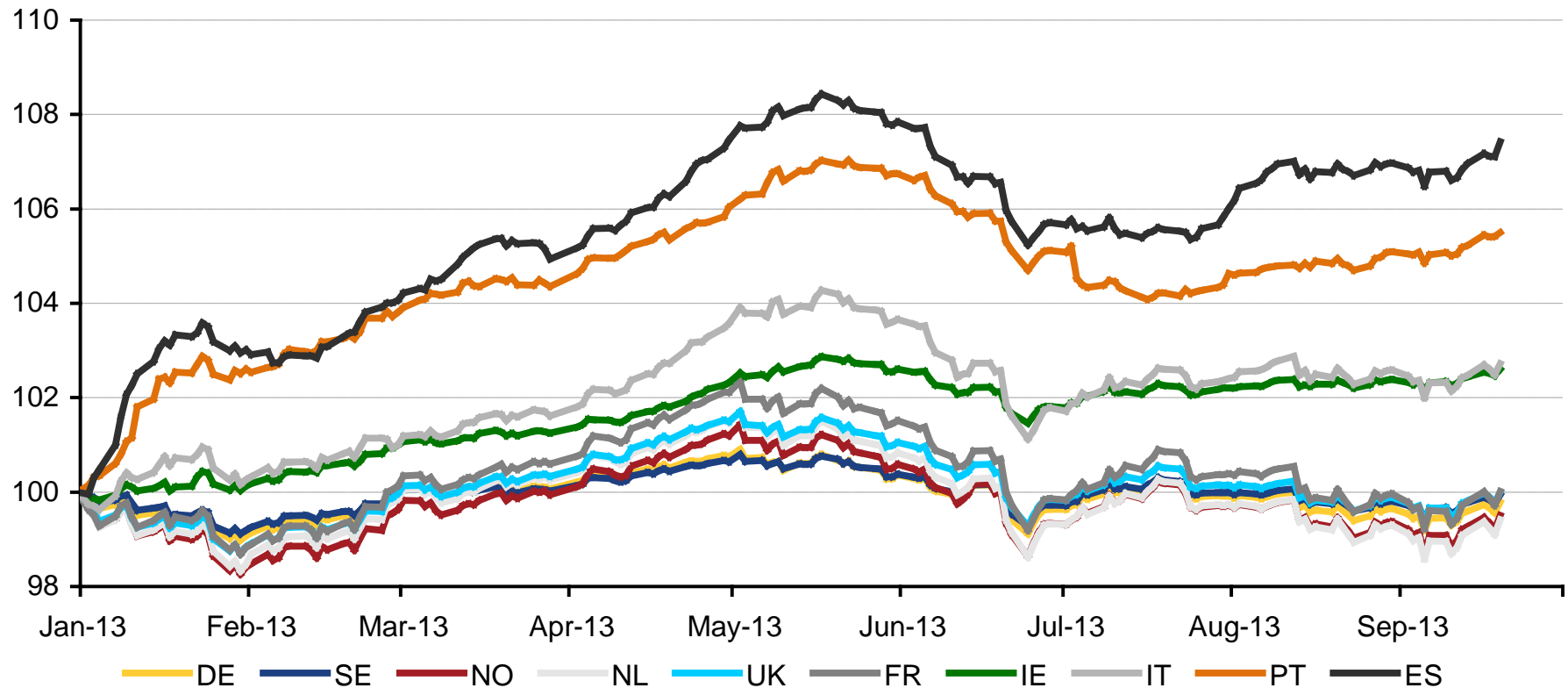




Covered Bond Update

A mixed picture when looking at returns

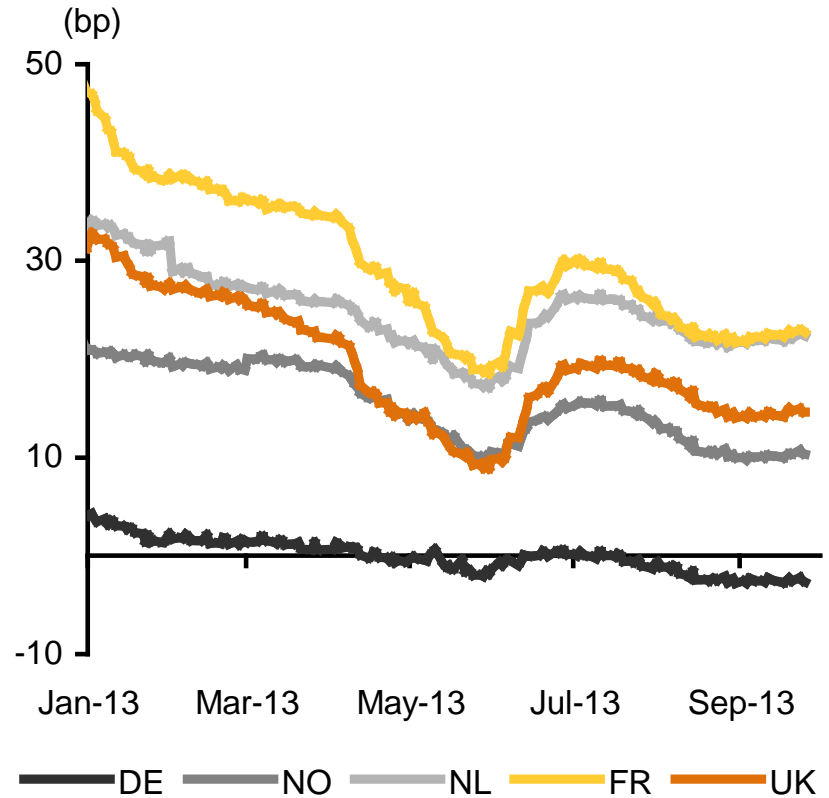
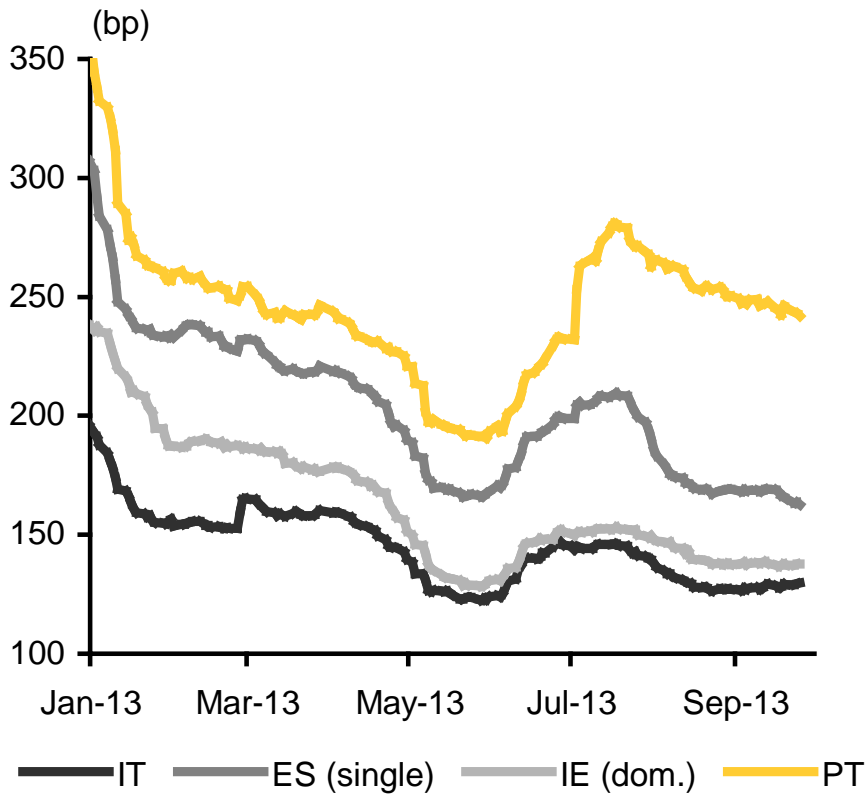
iBoxx performance indices by covered bond country



Source: Commerzbank Research

However, spreads have performed quite solidly

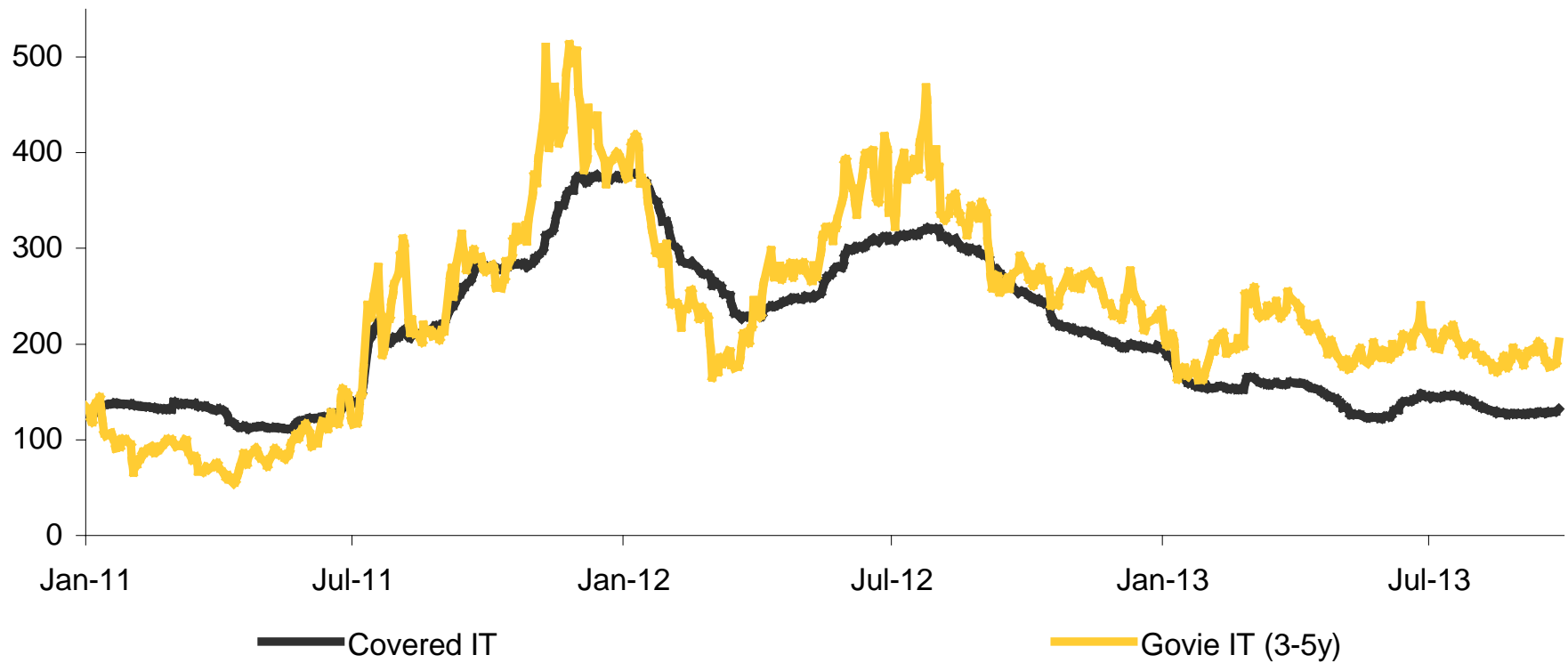
iBoxx swapspreads by covered bond country



Source: Commerzbank Research

Still trading below govies

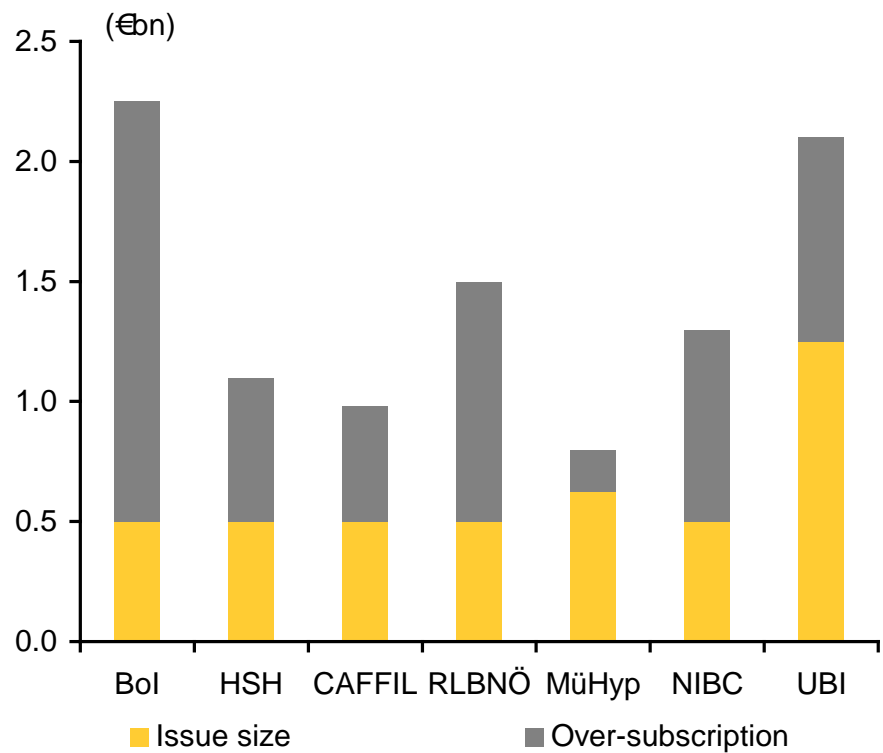
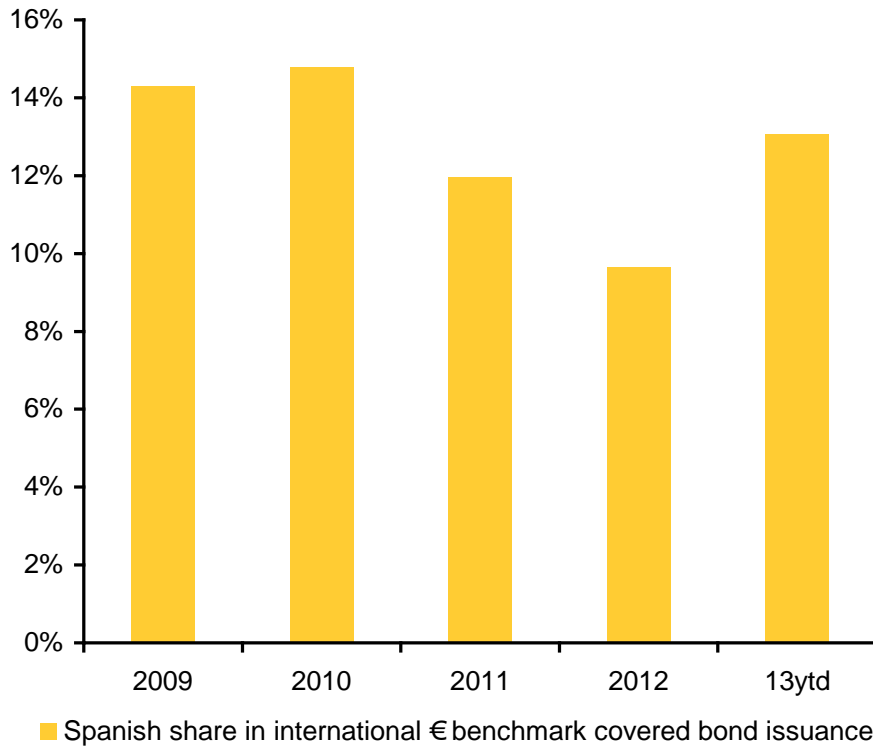
... not only in peripheral markets



Source: Commerzbank Research

How about market access?

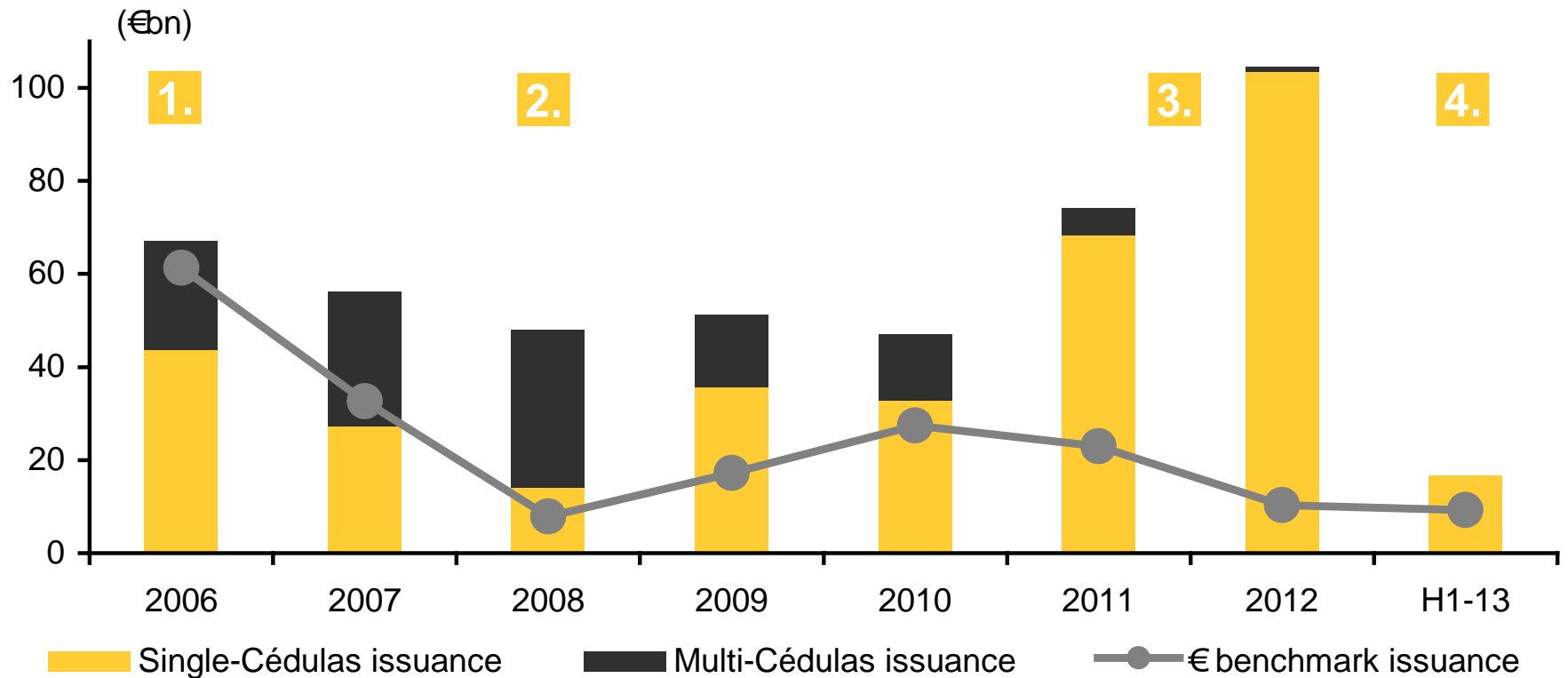
Market sentiment has shifted from a pure seller's market towards a better equilibrium of supply and demand



Source: Commerzbank Research

Case study: Spanish Cédulas Hipotecarias

After two waves of retained issuance, new volumes have fallen considerably

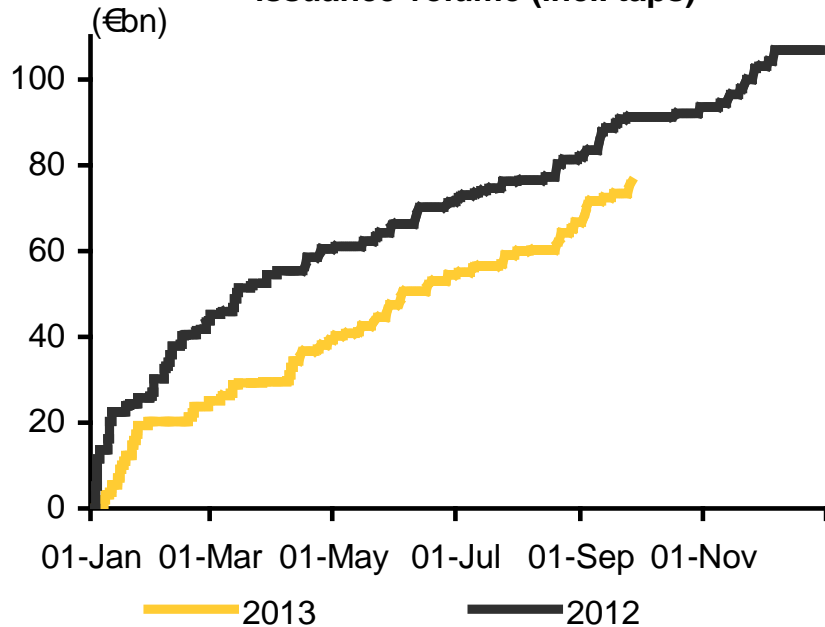


Source: AHE, Commerzbank Research

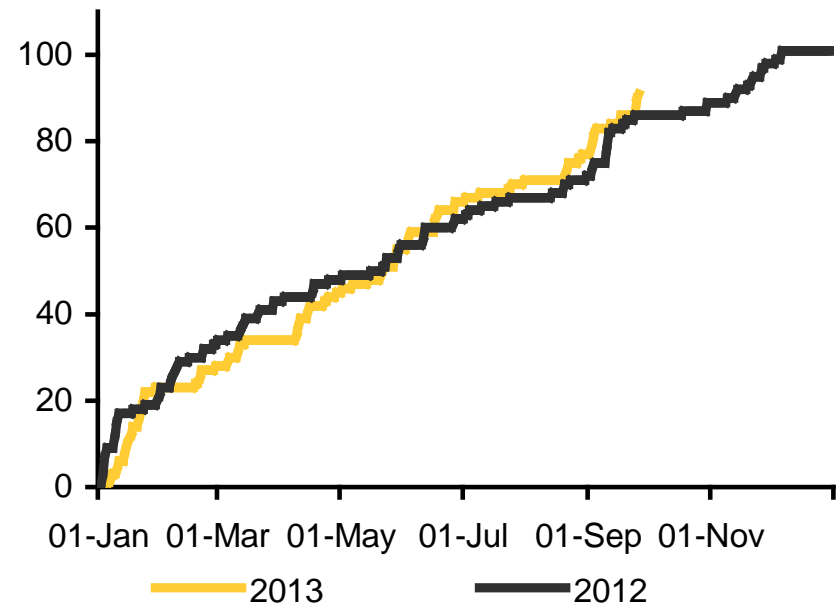
More of less

The share of sub-Jumbo deals has never been higher

Accumulated €benchmark covered bond issuance volume (incl. taps)



Accumulated number of €benchmark covered bond deals



Source: Commerzbank Research

Plenty of reasons

For example...

- › Surplus O/C already at relatively low levels
- › Banks in deleveraging mode
- › Downturn of public-sector financing business
- › Pressure on several housing markets
- › Asset quality issues
- › Focus on deposit base, senior and sub debt
- › Ample central bank liquidity
- › Smaller newcomers
- › Stricter ALM guidelines

Less newcomers but including some interesting new structures

How to... 1) overcome rating constraints, 2) use covered bonds for other core assets



Aktia



MEDIOBANCA



Banca popolare dell'Emilia Romagna

NIBC's conditional pass-through structure

Some pros and cons

Pros

- + Stable AAA/AAA ratings with the least possible ties to the bank's credit quality.
- + Therefore, low risks of regulatory or internal rating limits being broken.
- + Lower loss risks compared to forced stress sale of pool assets. More flexibility for decision takers.

But

- Higher complexity.
- The higher ratings do not mean better issuer or pool quality but are basically due to methodological reasons. This results in lower rating transparency in comparison to other programmes.
- Lower liquidity provision and over-collateralisation likely.
- Repayment may take longer than in the case of bullet structures. Long legal maturities may imply accounting difficulties for individual investors.
- Smaller group of investors might be negative for liquidity.

Neutral

- Legal registration, therefore also UCITS- and CRD-conform including all resulting advantages.
- We expect no negative surprises in terms of index categorisation.

Source: Commerzbank Research

Moody's reacting to bail-in proposals

Upgrades of 1-2 notches expected

The current methodology

Step 1: anchor point	Senior unsecured rating	+ 0 notches
Step 2: upnotching	based on TPI table	

The proposed adjusted methodology

Step 1: anchor point	the higher of a)	Senior unsecured rating	+0 notches	if unsec.senior + sub.	<5%
			+1 notch	debt / total liabilities...	>5%
Step 1: anchor point	... and b)	Adjusted Baseline Credit	+0 notches	if unsec. senior + sub.	<5%
		Assessment	+1 notch	debt / total liabilities...	5-10%
			+2 notches		>10%
Step 2: upnotching	based on unchanged TPI table				

Source: Moody's, Commerzbank Research

The ECBC Covered Bond Label

... is supposed to...

- › ... establish a clear **perimeter for the asset class** and highlight the core standards and quality of covered bonds
- › ... increase **transparency**
- › ... improve **access to information** for investors, regulators and other market participants
- › ... improve **liquidity** in covered bonds
- › ... position the covered bond asset class with respect to upcoming **regulatory challenges**

1) “Clear perimeter for the asset class”

Checklist

- › Structured covered bonds, SME deals, Aircraft covered bonds etc. excluded
- › Otherwise, however, UCITS criteria offer little protection against credit dilution
- › Non-European covered bonds also excluded for the time being

Survey feedback

- › Only a first step
- › Minimum standards expected to increase over time

2) “Increasing transparency”

Checklist

- › National reporting templates defined
- › No international harmonisation yet, reporting standards can deviate substantially
- › After some initial hiccups, frequent reporting seems to have been established by now
- › Limited market penetration (e.g. in Germany, Austria, Belgium)

Survey feedback

- › Further international standardisation of reporting templates and of underlying data desirable (LTVs, NPLs etc.)
- › Loan-level data typically not required

3) “Access to information”

Checklist

- › www.coveredbondlabel.com website established featuring links to pool reports and bond details
- › No pool reports on the Label website itself
- › No programme docs etc.
- › Limited market penetration

Survey feedback

- › Increasing penetration required

4) “Improve liquidity”

Checklist

- › No effect measurable so far

5) “Position covered bonds for regulatory challenges”

Checklist

- › Under discussion

Issues for discussion

- › A harmonisation of covered bond laws and practices across Europe?
Shouldn't we start with a standardisation of some 'basics' such as the form of special supervision, cover calculation practices, insolvency proceedings etc.?
- › Transparency is a moving target!
In addition to further harmonisation, new requirements will become relevant along the way (eg info on maturity structures, amount of bail-in-able debt etc.).
- › Chicken and egg?
The Label will only become truly relevant once it gains regulatory acceptance, which seems to depend on the Label's market relevance though...

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