GlobalCapital

HD **Covered bonds' new world vintages bring fresh flavour to euro palates**

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Covered bond issuers from Canada, Sweden and Australia gathered together in March as participants in this GlobalCapital roundtable to discuss their markets. Borrowers still have plenty of issuance capacity but their plans for supply are likely to remain steady rather than spectacular over the foreseeable future. Issuers are conserving their covered pool collateral in case unsecured access becomes more constrained due to increased market volatility. Local currency issuance complements US dollar issuance, but for Australians and Canadians, the euro market offers more depth, especially at the long end of the curve. But for many issuers, and especially the Canadians, the cross-currency swap only became attractive in the summer of 2013. Fortunately, this coincided with local legislative programmes becoming operational. Australian, Canadian and Swedish covered bond issuers all benefit from solid senior ratings, stable real estate markets and they all present a great diversification tool.

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And, with a very limited amount of bonds outstanding in euros, investors have plenty of credit line availability.

<h2 class="p1">Participants in the roundtable were:

Ralf Burmeister, senior portfolio manager, Deutsche Asset & Wealth Management

Richard Coyne, senior manager, group funding, National Australia Bank

Jacques Descôteaux, chief of treasury, La Caisse Centrale Desjardins du Quebec

Ulf Jacobsson, head of funding, Swedbank

Mostyn Kau, director of group funding, ANZ

Wojtek Niebrzydowski, vice president,treasury, Canadian Imperial Bank of Commerce

Cedric Perrier, executive director — covered bonds and ABS syndicate, Natixis

David Power, vice president, funding and capital management, corporate treasury, Royal Bank of Canada

Bill Thornhill, GlobalCapital, moderator

<h2 class="p1">Funding needs

GlobalCapital: What are the panel's funding requirements for this year?

Jacques Descôteaux, La Caisse Centrale Desjardins du Quebec: Our wholesale funding this year will be about the same as last year at C$5bn-C$7bn.

Mostyn Kau, ANZ: It's largely unchanged from the last few years, so it's in the region of A$20bn-A$25bn, and we've been consistently in that range for the last four or five years. Our growth has been met largely by deposits in the last few years.

David Power, Royal Bank of Canada: Last year we took on Ally Financial Canada, so it was a little bit of a heavier funding year for us. All else being equal, our funding will be a bit lighter this year.

Richard Coyne, National Australia Bank: Our term funding programme has remained broadly unchanged in recent years. The **group**'s term wholesale funding task for the financial year 2014 is A$25bn-A$30bn. Given the strength of our balance sheet we are managing to refinance existing maturities.

Wojtek Niebrzydowski, Canadian Imperial Bank of Commerce: We're generally pretty well funded, and it's a function of the activities that have taken place in the past two to three years. That means our funding need is limited, and it would be less overall in comparison to last year.

We issued two **transactions** in the second half of 2013. In the context of our more limited funding needs, anything on the covered side, if and when we do it, would be more of a strategic nature, for good and logical reasons one may want to maintain presence.

Ulf Jacobsson, Swedbank: Our overall funding need this year is €13bn, which is more or less in line with last year. Of this, €9bn will be covered. Any issuance of capital will be above this volume but it is too early to say what our capital needs will be.

GlobalCapital: And presumably a large portion of that's going to be supplied by the domestic market?

Jacobsson, Swedbank: Yes, we plan to issue about €1.5bn of covered bonds denominated in euros. That is one public benchmark and private placements on top of that.

GlobalCapital: Richard, what portion of your funding do you envisage will be done in covered bonds?

Coyne, NAB: We typically look to raise about a quarter of our annual funding needs in secured funding, which is a combination of covered bonds and other secured issuance like RMBS or ABS, though for the financial year 2014, our secured programme is mostly going to be in covered bond format.

GlobalCapital: What could provoke you to change that proportion to a greater or lesser extent?

Coyne, NAB: There is a multitude of factors that influence our thinking, such as market conditions, the basis swap, investor demand, and so on.

Kau, ANZ: For us, much depends upon the state of the markets. Two years ago we issued close to A$12bn across the **group**, and that really was in response to the weaker markets when the euro sovereign crisis was at its height. But last year we only did in the region of A$4bn-A$5bn in covered bonds as the unsecured market was so strong and using collateral didn't make sense.

Covered bonds provide increased access when markets are stressed so we manage our capacity very closely. We have used up less than half our regulatory limit of around A$30bn and we have maturities coming up in the next couple of years. It's important for us to keep that portfolio well managed so we can access it in times of need.

Descôteaux, CCDJ: We intend to issue one or, at the most, two covered bonds a year.

Power, RBC: We've issued covered bonds every year since we launched our programme in 2007 but the mix overall is still primarily senior, and that would be true pretty much in every year.

We have about C$20.5bn outstanding issued from a capacity limit of C$32.3bn, of which about 10% was issued in euros. I wouldn't expect a big change in our issuance pattern in terms of the senior/covered mix.

Coyne, NAB: We expect our portfolio share of covered bonds to increase over time and that's a function of the fact that we've only used a third of our total capacity. We still have capacity, which is a comfortable place to be.

GlobalCapital: What is the main strategic role of covered bonds?

Kau, ANZ: As I alluded to previously, the primary role of covered bonds are to enable market access in times of stress. They have proven to be a more defensive, resilient instrument during periods of market dislocation. They are a valuable, finite resource and as such we will always ensure capacity is available to utilise when unsecured markets are compromised.

A secondary benefit is that covered bonds provide a more efficient way to access tenor. The spread differential between covered and senior increases the further out along the curve you go, so it's generally better to use covered bonds to fund at the long end.

<h2 class="p1">Currencies

GlobalCapital: Mostyn, do you have any policy as to how you split between euros, Aussie dollars, and US dollars?

Kau, ANZ: The markets outside Europe have nowhere near the depth of the euro market and the tenor is generally shorter. That's why the euro market is much more strategic in nature. The peripheral markets tend to be opportunistic.

Jacobsson, Swedbank: We issued our first US dollar covered bond in 2011 under our 144A programme and we would like to return to the market also during 2014 if conditions permit. Except for euro and US dollar benchmark **transactions** we are active in other currencies in the private placement market where Swedbank has traditionally been quite active.

GlobalCapital: What's driving this?

Jacobsson, Swedbank: Credit growth in Sweden has decreased, particularly in the housing market. The lending was at a peak around 2007 but since then total lending has decreased quite a lot. That means the borrowing volume has been fairly stable.

GlobalCapital: To what extent do you take into account the cost of senior funding relative to covered bonds?

Jacobsson, Swedbank: I would say the relative spread between senior and covered bonds will have an impact on our funding decision. In a market where the relative spread is tight, one could argue that the covered pool capacity is better used when funding conditions are less friendly. Then there are regulatory initiatives like bail-in and MREL (minimum requirements for own funds and eligible liabilities), which could of course drive the composition.

Coyne, NAB: We don't have set targets for euro denominated covered bond issuance. Across the major markets, and as a rule of thumb, our annual funding task is roughly split evenly between our domestic Australian dollar market, US dollars and euros, excluding other markets.

Niebrzydowski, CIBC: There are two overriding factors for CIBC. One is that it has to make sense in the context of the overall cost of funding and in relation to domestic senior unsecured.

Then it's a question of choosing between different markets. We try to maintain a presence in most of the markets so, inclusive of the legacy programme, we've issued in dollars, in euros, in Swiss francs, in Aussie dollars.

Obviously markets like Switzerland or Australia provide diversification, but for logical reasons that's not where you can go and fund in volume. We've been waiting for the opportunity to come back to the euro market since, effectively, 2009.

The cross-currency swap only became viable in the summer of 2013, which coincided with us getting the legislative programme up and running.

Euros and dollars are likely to remain our key funding markets. We've made a significant contribution to the creation of the dollar market in the form it is right now, and we still have a number of benchmark **transactions** outstanding.

In the context of trying to keep a name in the market, and have enough **transactions** out there to have a curve that would, in theory, call for perhaps another **transaction** in euros. But ultimately, if and when this happens, it will be again a function of economics and funding needs.

Descôteaux, CCDJ: The decision to issue in euros or dollars is mainly driven by the basis swap, but we also commit to our US and European investors to come in covered bonds or senior at least once a year.

Euro issuance diversifies our funding, but it's also much bigger and deeper than other currencies. Also, local European investors are knowledgeable about the co-operative business model we have.

GlobalCapital: The euro market also offers the ability to fund further out on the curve beyond the five year area. Is that something that appeals to you compared to other currency markets?

Descôteaux, CCDJ: There is no need for us to pay a higher spread for longer funding as most of the mortgage assets on our balance sheet are five year, so we prefer to match this with our funding.

GlobalCapital: Irrespective of the fact that the currency basis swap has probably moved in favour of dollar issuance, you're still probably going to look at doing at least one dollar benchmark and one euro benchmark a year; would that be correct?

Coyne, NAB: That's probably fair, we like to take a strategic view in terms of our funding profile, and we value diversity.

<h2 class="p1">Spreads

GlobalCapital: Ralf, what is the main driver for spreads?

Ralf Burmeister, Deutsche Asset & Wealth Management: The main driver for spreads is going to be central bank policy, growth expectations and the realisation of growth.

GlobalCapital: And with inflation still falling in Europe the outlook is surely constructive for rates?

Burmeister, DeAWM: Yes, but the question is whether inflation will fall to levels that would make the central bank react. As we are not pessimists regarding growth and central bank policy we would say that spreads in the European periphery should tighten from the start of the year.

GlobalCapital: Do you think spreads in the core markets have tightened by as much as they can?

Burmeister, DeAWM: My guess is that the people buying into core markets like Austria and Germany are not necessarily doing so because they expect further spread tightening.

GlobalCapital: What’s driving investment decisions?

Burmeister, DeAWM: The investment decision is benchmark driven. Also many investors are restricted to investing in certain countries, which means they have a forced bias into core European markets.

But these investors could also be buying core Europe as a defensive play, as they may not subscribe to our positive growth outlook and may still be preparing for the worst.

Also, bank treasuries tend to be very ratings sensitive so they would be more likely to go for something that has low rating volatility and a high absolute level of rating.

GlobalCapital: How do you expect spreads to change over time?

Kau, ANZ: We did a seven year in May and by the time we did a five year in September it was at the same level. So spreads have drifted and struggled to get back to those levels we saw mid-last year. It’s difficult to tell, but the potential lack of supply might drive spreads back in, all else being equal.

Niebrzydowski, CIBC: We’ve seen core market spreads narrowing for a number of months and if you look at the probabilities or reversion to mean, the likelihood is probably for spreads to widen rather than tighten further. If we are trying to make predictions, I wouldn’t be surprised if at the end of the year the spreads were wider.

Perrier, Natixis: I expect to see more compression, but regarding the top Scandinavian or French names, I’m not sure that we’ll go much tighter than around 8bp that BNP Paribas achieved in its recent five year. I’m very positive on peripheral Europe. Australian and Canadian deals probably have room to compress a bit further but Sweden may have less scope.

Jacobsson, Swedbank: There is probably room for spreads to tighten even further.

GlobalCapital: But Swedish covered bonds are already very tight. Do you think they could come into line with Germany?

Jacobsson, Swedbank: Yes, there is probably room for that.

GlobalCapital: How do you expect the relationship between covered bonds and senior to develop?

Jacobsson, Swedbank: Covered spreads could tighten in the long run both during this year and in the next couple of years. In terms of senior I’m less convinced. I don’t think there is the same potential as in covered.

Power, RBC: You could see covered bonds tighten relative to senior due to regulatory developments that affect investor appetite and depending on how liquidity rules evolve. But I wouldn’t predict that happening in the near term.

Descôteaux, CCDJ: Last month senior spreads tightened by 10bp-15bp in the five year and covered bond spreads could also tighten, especially if Canadian covered bonds are eligible for inclusion in the liquidity coverage ratio for European banks, because right now they’re not.

Niebrzydowski, CIBC: In the absence of some particular event that would make the market favour one asset class versus the other, I see no reason why the overall relative relationship should change other than, as I said, I’d more expect widening rather than tightening.

Burmeister, DeAWM: One or two years from now, a rise in absolute yields is probably on the agenda. But this will depend on how credit markets react, and this may in turn depend on the speed of the expected rise in yields.

Standard academic teaching would suggest higher yields go together with wider spreads, but history has shown it is possible to have tightening spreads and rising yields, or even widening spreads and falling yields. There's not a perfect correlation.

Central banks are still very actively involved so it's likely to be a question of waiting and seeing and looking from quarter to quarter.

I'm not a central bank expert, but if they feel the need to provide forward guidance in an explicit way it follows that the interest rate outlook is unclear.

Kau, ANZ: In terms of the extraordinary central bank support it's hard to back away at this point, so they're in it for the long haul. Obviously it does have to end but in my view, which is probably in line with the consensus, things will continue to tighten on a technical basis just because of the sheer amount of liquidity being provided.

GlobalCapital: What sort of spread do they offer relative to European issuers?

Cedric Perrier Natixis: These deals offer good relative value, especially the Australians. For example, five year Aussies in euros trade around 15bp-17bp while BNP Paribas recently issued at 8bp, the Nordics, including Sweden, trade around 5bp-6bp and KBC was recently printed at 10bp.

On the other hand, some investors prefer Australian banks' senior paper, which trades with a 25bp pick-up to covered bonds at around 40bp. So you see some investors who are comfortable with the name will often just go for the spread. After all, the Aa2 rated senior bonds are rated more highly than some covered bonds.

Fitch recently published a study of investors' views for the primary market in 2014 and many of them said peripheral names would be very much in favour.

But they also liked the UK, Australia and Canada, so it's quite positive to see that European investors want to increase exposure to these countries.

<h2 class="p1">BRRD

GlobalCapital: Ralf, where do you think senior unsecured spreads are going in relation to the implementation of the Bank Recovery and Resolution Directive?

Burmeister, DeAWM: If you create a tool like you have with the resolution regime it certainly raises the possibility it could be used. So, once you have it in place, maybe there's a motivation, either on the political side or on the regulator side to make use of the rules. But I wouldn't rule that out.

Senior spreads are a function of loss-given default and the probability of default. With all the regulation that has been enacted, the funding structure of banks has become sounder and more diversified. And on the capital side banks have improved dramatically, which means the probability of default has gone down on average and this makes banks more stable.

That doesn't rule out individual failures but on average the probability of default has come down due to tighter regulation lowering the loss-given default which, on average, would normally support tighter senior spreads.

It could be that senior spreads widen for selective banks that may be weaker, but for the industry as a whole, it's a very bold to assume senior spreads will widen simply because of bail-in regulations.

Niebrzydowski, CIBC: That was what I was referring to in my comment earlier that in the absence of events impacting one versus another asset class, it's logical, if ultimately, in a global regulatory scene, covered bonds end up being exempt from bail-in, and senior may be subject to bail-in.

But it depends on the circumstances and the chances are it may vary from jurisdiction to jurisdiction. This should augur obviously for widening of the spreads between the two asset classes.

Though this may be more limited for higher rated institutions versus others.

GlobalCapital: But what about asset encumbrance?

Burmeister, DeAWM: Asset encumbrance needs to be considered on a case by case basis. I certainly question the view that it has systemically increased so dramatically that senior investors will now lose more if a bank runs into trouble.

According to Fitch, asset encumbrance hasn't changed that dramatically over the course of the crisis. So just because we have bail-in, it doesn't automatically mean senior spreads must widen.

GlobalCapital: What do you think about the nationally imposed covered bond issuance limits of 4% of assets in Canada and 8% in Australia?

Burmeister, DeAWM: That's also something that gives me comfort, as you know there'll never be a problem generating over-collateralisation if it's ever needed.

<h2 class="p1">Canadian legislation

GlobalCapital: Wojtek, what have the main points been when it comes to your discussions with investors?

Niebrzydowski, CIBC: We generally look at three themes. In no particular order, the Canadian banking system and the housing market are two. But we spend a fair amount of time explaining the ins and outs of the legislative set-up, and programmes, compared to what the market has been used to during 2007-2012.

As a banking system we continue to be in a fairly favourable position, where you have a combination of a strong economy and banking sector. Canada is one of probably eight countries rated triple-A from all the agencies. The housing market does come up occasionally, especially in the North American context. But that's principally a function of our reasonably strong economy and the fact our banks systems didn't need any bail-outs. Relatively low interest rates improved housing affordability.

At the same time there has been an urge to make a comparison between Canada and the US. There was a big correction in the US and some people question whether perhaps there should be one in Canada. We've been collectively, as an industry, explaining why the two situations aren't necessarily comparable.

GlobalCapital: Jacques, tell me about the changes to your programme in the last year.

Descôteaux, CCDJ: Our IT systems have been slightly adjusted to meet the requirements of new legal framework.

Power, RBC: The news this past year has revolved around the legislation coming into effect for the Canadian programme. Our existing programme became legislative, which was unique, and up until now we're still the only bank with SEC registered covered bonds.

In terms of the changes to the programme, it revolved around a lot more disclosures. There were a few structural enhancements as well, such as the security sharing agreements.

If you look at RBC's investor relations website you can see all of our programme documents, including swap confirmations, servicing agreements, standby agreements — it's a very complete disclosure regime across different types of information, not just the collateral. You're going to see virtually all the related programme documents in a way that I'm not sure other issuers outside of Canada provide.

Collateral disclosure was also further enhanced, because our covered bond report went from about five pages long to about 20 pages long with new elements such as two dimensional pool stratifications.

GlobalCapital: What does two dimensional pool stratification mean?

Niebrzydowski, CIBC: There's an ability to slice and dice the data. You can create your own views as an investor, for instance, looking at the profile of geographic concentration combined with credit bureau scores, or credit bureau scores combined with LTVs, that type of thing.

The audience that buys our covered bonds are sophisticated investors. We provide all the disclosure that we can but ultimately it's up to them to decide whether they get paid sufficiently for the risk or not.

GlobalCapital: But CIBC comes from a very different perspective than RBC as, unlike them, you had to start completely from scratch.

Niebrzydowski, CIBC: Out of seven Canadian issuers, six will either need to set up a new programme, or are doing so. The reason for doing so was, under the legislative framework, the inclusion of insured collateral is prohibited.

Residential mortgages, in Canadian dollars, domiciled in Canada, up to 80% loan to value at the time of inclusion in the covered bond programme, are one form of eligible collateral but there is another.

The legislation allows for two asset classes, both up to 80% LTV, one is conventional residential mortgages, which is the standard mortgage that pays down over a prescribed amortisation period. The other asset class is a residential real estate secured loan that consists of two components. There is an amortising mortgage, but there is also a real estate secured line of credit attached to it. But only the amortising mortgage portion of such a loan is eligible.

There is also a new function of asset custodian, which is a third party that maintains, on a prescribed periodic basis, all the records of the loans in the cover pool. Under the law this arrangement was more formalised.

Jacobsson, Swedbank: In Sweden, we've tried to be as transparent as possible. We have a national transparency template where we try to be as transparent as possible. But how that stands in comparison with the other jurisdictions I'm not sure. This transparency requirement is mainly done on a voluntary basis though to some extent transparency requirements are now being coded into European regulations.

<h2 class="p1">Pros and cons

GlobalCapital: Cedric, what do you see as the pros and cons when you think about syndicating Australian and Canadian covered bond deals?

Perrier, Natixis: Australian and Canadian covered bond issuers benefit from a very solid minimum double-A senior rating, which is generally much better than eurozone issuers.

They've got solid real estate markets and though we've seen prices fall in some areas, the market is still solid compared to parts of Europe.

Investors see these names as a very good diversification tool. They have a very limited amount of cover bonds outstanding in euros, not only because they are quite recent issuers but also as they've been very active in other currencies, which means investors have plenty of credit line availability.

Kau, ANZ: Investors say they like the consistency that we provide. Our funding programme, broadly, hasn't changed in the last five years in terms of volume. It's just got more sustainable with the introduction of covered bonds and RMBS.

Diversification has increased, and therefore the strength and sustainability of our funding programme has also become greater. Strong profitability has assisted capital generation too so there's a high degree of confidence amongst investors generally.

GlobalCapital: Wojtek, you sold to investors under your legacy programme and now you sell to the same investors but with a new programme. Has there been much change in the feedback that you've had since you set up the new programme?

Niebrzydowski, CIBC: There hasn't been anything explicit. The standard response is that more disclosure is better than less, although I suppose there can be such a thing as too much disclosure.

To use a case in point, we've had a number of discussions in Canada with the administrator and the government whether there is a need for loan level disclosure, and over the last five years, having spoken to hundreds and hundreds of fixed income investors, I can recall only one instance where an investor actually expressed their preference for loan level disclosure.

In many circumstances their response was: "No we don't want loan level disclosure; we want something less than that, but something that reflects reasonably well the risk profile of the pool."

So what we have right now is a fairly good compromise. There are a lot of factors that we disclose, we have the ability to provide the stratification that investors can access on a customised basis, depending on what factors they want to look at in combination with each other.

GlobalCapital: Can investors make a like-for-like comparison across different Canadian programmes?

Jacobsson, Swedbank: The housing price development is a topic that very often comes up in discussions. But what gives our investors comfort is that we originate and we keep these assets on our balance sheets.

We have high origination standards and good servicing of the loans. Investors like the transparent credit information systems we have in Sweden where we have access to our clients' income, tax payments and credit behaviour. These credit checks weed out, let's say, 95% of clients that shouldn't really have a mortgage.

Niebrzydowski, CIBC: There are some minor things that may not be 100% comparable, for instance, there are at least two providers of credit bureau scores in Canada, and those levels aren't 100% comparable. If you are comparing Institution A with Institution B, a loan rated 750 in one versus the other is not identical.

Coyne, NAB: Investors value the fact that we have a legislative framework, which includes strict asset eligibility criteria. Investors also appreciate the fact we only allow prime Australian **residential** mortgage loans as eligible cover pool assets. Indexation is also a key feature of our programme.

GlobalCapital: Indexation of cover pools to house prices is, I understand, coming up on the agenda in Canada as well?

Power, RBC: The implementation of indexing, which we need to complete by July 1, is one of the conditions of registering our programme with the CMHC.

GlobalCapital: Are there any distinguishing features between the Aussie programmes?

Coyne, NAB: There has been industry-wide participation on what we were going to present to the offshore markets in terms of the Australian covered bond model so, broadly speaking, all the programmes are fairly similar.

GlobalCapital: Ralph, what's your overall macro view on Canada, Sweden and Australia?

Burmeister, DeAWM: Canada has one of the most solid banking sectors in the world and the same is probably true for Australia. Sweden, Canada and Australia are all open market economies that could be disproportionately hit by a downturn in global growth.

GlobalCapital: And being outside the EU presumably means they don't enjoy the same regulatory benefits?

Perrier Natixis: As for the cons, because they're not part of the EU, Canadian and Australian-NZ covered bonds are not Ucits compliant, nor CRD IV compliant and the Australian-NZ deals are not ECB eligible, though Canadian ones are. So we see some investors saying, because of that, they will be slightly more reluctant or interested but in smaller size.

So, even though you have all these advantages, the investor base is smaller. And this smaller investor base means they are not performing as they should, given their strong credit rating compared to other core country issuers.

Burmeister, DeAWM: As big commodity exporters the Canadian and Australian economies are more dependent on **China**, while Canada's proximity to the US makes it more dependent on the US economic cycle.

Kau, ANZ: There have been a number of stress tests that show the correlation between the Australian and **Chinese** economies is over exaggerated sometimes. Or it's thought to be more relevant than what it is. But there's no doubt at all there will be some effect, given **China** is our biggest trade partner. The mining infrastructure boom has peaked and export capacity has increased, so if demand drops off there will be excess capacity and something that we speak to investors about.

Coyne, NAB: There is definitely a resource reallocation story playing out in Australia, especially as the larger capital projects come online and become less labour intensive to operate. The high Australian dollar also gets a mention, especially its impact on industries like manufacturing and domestic tourism.

GlobalCapital: In terms of the housing market, are you concerned? Australian prices have clearly accelerated to a much greater extent than either Canada's or Sweden's but the UK's house price inflation record trumps all three.

Kau, ANZ: It looks like it's less of a housing bubble in Australia, and more of a fundamental increase when you consider the dynamic between relatively low interest rates and rising incomes. Lending standards are high and this together with the full recourse, non-tax deductible structure of the mortgage market has led to low loss rates historically.

Descôteaux, CCDJ: Investors are mostly concerned about the Canadian real **estate** market, especially for condos in places like Vancouver and Toronto. In Montreal and Quebec generally house price inflation has been lower. The LTV of uninsured mortgages in the pool is very low at around 57%.

Burmeister, DeAWM: It’s not only the price increases, you need to take into account the behaviour of borrowers to understand more about amortisation rates and leverage in the private sector.

In Sweden, for example, the amortisation rates were historically lower, though recent regulation should cause that to change.

GlobalCapital: What’s the relationship between amortisation rates and house price inflation?

Burmeister, DeAWM: If house prices keep rising, borrowers are less inclined to pay back their loans.

Jacobsson, Swedbank: There have been discussions in Sweden about mandatory amortisation plans. The household saving ratio in Sweden is one of the highest in Europe so it would definitely be possible to implement with limited impact on the domestic economy. But with the low interest rates and the tax deductible on the interest expense of the mortgage loan, it’s sometimes more beneficial to save in other products than amortise on your mortgage.

GlobalCapital: If you look at the Canadian, Australian and Swedish programmes, do they have distinguishing features?

Burmeister, DeAWM: Sweden has a huge domestic market for its krona-denominated covered bonds, which means they have a very good and liquid backstop for their bonds and this can be a big differentiator if liquidity dries up. This factor gives you a lot of comfort to invest in non-domestic currency deals as long as the currency swap is properly handled. This is surely an argument where you’re potentially willing to pay a tighter spread when there is a solid home base of buyers. The other two countries are trying to build their domestic investor bases, but they’re rather young covered bond markets.

<h2 class="p1">Bail-in

GlobalCapital: Ralf, do you think a bail-in will be interpreted differently by national regulators?

Burmeister, DeAWM: I wouldn’t rule that out. You’ve seen there have been national differences in Europe in the previous three versions of the Capital Requirement Directive, so I don’t think bail-In should be any different.

GlobalCapital: How do you think national regulators would treat the senior claim of covered bondholders?

Burmeister, DeAWM: If the cover pool was unable to generate sufficient funds to repay the outstanding covered bonds, then the senior claim would probably not be against the insolvency **estate**, but against the going concern entity that’s been spun off.

GlobalCapital: Has the Australian Prudential Regulation Authority given any guidance on how excess OC might be treated in the event of an issuer’s insolvency?

Kau, ANZ: In the case of excess collateral over and above that required by the Asset Coverage Test, upon issuer default, the administrator/regulator will make a claim on the issuer’s behalf on those assets.

Power, RBC: The Canadian authorities will soon publish a consultation document outlining their thoughts and inviting feedback.

GlobalCapital: And how do you think regulators would treat cover pool collateral that’s well in excess of the outstanding claim and legal minimum?

Burmeister, DeAWM: If you have, say, €10bn of assets with €5bn of outstanding covered bonds it would be naïve to assume this will remain untouched. But it’s still a bit of a guessing game and we will have to wait for clarification.

Kau, ANZ: And Australian banks are in a similar situation with a lack of eligible HQLA. However to the extent covered bonds meet Reserve Bank of Australia repo-eligibility criteria they will be allowed to form part of the Committed Liquidity Facility and therefore form part of the liquidity portfolio.

Jacobsson, Swedbank: The main driver for our OC level is internal limits. The limit is designed so that we would never jeopardise our triple-A rating. The OC-level in our cover pool is above 45% so there is room to increase issuance if needed. The Swedish covered bond law requires a positive OC but not at an absolute level.

GlobalCapital: Why did the Canadian regulator decide not to introduce a minimum level of OC in the Canadian law?

Power, RBC: There's a subtlety in what they did. They wanted to make sure that whatever our maximum asset percentage was set at, it could not be increased. In the case of our programme, we have a hard cap of 93%, which is about 7.5% OC and this cannot be decreased at the management's discretion.

GlobalCapital: Who calculated that number?

Power, RBC: We had already made that change before knowing about the legislation requirement, in response to a request from Moody's.

GlobalCapital: That's not exactly in the legislation then?

Power, RBC: The new guidelines latched on to the concept that we had implemented in response to Moody's, and it required the same level as OC. So the new guidelines duplicated Moody's concept, which meant it didn't change anything for us in terms of the OC RBC had already committed to.

Niebrzydowski, CIBC: There is no minimum OC mandated, in the context of the regulatory framework. What is signed off is our contractual commitment to rating agencies. So effectively OC will depend on committing to the most conservative asset percentage, which is the inverse of the OC. The legislation works in a fashion where it protects the commitment you've made to the rating agencies, but it allows for pull back of any, for the lack of better word, voluntary over-collateralisation.

If you look at our legislative programme, we have an AP of 92.4, which would translate to an OC of about 8.2%. So that's what we are required to maintain, and that's what's protected under the legislative framework. We have about C$5.4bn in the collateral pool and about equivalent C$1.9bn of outstanding issuance.

GlobalCapital: So your OC is much higher than it needs to be, but the amount that's protected will be the amount that has been signed off by the CMHC, which is broadly in line with what the rating agencies have signed off?

Niebrzydowski, CIBC: Correct. Once we've committed to certain level of OC we cannot lower it.

GlobalCapital: The CMHC has signed off this amount, which is based on the rating agencies at a certain point in time, when the market was as it was. But obviously things change over time. What I'm trying to fathom out is, if the rating agencies suddenly required you to put more over-collateralisation in, would the CMHC necessarily say you need to follow what the rating agencies are telling you?

Niebrzydowski, CIBC: I'm not aware of anything that would, from a legislative standpoint, preclude us from providing more collateral. There is a maximum uplift that can be accorded to covered bonds compared to the issuing bank's senior rating. So at some point, depending on the severity of hypothetical downgrades, adding more collateral is not going to keep you at triple-A.

<h2 class="p1">LCR

GlobalCapital: Ralf, what do we know about how covered bonds will be treated when it comes to their eligibility for bank liquidity buffers under Basel III's liquidity coverage requirement (LCR)?

Burmeister, DeAWM: The Swedes are in the same position as the Danes and Norwegians who all have little government debt outstanding to satisfy the liquidity requirements of their domestic banks. So having access to top quality alternative assets, such as covered bonds, could make sense.

Kau, ANZ: And Australian banks are in a similar situation with a lack of eligible HQLA. However, to the extent covered bonds meet Reserve Bank of Australia repo-eligibility criteria they will be allowed to form part of the Committed Liquidity Facility and therefore form part of the liquidity portfolio.

Jacobsen, Swedbank: The liquidity coverage ratio was introduced in Sweden on January 1, 2013, so for us it is already binding. We are required to fulfil the LCR in US dollars and euros on a standalone basis and in all currencies combined. There are limited level 1 assets in Sweden due to the fiscal situation, as there's not much government debt issued. That means that the level 1 assets we need are mainly fulfilled by buying assets in currencies other than the Swedish krona.

We don't expect the Swedish regulator to demand that we should be compliant in Swedish kronor on a standalone basis, but if that demand were to come it would be very difficult to live up to, unless our domestic covered bonds were treated as level 1 assets.

Descôteaux, CCDJ: Canadian covered bonds are eligible for bank liquidity buffers in Canada.

Coyne, NAB: Similar to Sweden, we have a shortage of high quality liquid assets in Australia as defined by the APRA, which is a result of the strength of our government fiscal position. While major bank covered bonds denominated in Australian dollars are not currently level one or two liquid assets, they are still repo-eligible at the Reserve Bank of Australia.

Power, RBC: My expectation is that Canada will follow the Basel III rules so I assume that covered bonds, subject to requirements, would be eligible generally in Canadian LCR calculations as liquid assets. But you obviously have to distinguish by jurisdiction. For US banks that may not be true, at least for now.

And in Europe we need to understand how Ucits interacts with the LCR rules as there seems to be some conflict, so that's something we're going to remain interested in. It's impossible for us to be in full compliance with Ucits as that requires the bank to be from an EU member state.

Niebrzydowski, CIBC: One development that happened concurrently with the introduction of Canadian legislation was that the Bank of Canada changed its eligibility for repo criteria. Canadian bank-issued Canadian dollar denominated covered bonds are now on the repo eligibility list. If you look at what's eligible at Bank of Canada, the number and type of securities is more restrictive than it would be in the context of the US Fed or European Central Bank. So the fact that the bank itself recognises that as a type of asset that should be eligible for the liquidity facility is a good sign.

CO royca : Royal Bank of Canada

IN i814 : Banking | i81402 : Commercial Banking | ibnk : Banking/Credit | ifinal : Financial Services

NS c172 : Corporate Debt Instruments | e1121 : Home Sales/Housing Affordability | mswap : Swaps | c17 : Funding/Capital | cactio : Corporate Actions | ccat : Corporate/Industrial News | e11 : Economic Performance/Indicators | ecat : Economic News | ereal : Real Estate Markets | m15 : Derivative Securities | mcat : Commodity/Financial Market News | ncat : Content Types | nfact : Factiva Filters | nfce : FC&E Exclusion Filter | nfcpin : FC&E Industry News Filter

RE cana : Canada | austr : Australia | swed : Sweden | uk : United Kingdom | apacz : Asia Pacific | ausnz : Australia/Oceania | eecz : European Union Countries | eurz : Europe | namz : North America | nordz : Nordic Countries | scandz : Scandinavia | weurz : Western Europe

IPD Covered bonds

PUB Euromoney Institutional Investor PLC

AN Document EURMCM0020140630ea3v0013p