PFANDBRIEF | MARKET

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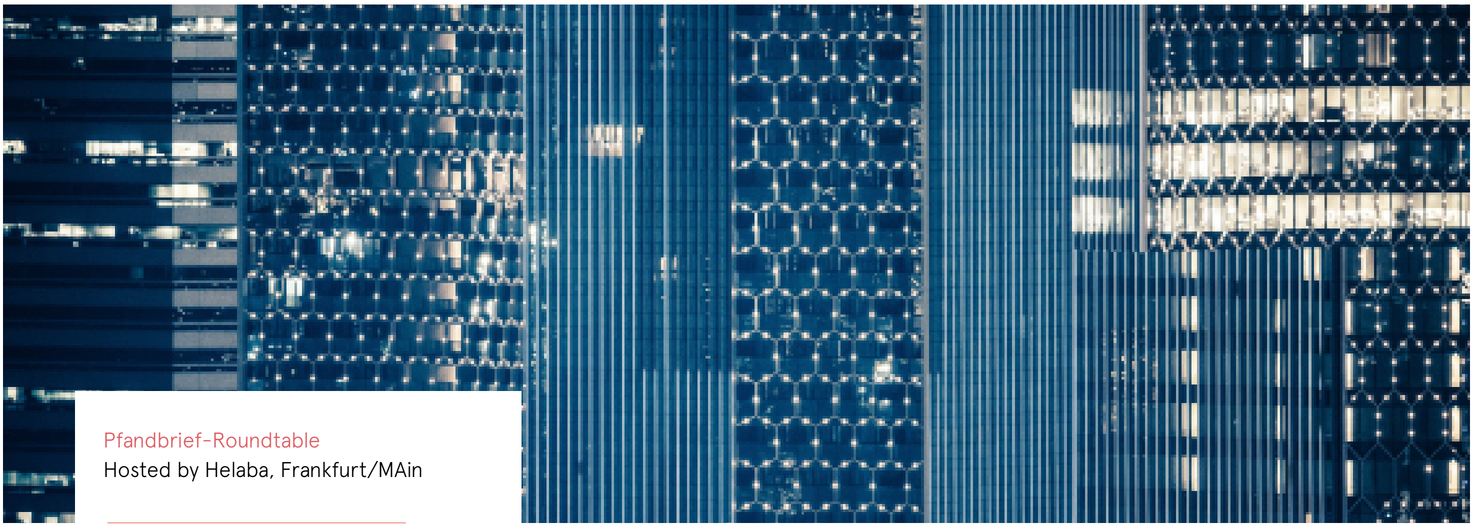

Pfandbrief-Roundtable
Hosted by Helaba, Frankfurt/MAin

The Pfandbrief Roundtable 2018

The end of CBPP3 and forthcoming Covered Bond Directive were top of the agenda in the annual Pfandbrief roundtable — chaired by Neil Day of the Covered Bond Report and hosted by Helaba in late June — as leading issuers and investors joined us to share their views on these plus ESNs, the expansion of the German product, and green bonds.

Roundtable participants (left to right above): **Thomas Behme**, head of treasury, Natixis Pfandbriefbank; **Moritz Rieper**, portfolio manager, DWS; **Neil Day**, managing editor, The Covered Bond Report; **Jens Tolckmitt**, chief executive, Association of German Pfandbrief Banks (vdp); **Sabrina Miehs**, senior covered bond analyst, Helaba; **Olaf Pimper**, director, treasury and liquidity portfolio management, Commerzbank; **Martin Gipp**, head of funding, Helaba; **Silvio Bardeschi**, director, treasury – funding, Deutsche Pfandbriefbank (pbb)

Neil Day, The Covered Bond Report: There has been a lot of discussion about the merits of CBPP3 and its impact on the market. When Eurosystem orders began to be cut back in March, how did that affect things? Was it a key moment for the market?

Martin Gipp, Helaba: Yes, I think it was some sort of a key moment for the market as it brought back to everybody's mind that we were living in an artificial environment for quite some time due to the ongoing support from the ECB.

From an issuer's perspective, the ECB involvement led to a strong spread tightening in covered bonds across all jurisdictions, spreads fell to historical low levels and credit-driven pricing differentiation vanished almost completely. But it also had significant negative effects, especially from the investors' point of view, as the price insensitivity of the ECB led to an unjustified equalisation of covered bond spreads across jurisdictions and ultimately squeezed several institutional investors out of this product spectrum.

In our case, from a timing perspective we were lucky to issue our Pfandbrief benchmarks early in the year, ahead of the first ECB decision to reduce their primary order. But although the ECB's decision means an increased cost of funds, I'm in favour of the movement of the ECB as long as it is done in an orderly way. So here I hope for clear and timely communication from the ECB with regards to their future usage of the QE programmes. The spread reaction that we have seen so far was a smooth one and helped bring primary and secondary spreads back to normality and more or less to the levels we have seen before the start of ECB's involvement.

So overall the decision to scale back orders is a healthy development.

Olaf Pimper, Commerzbank: From the investors' point of view, you can see a clear impact since the ECB announced the lowering of its orders in March, which is that issuers have been paying higher new issue premiums. I'd like to point out that my personal view as an investor is that this is absolutely not a sign of weakness; it is simply a sign of normalisation. The ECB's lower orders give the normal investor again the opportunity to place orders at the level the normal market sees the fair price for Pfandbriefe. And it hasn't moved a lot from where we were in January or February – it's a maximum of some 10bp and I don't expect the market to cheapen much more from here.

Moritz Rieper, DWS: I would agree with that stance – we also believe that the ECB gradually reducing its purchases is positive. However, we have to bear in mind that the ECB is going to remain heavily involved in the covered bond market via its reinvestments. It faces

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Olaf Pimper, Commerzbank

around EUR7bn of reinvestments in addition to around EUR7bn of net asset purchases over the remainder of the year – and a further roughly EUR20bn of reinvestments next year. Overall, the ECB's gradual withdrawal will lead to improved market conditions in terms of liquidity, healthier order books and more differentiation between covered bonds.

Jens Tolckmitt, vdp: I would like to underline this view that this is a healthy development. From the outset we have been apprehensive about the ECB's intervention, especially for the Pfandbrief market, where its impact has been more unhealthy than helpful. The Pfandbrief market didn't need such intervention, especially the second and third programmes. We are therefore happy that the ECB's latest moves offer a chance for traditional investors to come back to the market. We expect the impact to be relatively low in terms of spread widening.

It is worth bearing in mind that the first covered bond purchase programme in 2009 had a volume of EUR60bn versus a market of more than EUR2tr, but the simple fact that the ECB was there had a very positive effect on the overall market. As long as the ECB doesn't abruptly declare that it is stopping buying – which I doubt she will do for the time being – such a positive impact will persist without the ECB buying half of every new issue. The psychological factor of the ECB still being there is the most important thing, not the sheer volume of its purchases.

Sabrina Miehs, Helaba: The ECB's reinvestments will be quite large. Looking at the next two to three years, in 2019 there is around EUR22bn of redemptions from the covered bond purchase programmes, meaning almost EUR2bn per month that will flow back into the market, and in 2020 it's EUR26bn-EUR27bn, so more than EUR2bn per month. I agree that will provide good support where necessary, and some markets may need it a little more than others considering the uncertainty in certain countries. So it's good to still have that in place to keep volatility a little lower than it might otherwise be if the ECB wasn't there.

They will probably invest more in the secondary market than the primary market, that's my guess. That would again support secondary levels, but on the primary market side we will probably see new issue premiums remaining at the higher levels of recent weeks.

Silvio Bardeschi, pbb: We issued in May just after the ECB began scaling back and we could already see a bit of an impact from the lower order, and we did pay a higher new issue premium compared to our March benchmark issue. But then again, as has already been said, it's not really a negative impact; it's rather a positive impact that we have returned to a more traditional

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investor distribution, not having 30%-35% to central banks but maybe 10%-15%, with other investors like asset managers and insurance companies coming back.

Thomas Behme, Natixis Pfandbriefbank: We looked at the market at the same time, when the ECB announced that it would buy less, and the market was nervous and there were a lot of discussions as spreads widened. But in the end the widening from then to today is about 4bp in the German market so it's pretty limited. We were all aware that the buying programme is not the new normal, and that at the end we would return to a situation where the central bank is buying, let's say, 20% in a deal. We have been able to do transactions without central bank support, as have many others, so while it made life easier, we can live without central bank orders of 50%.

Rieper, DWS: The reduced orders of the ECB have also played a role in a normalisation of the difference between IPTs and the re-offer price, which is a welcome development. The distance between IPTs and the final spread reached a peak in October last year, which made us withdraw partially from the new issue market, but now that relationship has improved.

Pimper, Commerzbank: I agree. I also have the feeling that more and more investors are limiting their orders, telling issuers and syndicates where they see a fair price, which makes a lot of sense. And in recent weeks we have received better allocations, which is really good. We also didn't participate in those moves of 6bp-7bp from IPTs.

Day, The CBR: The approach taken on a Helaba deal in February was highlighted by an investor with similar views that I spoke with. Do you take into account such feedback? Or are you better at knowing where you should come?

Gipp, Helaba: Firstly, I as an issuer should know where the fair price for my benchmark issues is. From that point of view there is actually no real reason to play around with the initial price guidance. And secondly, syndicates should know where my price is, so why should I give them such leeway?

Having talked to several investors in recent months, especially right at the peak of this trend around the end of last year and early this year, many investors indicated that they were very upset by this kind of approach. So we said to ourselves: well, if we are convinced what the right and fair price for our new benchmark should be, why don't we go out with it from the very start? That's what we did with our first benchmark this year and investors liked that approach. We went out with a tight price guidance and indicated from the very beginning the maximum tightening potential of the transaction. That proved to be very successful – we priced the issue as tight as we initially intended and at the same time gave investors clear guidance from the beginning what pricing to expect. And that has always been our approach in the past, trying to be clear about what we intend to do and where we want to end up.

Pimper, Commerzbank: Again, clearly this is not a sign of weakness. It simply shows they know what they are talking about, whereas when you have IPTs starting at plus 10bp and then pricing at plus 4bp it seems like someone in the process doesn't have a clear view of where the market is.

Behme, Natixis Pfandbriefbank: Many parties are involved in the pricing process and investors can indeed play their part by starting with more limit orders. As an issuer, I'm a bit sceptical about a process where you start over-carefully at one level and then tighten it in. It would be good if the investor says clearly, OK, I'm going to buy this asset at this price, and then the price is set.

This is a cleaner and probably a more efficient process, and then we won't have these issues with prices being tightened in dramatically and investors having to think twice if they still be want to in the deal or not.

Bardeschi, pbb: We experienced the trend Olaf mentioned in our May benchmark, with investors increasingly setting limits and showing where their real interest is, at what spread and what size. So it's not so much about inflating the book and just getting the tightest price for the issuer anymore; you really get a good picture of where to price your bonds.

Gipp, Helaba: It's even going one step further: I hear that more and more investors are placing their order in a transaction only after all final parameters of the trade have been set – final deal size fixed and final pricing set. So these investors don't really participate during the bookbuilding phase, leaving the issuer somewhat in the dark during bookbuilding.

Day, The CBR: Where will spreads go over the rest of the year?

Miehs, Helaba: In terms of core markets, we won't see much more widening. We have seen a lot of issuance already and supply is going to decrease after the summer break, so I don't expect any further significant widening in core markets.

In terms of the periphery, it depends. We are not yet back at the levels of four years ago, so there is some room left if we just deduct the effect of the ECB purchase programme. On top of that, we see some critical events coming up in the periphery, and people are looking at these and differentiation based on credit and country risk is returning. Italy in particular is a country we are looking at very closely these days and if the spread widening is followed by downgrades of the country and bank ratings then we haven't seen the end of the spread widening there. This typically then spills over to other closely linked countries.

Rieper, DWS: We expect a moderate overall spread widening against swaps of around 15bp, mainly stemming from peripheral countries as well as the non-CBPP3-eligibles, and less so from the core and semi-core countries. We believe topics like the CBPP3 withdrawal from the market – primarily via the order books feeding through to the secondary market – will particularly harm markets that have profited the most from it, that's one reason. The other reason is that we believe that political uncertainties in peripheral countries, mainly regarding Italy, will persist. We can see quite nicely in recent spread developments that in contrast to BTPs, spreads of Italian covered bonds have not really recovered from their highs. We believe that, contrary to some opinions, the non-CBPP3-eligibles are also likely to suffer from the withdrawal of CBPP3, as they also benefited from the portfolio rebalancing effect, which was one of the ECB's objectives.

Pimper, Commerzbank: With spreads having been so rich, I guess many traditional investors were simply underweight the Pfandbrief, and with the spreads we are now seeing it makes sense to invest in the Pfandbrief market again. There is a lot of cash to invest in this market, it simply needed some room to breathe again as an investor.

Rieper, DWS: Especially against core government securities. Predominantly for buy and hold investors the higher spreads make the German Pfandbrief an alternative now, so we are making use of this relative value trade in our euro aggregate mandates.

“We are happy to see the sub-benchmark market developing pretty well’

Thomas Behme, Natixis Pfandbriefbank

Tolckmitt, vdp: That is good news, because when CBPP3 was announced there was a lot of talk about whether the departure of traditional investors from the covered bond market would be for good. We said and we hoped that it would not, that safety-oriented investors might come back once the spread distortion ended. And in spite of all the damage done by the ECB, the worst did not come to pass, and safety-oriented investors are indeed coming back, which is good for the product.

Rieper, DWS: I agree. The degree to which traditional investors who had maybe left the market or scaled back on Pfandbriefe or other covered bonds will return is also dependent on how spreads in other parts of the APP programmes develop, and hence how the relative value to corporates, sovereigns and SSAs, for example, evolves. This is also very important for us to consider.

Pimper, Commerzbank: It's also a pretty simple equation from a bank treasury point of view. We are swapping out the interest rate risk and if you have a Pfandbrief that is trading at minus 20bp and you add the six month Euribor of minus 27bp, you are left with minus 47bp, and the opportunity cost is minus 40bp as a deposit with the ECB. So it's pretty easy to come out with a spread level where it makes sense to invest again as a bank treasury — as long as you don't have a clear view that spreads are moving even further, to minus 30bp, which I doubt they will.

Behme, Natixis Pfandbriefbank: And there was so much pre-funding done in the first half of the year that there's only maybe EUR25bn to be issued in the second part of 2018. The ECB is still buying, the ECB will be buying in 2019 as well with its expected EUR2bn per month, and there is so much liquidity around that there's no need for spreads to widen dramatically, especially for the core market.

Day, The CBR: It has felt like there has been a lot of issuance, and from Germany in particular.

Miehs, Helaba: Of the EUR85bn total of euro benchmark covered bond issuance as per the end of last week (22 June), we have seen EUR15.6bn of benchmark Pfandbriefe so far this year, so quite a lot. We expected EUR18bn this year and almost all of that has been done, so yes, definitely, that was quite unexpected. But on the other hand, if you now look at the redemptions we saw in April, the ECB had about EUR25bn on top of the EUR30bn new purchase amount, which brought in a lot of demand as well. And given the expectation that the ECB will be exiting there has been much more interest from issuers in tapping the market. Even with the summer approaching countries that had been missing from supply this year like New Zealand appeared on screen, so everybody is coming, whether CBPP3 eligible or not. We have therefore seen a lot of issuance being frontloaded and many issuers are ahead of their plans.

Day, The CBR: Has there even been net growth in Pfandbriefe this year?

Tolckmitt, vdp: It's a little bit early to talk about net growth. Over the last nine to 10 years, it turned out to be wiser to look at the end of the year. So far we are in line with expectations, at EUR25bn, and the forecast for the year was around EUR50bn. If it turns out to be EUR50bn at year-end then it would represent net growth in Pfandbrief volumes again.

Day, The CBR: Martin, you've done two benchmark transactions already this year. Was the potential ECB departure a factor in that timing?

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Gipp, Helaba: No, not really. We determine our annual funding needs at the turn of the year.

As part of our overall funding needs, we budgeted to issue up to EUR5bn in covered bonds for this year. In order to cover that amount we have to rely on public markets for that size as the proportion of private placement funding available to banks has been steadily decreasing in the last years.

So for a total annual issuing volume of EUR5bn, it was clear that we needed to go to the public market sooner rather than later. In order to maintain our market-friendly approach and to avoid appearing in the market too often and potentially creating some fatigue for our name we tend to do large issue sizes in one go. That is also one of the reasons for us issuing dual-tranche deals regularly – with this format we can raise good size in the two maturities that we prefer while at the same time appearing just once in the market.

So our general funding strategy has not much to do with the ECB's involvement in the market. Of course we factor in the cost of issuing, but the individual spread movement is not that relevant in itself; it's more a matter of when we see the market is receptive, then we try to tap it.

Day, The CBR: Silvio, where are you in your plan for the year, and what was your thinking in how you were budgeting for the year?

Bardeschi, pbb: Our new issue plans are determined by the new business on the asset side. We've been to the market three times this year and haven't really taken the ECB into account – of course it's nice to have their order, but it's not really about the spread; it's more just a question of getting the funding done and whether the market is there for our name. We tend to do a smaller size because we like to have a more balanced asset-liability profile in our cover pool, so we are in the market with EUR500m rather than one or two EUR1bn benchmarks. For the remainder of the year we may be active again opportunistically, taking into account our spread expectations and maybe even looking at what the ECB is doing.

Behme, Natixis Pfandbriefbank: When you have got the flexibility on timing your issue and the biggest investor tells you that he is leaving the market, you don't wait until he is gone before issuing. We therefore said, OK, let's do our issue in the first part of the year, and we have done one sub-benchmark issue, this will be enough for the year. Our funding programme is small so we don't need a second sub-benchmark and the rest we may fill with private placements. We did a bit at the beginning of the year and we plan to do some more in the second half of the year.

Day, The CBR: Martin mentioned that there have not been such good opportunities in private placements in recent years – how are you finding that market?

Behme, Natixis Pfandbriefbank: There is the underlying trend that the private placement market is getting smaller and smaller. When we started our issuance in 2013 there was still the opportunity to do private placements and as we try to have duration matched-funding, private placements was for us the perfect instrument. We then started with the sub-benchmark issuance three years ago, so the 7private placement share is getting smaller, but the market is still there. You can't open the door and expect someone to come right in; you have to wait and be a bit flexible. But we still see that it as positive that we can get a little bit done in private placements,

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> Martin Gipp, Helaba

especially in the long maturities, around seven to 10 years.

We are happy to see the sub-benchmark market developing pretty well. We have seen about 20 issuers in the German market doing sub-benchmarks, and not just issuers that don't do the bigger size – 12 of them have done EUR500m issues, too.

Day, The CBR: Some of that is nonetheless coming from new issuers, like the Bausparkassen and PSD banks. Is that a welcome development?

Tolckmitt, vdp: It's an interesting and welcome development. It's a sign of the new normal in the Pfandbrief market. The main difference between Pfandbrief before the crisis and after the crisis is that now it's an established funding instrument for basically everyone that has enough material on the asset side to form a cover pool. Although there are some costs involved in acquiring a licence and then being supervised, depending on the business model already reasonably small amounts of assets can make sense to be funded by Pfandbriefe.

What is driving that interest? On the one hand, it's a kind of liquidity line in difficult times. Many of the savings banks and also PSD banks are doing it for regulatory reasons. Bausparkassen have a different reason, for them it's kind of a safety net for their Bausparkassen business model, so that they can issue and get long term liquidity from the Pfandbrief if they need it in times of rising interest rates. And at least some of those that have acquired Pfandbrief licences are not small or will not remain small in terms of Pfandbrief issuance.

It's an instrument that has not only in Germany but almost globally – and at least Europe-wide – developed into a strategic funding instrument for the whole banking industry, and that's a new role.

Day, The CBR: Do the investors here look at the smaller ones? And do you see it as positive that there are more issuers taking up the product?

Rieper, DWS: We certainly appreciate more and more issuers taking up the product. We follow such developments closely and hope that some of these banks can develop into benchmark-sized issuers, as we are primarily focused on euro benchmarks for liquidity considerations. In most of our mandates we are not really focused on private placements due to a lack of liquidity and ratings in addition to more difficult price discovery.

Pimper, Commerzbank: As a bank treasury we also participate only in the benchmark market and that is simply for regulatory reasons since any issue that is smaller than EUR250m is not LCR-eligible anymore and therefore doesn't count for our liquidity portfolio. However, we do participate in the ones that are EUR250m-EUR500m, although they come with a higher haircut, but usually also with a higher spread. However, we don't go for the very long maturities in the smaller ones as they tend to be more illiquid than the benchmark sizes.

Miehs, Helaba: The Pfandbrief is very much supported by local investors and being at Helaba with the savings banks as clients I know that a lot of local bank investors don't look abroad to other covered bonds, so these smaller issuers are very attractive as they still have credit lines available. It's therefore a good development for the local investor market.

Day, The CBR: Have there been opportunities in foreign currencies?

Bardeschi, pbb: We have business in the UK, in Scandinavia and the US, so we tend to look at these markets for currency-matched funding with sterling, Swedish kronor and US dollars.

We previously issued a US dollar three year Pfandbrief and in November last year did a sterling £450m three year Pfandbrief, too. We are generally active around once a year, but always keeping in mind the alternative of raising cheaper euro funding and swapping it back into the required currency. So it is a play between how tight euro funding spreads are and what we have to pay as an additional premium in the currency market.

Day, The CBR: Might the widening in euros increase the likelihood of there being more issuance in sterling, for example, which has been particularly active since last autumn?

Bardeschi, pbb: It could, if it weren't for the basis moving in the other direction. The sterling-euro basis and euro-dollar basis have moved in the opposite direction, countering the improvement in relative pricing.

Day, The CBR: Senior preferred issuance is now possible out of Germany. How will that affect your funding plans in respect of Pfandbriefe, if at all?

Gipp, Helaba: Yes, that is correct, after 21 July German banks will be able to issue plain vanilla bonds in senior preferred format. That will be the long-awaited liquidity management tool of choice for many banks. But the legal implementation of "senior preferred" will not affect our covered bond funding; the senior preferred product will be a substitute for senior funding going forward, where we will predominantly focus on this product.

Bardeschi, pbb: For pbb it will have no impact on the Pfandbrief funding. However, this new product will certainly draw the attention of some traditional covered bond or Pfandbrief investors because of its higher rating. But this will only be for a short period of time, until it has become an established product, and then we will have the three products: Pfandbriefe, senior preferred, senior non-preferred.

Day, The CBR: The Commission has finally announced what its covered bond harmonisation proposals. How good a job have they done?

Tolckmitt, vdp: We think that they have done a good job — and given that we have discussed this for five years, I think they ought to have been able to do so. But it is a good job in that — in our view, at least — it currently look like it is going to be high quality harmonisation. It is principles-based harmonisation that leaves room for national regulators and legislators to develop their own product, which I think is not only in the interest of the Pfandbrief issuers, with their trademark Pfandbrief, but also in the interest of investors who continue to have choice. Everybody knows that at the very beginning one alternative was the so-called 29th regime, or even full harmonisation, and everybody can be happy that those who were advocating this were not successful.

If you go into the details, everything that has been said about the key features of covered bonds in the draft Directive is good because it's high quality. The only thing we criticise is that the range of assets that might serve as underlying for the Directive covered bonds — the second tier covered bonds, I would call them — is too wide. We think that you need these products to be ring-fenced, too — the core products which are additionally regulated by 129 CRR are properly ring-fenced and we don't have any problem regarding them. It is important to restrict the use of second tier covered bonds, Directive-based covered bonds, to certain assets that merit being funded by covered bonds. It's not only because we are purists, but because as a regulator, as a politician,

“There does need to be room for innovation

Sabrina Miehs, Helaba

“We are very happy with the harmonization

Olaf Pimper, Commerzbank

and also as an issuer of these second tier covered bonds, you want to have a funding product that is perceived as safe by investors, and if you don't limit yourself to certain assets that merit this product, then you won't achieve this kind of safety perception that in the end leads to lower spreads and so on.

Miehs, Helaba: I'm quite hopeful that a lot of the problems that have been highlighted will in the end be cleared up. They are mostly rather technical points and it may be that the intention was the right one but that the wording didn't turn out appropriately, so I guess they will clarify these points so that we don't have different national interpretations.

I was a bit disappointed that they left away the different names. I was quite a fan of the suggestion to have Premium and Ordinary covered bonds because for some of the investors – probably not the very professional ones, but those that prefer to rely on standards – it would make it easier to distinguish between then those covered bonds that only satisfy the national law and those that additionally satisfy the CRR rules. Now you just have the EU Covered Bond and then have to a look a little more closely at which type of covered bond you have in front of you. But perhaps that's a minor point.

Ultimately the result is really good. Countries like Germany, France and the Netherlands have set the standard because they won't have to adjust very much – some things here and there, but not a lot. Others will have to adapt their national laws quite a lot – one of the most notable is Spain – but in the end that will help the market. The Directive will also help the young markets coming through and there will be more diversity, so that's quite helpful.

Tolckmitt, vdp: We are optimistic that our idea of two different product labels will finally be supported. We are working in that direction, because we also think that there needs to be a differentiation in order to make clear that you have core products and the second tier products. Maybe it's Premium and Ordinary, maybe not, but hopefully a distinction, at least.

It's also because the original aim of having harmonisation was to ring-fence the product to justify the preferential treatment. If you now create two products of different quality but don't ring-fence by name the core product, you risk a constant discussion about whether the preferential treatment is justified or should be changed, and that's exactly what we didn't want. One of the reasons we were so in favour of harmonisation was that it would end this discussion – which was only natural given the extent to which the product has been privileged.

Day, The CBR: The Commission talked from the beginning very much about their initiative working in favour of investors. What do you make of what they have come up with?

Rieper, DWS: We very much appreciate this harmonisation initiative as it raises the standards and also the comparability of covered bonds. There are a couple of things that need to be clarified such as with respect to the homogeneity of the pool, the eligible assets, and the third country regime where three years is quite a long time to wait for some clarification on that. But overall we very much appreciate the initiative. We do not think it will have immediate repercussions for spreads though.

Pimper, Commerzbank: We are also very happy with the harmonisation. As Mr Tolckmitt already pointed out, it still gives us as investors the opportunity to diversify. There is a level playing field where every country can start and then it's up to the different countries to make their product even safer. That is very good.

I'm also very happy with harmonisation because, although it took five years, it shows that there are fields where you get an agreement between European countries at the end, so from the political side this might be a good sign, too. Everybody seems to be happy with it and this is good news.

Day, The CBR: Do the issuers have any concerns, or are you as happy as everyone else?

Gipp, Helaba: No, as an issuer I don't have any concerns. We have no intention of issuing second tier covered bonds and we will stick to the traditional Pfandbrief issuance, as in the past. Generally it's very good that in the harmonisation the high standards of German Pfandbriefe have been mutually recognised.

Day, The CBR: In the past pbb representatives have been involved in ESN discussions, with respect to infrastructure, I believe. Is it still something that may be of interest?

Bardeschi, pbb: Maybe not really as a product to issue, but more on the intellectual side. All of us have read the EBA presentation where they have clearly given the guidance that ESNs should have SME loans as assets and not so much infrastructure. As we are not active in the SME space, infrastructure would have been the only angle where we could have had an interest in ESNs.

Day, The CBR: Are they perhaps wrong in their views?

Bardeschi, pbb: No, they are not wrong. They have some quite valid arguments for excluding infrastructure, like the lack of granularity and the very long maturities, which would lead assets-liability maturity mismatch problems.

> “We have seen a lot of issuance being frontloaded
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> Sabrina Miehs, Helaba

Day, The CBR: I guess at the vdp you must be quite happy that EBA has stressed that ESNs must be a completely different product and that the Commission is working on them in a distinct process?

Tolckmitt, vdp: Yes, we are, definitely.

But since you can include effectively everything in the Directive as it stands, maybe there would be room for ESNs in it, as this would be a further argument for narrowing down the definition of assets eligible for the second tier covered bonds. If that happens – and I think it should – we will be even happier. At the moment, we don't see any room for ESNs simply because the definition of assets in the Directive is so wide that you don't need any distinct rules for ESNs.

Personally, I think adding ESNs to the Directive is the only way they will be created. If they are not part of the Directive then – simply based on political experience – there is a high likelihood that ESNs will be dropped by the new Commission after the EU elections next year.

Day, The CBR: Is there not a danger trying to put ESNs in there would slow down the whole Directive getting finished?

Tolckmitt, vdp: Yes, and we have to bear that in mind, too. Despite all the optimism about Europeans being able to agree on something, if such questions are opened up again then they might disagree, and then the whole process might falter ahead of the elections, and we should avoid that. So one of the main things going forward – also with regard to working with the parliament – is to look at how the whole process works and how we can realistically get an outcome – provided it is high quality – at the end. But there is a certain willingness among the EU institutions and many countries, and also Richard Kemmish, to propose an inclusion of ESNs in the Directive. Some countries oppose it rather strongly, and we are working with them to be open to the idea.

Coming back to the discussion we had before, a question I have is whether there is a place in the funding universe of banks for second tier covered bonds and more importantly ESNs given that you now not only have Pfandbriefe and senior, but you have Pfandbriefe, second tier covered bonds, senior preferred and senior non-preferred. I'm not so sure they have a place in the funding mix because you have additional costs and maybe the spread differential is not that big.

Pimper, Commerzbank: As a bank treasury investor, the most important thing would be to have regulatory preferential treatment – not the same as for covered bonds, of course, but more or less in line. Even more important for bank treasuries would be LCR eligibility. But it doesn't look like ESNs will be LCR-eligible as they don't have any history, so in order to buy

them I would have to compare them not with covered bonds, but with senior preferred – another new asset class. My guess would be that an issuer using ESNs would like to issue them at a lower spread than senior preferred, but as a buyer I would rather go of course for the higher spread. So in order to be successful, they need to be in the same LCR category as covered bonds or at least LCR eligible – if they are coming with a higher haircut, that doesn't matter. Otherwise I doubt they will be competitive versus senior preferred.

Rieper, DWS: We would certainly look at that product. However, we have to wait until the final specifications are out and until there is a curve and a certain liquidity in the market. It remains to be seen how liquid that market can be and how diverse in terms of countries.

Day, The CBR: I suppose that for somewhere like Italy the whole spread universe is much less compressed, so there's maybe going to be more of an advantage in coming with a collateralised product. There may be investors who might not want exposure to a second tier Italian bank in any unsecured format but might look at something like a SME-backed covered bond from them.

Pimper, Commerzbank: I agree, but then you are not talking about a broad market, but niche markets.

Miehs, Helaba: And I doubt if that product is very attractive for Italian banks at the moment; they have a lot of other things to look at. Setting up this product would involve a lot of work and going through the whole rating process. Right now they are more focussed on getting rid of NPL portfolios and so on.

Day, The CBR: Green covered bond issuance has achieved new momentum this year. Are green bonds something you expect to be involved in?

Behme, Natixis Pfandbriefbank: We believe that green bonds and ESG bonds is not just a trend that will vanish. We believe it is really becoming a core part of the financial market. Especially in France, the awareness about green finance is very high. Natixis is pushing hard in this area with the creation of a dedicated team within the CIB (the Green & Sustainable Hub) and a great number of transactions arranged as well as own issuances – the group issued its first green bond in 2015, Natixis in the USA did the first ever green CMBS, and Natixis in Paris has a green note framework in place. We at Natixis Pfandbriefbank are looking at the subject as well.

Gipp, Helaba: I'm with you – the green trend will probably persist and I also believe that the sustainability of the institution will be of much greater importance in the future, even more than the green bond issued by the individual institution. So once we have regulation for green bonds/green finance in place and business models have been adapted accordingly, we might even see the green bond recede again. In the future investors might not decide on the basis of the format of the bond anymore, but on the basis of the sustainability of the issuer.

But until then the green bond is a very valid product. For us, though, it is not a product in Pfandbrief format – the Pfandbrief in itself is already a golden product, with its triple-A rating and broad investor base. We see more value for green bonds in the senior unsecured space, where you can diversify your investor base much more. Funding cost savings so far are not achievable by issuing green bonds, but if they will be achievable any time in the future, that will be probably more in the senior space given how tight covered bonds already trade.

For now we are still some steps away from actually issuing something in green bond format, but we are carefully looking into it internally and monitoring market developments. Our internal process is driven by our bank-wide sustainability efforts, which in the end could lead to a green bond issue.

Bardeschi, pbb: We also have a more holistic approach to green, meaning that we are not looking at separate green products but at the whole company. We already have imug and oekom ratings and a Cicero opinion all in place. We will not be issuing in the near future, but we definitely don't see the green market as merely a trend, we see it as an established market, and at some point we are probably going to be active in it.

Tolckmitt, vdp: We have been supporting initiatives on an institution by institution basis, and are now working closely with the EU Commission on its sustainable finance action plan. There are two things worth highlighting in that respect.

One is that, yes, politics can offer some kind of standardisation and it may be helpful for the market to have some direction on what is considered green or sustainable. The problem is that the initial draft regulations are quite detailed and as always with these things there is a certain danger that all the efforts that have already been taken by the industry are not acknowledged properly. Industry needs to be vocal in pointing out that it has already done something – which has to a large extent been investor-driven – that should be looked at. As I always say, you don't need someone in Brussels telling you what you already know, and maybe better.

The second thing is that the Commission is bringing the financial industry under such regulation because it understands that it cannot reach the every part of the real economy by itself, but can do so by defining rules for how the financial industry grants loans. At a certain point this will involve incentivising green loans, but this should only be done on a well-founded basis, with good arguments why preferential treatment is granted to certain types of activity, and not indiscriminately showered over the market.

> “Sustainability of the institution will be of much greater importance
>
> Martin Gipp, Helaba

Those are the two points that we would look for and the EMF-ECBC is working in the same direction, particularly for arguments to really justify preferential treatment for green or sustainable finance.

Miehs, Helaba: I agree. One the one hand, having a taxonomy and standards is important for gaining investors' trust and hence not the wrong place to start. From my discussions with investors it seems there is a lot of uncertainty in this field. But there does need to be room for innovation. It will be interesting to see how the regulators find the balance between standards and having a flexible framework that leaves room for progress.

Rieper, DWS: We witness increasing ESG awareness generally from our customer base, and DWS itself is committed to considering ESG aspects within the investment process. Within the covered bond space we have seen an increasing number of issuers – there are 10 right now – and we welcome that. Unfortunately, the overall size, is relatively small, not only within the green bond space in general but also within the covered bond universe. But with increasing issuance and increasing ESG and green awareness, there will be more specialised funds focusing on that. This increasing awareness will also lead traditional funds with no explicit focus on ESG, investing in those kinds of bonds, too, maybe even with a certain overweight.

With respect to the deals, the structures are pretty different in terms of focus – be it energy efficiency or social, or a mix of the two – and also in terms of standards, for example, which energy efficiency certificates are used, and there we probably need a bit more standardisation. But overall we very much welcome that development.

Pimper, Commerzbank: I would take an even broader view. Hopefully green funding is going to stay simply because "green" is good, as we have to do something about climate change. My hope would be that green funding will become the new normal, with everybody investing in green houses and green factories, and using the green funding tool, and that ultimately issuers can thus fund themselves a little bit cheaper – and that today's "normal" bonds come with a handicap rather than the green bonds with a bonus. This is how I hope to see the market developing – but that is going to take a long time, of course.

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