ECBC
EUROPEAN COVERED BOND COUNCIL

ECBC – COVERED BOND MARKET

May 2014

European Covered Bond Council
The Covered Bond Voice of the European Mortgage Federation

Changing Regulatory Environment

Crisis Management/
EU framework for bank
recovery and resolution

EU regulation on OTC
derivatives, central
counterparties and trade
repositories

Tightening of
ECB repo rules

ESRB's
Recommendation on
the Funding of
Credit Institutions

Financial
Transaction Tax
(FTT)

Basel's Liquidity
Coverage Ratio
(LCR)

EU's Liquidity
Coverage Ratio
(LCR)

Single
supervisory
mechanism

Basel's Net Stable
Funding Ratio
(NSFR)

EU's Net Stable
Funding Ratio
(NSFR)

EU Regulation
on Asset
Encumbrance

European Market
Infrastructure
Regulation (EMIR)

Basel III

Solvency II

EU Green Paper on the Long-
term Financing of the European
Economy

SME

Capital Requirements Directive (CRD IV)/
Capital Requirements Regulation (CRR)

Once-in-a-lifetime changes to the entire regulatory environment of the financial sector

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Essential features of covered bonds

Covered Bonds

- Dual Recourse
- Credit Institution
- Dynamic pool/OC
- Quality of Assets
- Public Supervision/ Dedicated Legal Framework

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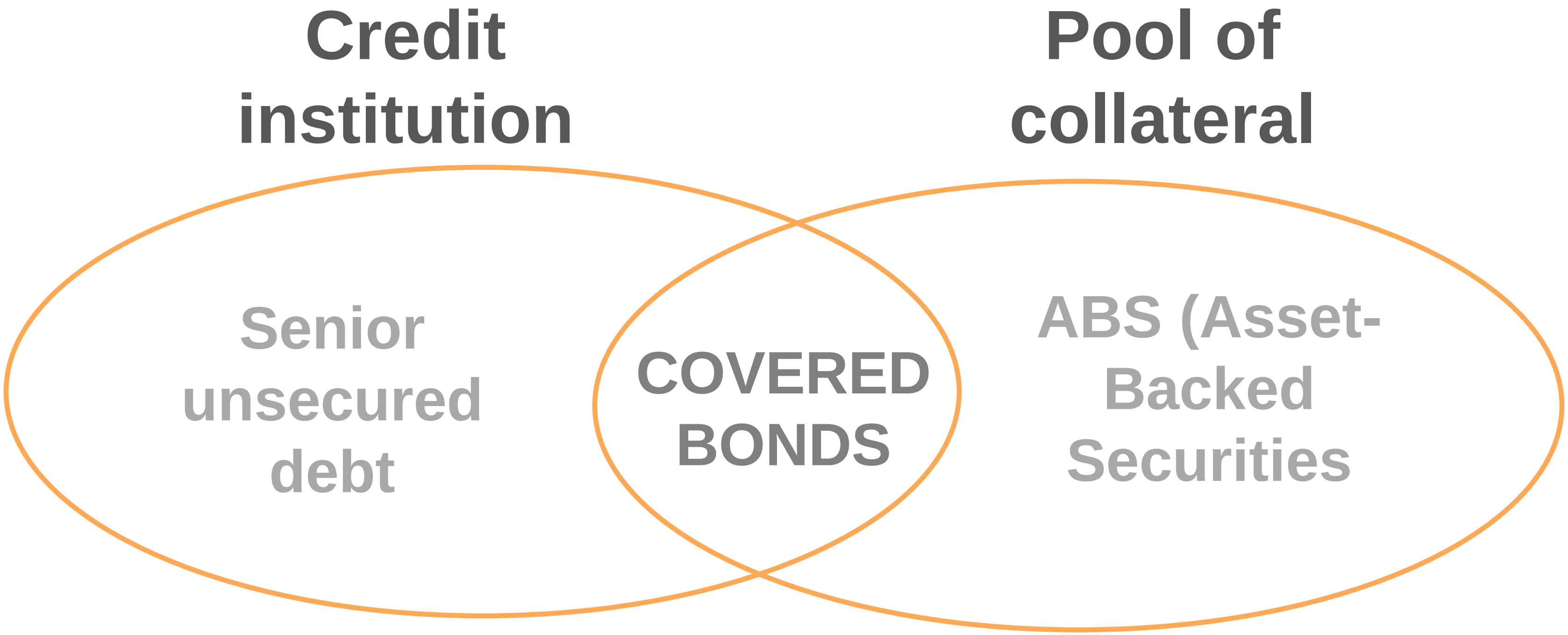
Covered bond: a dual-recourse instrument



Covered bonds & MBS

- Common features of covered bonds and MBS:
  - ➢ Diversification from unsecured debt investor base;
  - ➢ Cheaper funding than senior unsecured;
  - ➢ Large issuance amounts.

Pro Covered Bonds:

- ➢ Lengthening of debt maturity profile;
- ➢ A supportive regulatory environment
- ➢ More liquid funding instrument;
- ➢ Easier execution and lower transaction costs.

Contra Covered Bonds

- ➢ No capital relief;
- ➢ More sophisticated ALM compared to securitization.

- Prior to the crisis, some convergence between covered bonds & MBS:
  - ➢ Some CBs becoming increasingly structured
  - ➢ CRA methodologies converging
  - ➢ Similar techniques and tools used by both

Covered bonds & MBS

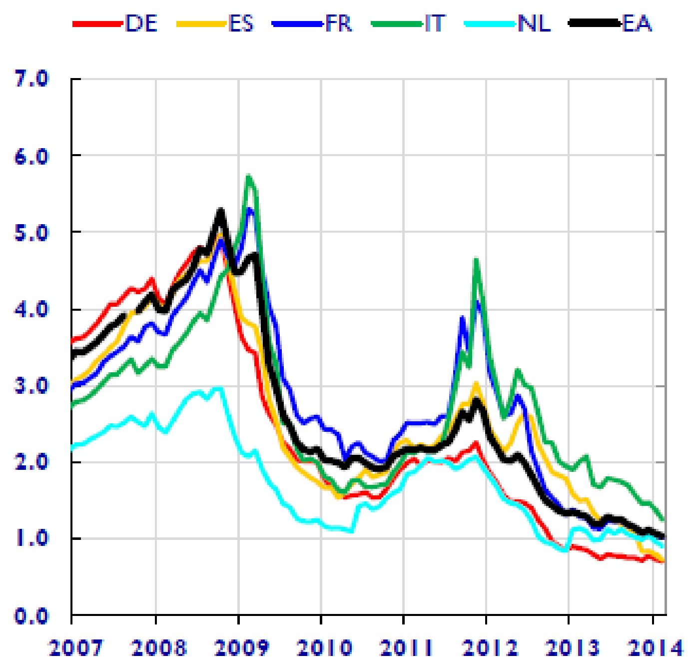
	Covered Bond	MBS
Issuer	the issuer is mostly an operating entity, i.e. a bank	issuer is an SPV
Supervision	mostly specific supervision of covered bond issuers	SPV generally not specifically supervised
Claim	investor has dual claim: issuer & collateral incl. respective cash flows; claims of bond holders pari passu	investor has a claim on collateral and its cash-flows depending on purchased tranche (senior or junior)
Balance sheet treatment of originator	Assets mostly remain on issuer's balance sheet	assets (or associated risks) are transferred to an SPV
Homogeneity	high degree of standardization within a legal framework	low degree of standardization given contractual basis
Cover pool	dynamic & actively managed - new assets enter as others mature	mostly static and well defined; remain in SPV
Issue structure/ prepayment risk	bullet format therefore no prepayment risk assumed by investor	amortization is common therefore prepayment risk assumed by investor

Covered bonds & MBS

	Covered Bond	MBS
Liquidity	supplied by Market Maker in Jumbo segment	no Market Making
Capital weighting	mostly 10 % in standardized approach, advantageous assumptions in IRB	depends on rating
Credit risk	assumed by issuers	assumed by investors
Servicing	by issuers	by separate servicer
Valuation of loans and LTV's	legal requirements on evaluation and conservative, LTV	market values and no LTV requirements
Disclosure rules	partly stipulated by law	depend on individual transaction
Rating methodologies	partly "fundamental", i.e. dependent on issuer credit, but mostly structured finance, i.e. independent of issuer credit	structured finance approach
Liquidation	insolvency remoteness of cover pools	insolvency remoteness of SPV

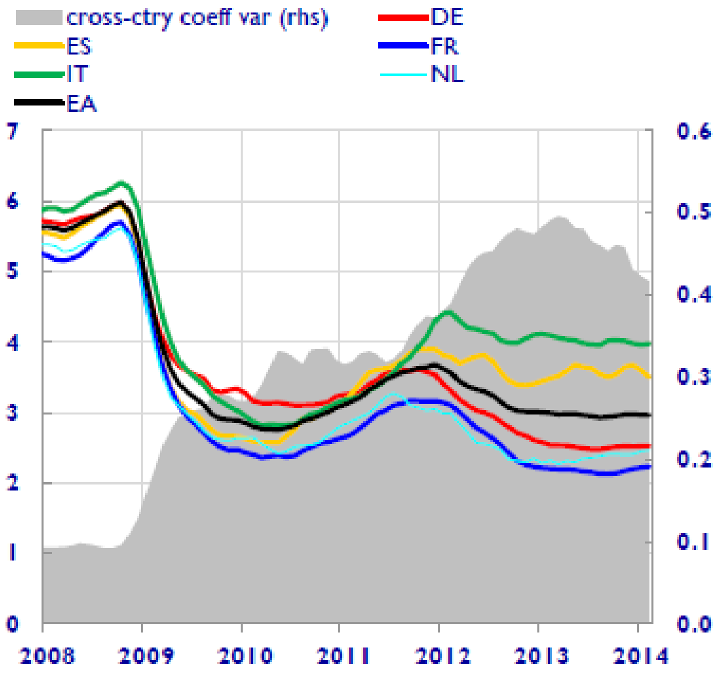
Borrowing costs remain stable in spite of improving funding conditions

Bank's composite of cost of bank debt financing
(composite cost of deposit and non-secured market debt funding; percentages per annum)



Sources: ECB, Merrill Lynch Global Index and ECB calculations.
Notes: Deposit rates and cost of market-based debt financing are weighted using outstanding amounts taken from BSI statistics.
Latest observation: February 2014.

Composite indicator of the cost of borrowing for NFCs
(percentage changes per annum; three-month moving averages)



Sources: ECB.
Note: The composite indicator of the cost of borrowing is calculated by aggregating short- and long-term rates using a 24-month moving average of new business volumes. The cross country coefficient of variation is calculated over a fixed sample of 12 euro area countries. Latest observation: February 2014.

Source: ECB

CONTACT DETAILS

European Covered Bond Council (ECBC)
Avenue de Cortenbergh, 71
B-1000 Brussels
Belgium

ecbcinfo@hypo.org
+32 2 285 40 49

http://ecbc.hypo.org - www.ecbc.eu