The Covered Bond Report

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September 2020

vdp The German Pfandbrief Banks

The Pfandbrief Roundtable 2020

Although TLTROs have muted benchmark issuance this year, the German Pfandbrief has shown its mettle amid the Covid-19 crisis, according to participants in our annual roundtable — held in association with the vdp in July — with the credit outlook, the product's role in the recovery, and green and social issuance high on the agenda.

Neil Day, The Covered Bond Report: How has the Pfandbrief market and the wider covered bond market been affected by the crisis?

Sascha Kullig, Association of German Pfandbrief Banks (vdp): The vdp member banks were quite active at the beginning of the year. We saw several benchmarks in January and February, the last one at the beginning of March, and then we had a very long break. We didn't see any benchmarks in March, April and May, at least not from Germany. But starting in June, we had four public benchmarks, totalling €3bn, including two mortgage jumbos, a green Pfandbrief and a public Pfandbrief benchmark. So we are back on track, I would say.

Although we had this break, this doesn't mean banks weren't issuing; to the contrary, banks were very active in issuing Pfandbriefe, but most of them were retained Pfandbriefe. Between March and June, we saw more than €30bn in Pfandbriefe and €24bn-€25bn of these were retained Pfandbriefe. So, the picture is quite clear: banks issued Pfandbriefe for own-use purposes, placing them with the Bundesbank, and one reason for that may have been that they didn't want to initiate a repricing of the secondary market but instead take advantage of favourable TLTRO conditions.

As a result, we already had an issuance volume of more than €45bn for the first half of the year. Our member banks had anticipated aggregate issuance volume for the whole year of €47bn, so we almost reached the prediction for the entire year in H1 already. But, as I've said, a huge amount was placed at the Bundesbank and only about one-third of this was used for benchmarks and was allocated to the market.

Day, The CBR: That's a helpful overview of issuance before and during the crisis. The Pfandbrief and covered bonds in general are marketed to people as something that helps you sleep securely at night, a resilient product that investors can rely on. Mehdi, did the asset class perform in line with your hopes and expectations through the peak of the crisis?

Mehdi Abdi, Actiam: We invest in sovereigns, corporates and also covered bonds, and covered bonds were indeed one of the spaces where we could sleep well. In such a crisis you would expect a degree of widening, and looking at the overall covered bond market it widened from close to flat to swaps to 10bp over on average. But in spite of this widening, it was nothing compared to what we saw in credit, where some names really were a disaster. So the covered bond market was, as expected, relatively reliable amid the turmoil.

And even though yields on covered bonds are at all-time lows, if you compare them with the sovereign, they still are attractive. The German Pfandbrief still offers a 30bp pick-up versus Bunds in the same duration, for example.

But the big problem was that there was no liquidity at all. This was unexpected, because I started my career in 2007 and until this crisis I had never had a problem with liquidity in covered bonds. Even in the Pfandbrief market, which is one of the safest assets within the covered bond space, we couldn't find any liquidity — nobody wanted to show

Roundtable participants:

Mehdi Abdi, head of fixed income, Actiam

Karlo Fuchs, head of covered bonds, Scope Ratings

Alexander Kirsch, director – treasury, funding and debt investor relations, Aareal Bank

Sascha Kullig, member of the management board, head of capital markets and investor relations, Association of German Pfandbrief Banks (vdp)

Holger Oberfrank, co-head of treasury, UniCredit Bank AG

Anna Stawowy, funding and investor relations, Deutsche Kreditbank

Patrick Steeg, head of asset and liability management, LBBW

Neil Day, managing editor, The Covered Bond Report, and moderator

us a bid on any names. We wanted to make some changes to our allocations, but after two or three weeks of trying, we couldn't shift anything at all. That was a bit shocking given that this is a triple-A asset class. It was not normal circumstances, of course, and we had to adapt to the situation, and thankfully after the crisis peaked we saw liquidity improving into June, alongside the pick-up in supply.

Day, The CBR: Some of you have been involved in the Pfandbrief market since the last crisis. What do you make of the way that the Pfandbrief performed this time around in terms of some of the points that Mehdi mentioned?

Patrick Steeg, LBBW: It is indeed another crisis, but I don't think it's comparable with the crisis back in 2008. This one hit suddenly, but lessons had been learned, and monetary and fiscal politics measures were implemented very quickly around the globe — the Fed cut rates by 100bp and a lot of measures were taken by central banks to support the market.

And unlike the previous crisis, it's not in the first instance a banking crisis; it's rather a crisis that went directly to the real economy and only as a second round effect potentially to banks. So that's a completely different starting point.

It has similarities in terms of spread reactions. We, of course, look at instruments across the bank capital structure, and Pfandbriefe and covered bonds did not react as sharply as others.

There has still been liquidity in the market, but there have been phases where the street is one-sided, only sellers or only buyers — although this time around central bank purchase programmes have been able to mitigate risk a little. Screen prices were more or less theoretical. One factor that put pressure on spreads was the high new issue premiums that were paid on those deals that did hit the market, initially from the Canadians, as these pushed secondary markets wider and wider, and that spilled over into other jurisdictions. In this respect, Pfandbrief performed relatively well through the crisis, and NIPs went down very quickly, almost to zero.

At LBBW, as an issuer we look at the market strategically, and when there's a window that makes sense, we are happy to tap to market. This was the case after we saw the encouraging development in spreads and new issue premiums decreasing, with the covered bond purchase programme and overall central bank measures helping the market, such that we did not expect Pfandbriefe to

Holger Oberfrank, UniCredit: 'The TLTRO was a big game-changer, for us, too'

widen even if there was another shock. At the same time, German Bundesländer spreads had widened and presented something of a floor for Pfandbriefe. So we felt that it was an appropriate time to launch a new transaction.

The Pfandbrief is an ideal instrument to navigate through any crisis. It has a natural investor base and additionally, of course, a central bank bid. It's an ideal instrument for raising liquidity and more importantly liquidity that goes beyond the three year tenor offered by TLTRO III. Pfandbriefe play a very important role in raising strategic liquidity for LBBW.

Day, The CBR: It is quite some time since Aareal launched a benchmark Pfandbrief — did the crisis affect your funding plans for the year?

Alexander Kirsch, Aareal Bank: Looking at the secondary performance of our outstanding euro benchmarks, we saw an increase of around 15bp from a sub-Libor level in February until the peak towards the end of March, beginning of April. This led to several discussions, because in our initial plans we wanted to issue in March, but the new issue concessions that several investment banks expected us to pay were between 10bp and 20bp. We also discussed senior unsecured, and saw several issuances, also from non-European banks, with spreads as high as 400bp for senior non-preferred. Banks indicated spreads in the low to mid-triple-digit figures for Aareal, with a gap of 100bp between the levels they were suggesting.

For me, this reflects the stability of the Pfandbrief as a funding source even in difficult times. Had we issued a Pfandbrief, we would have had to pay maximum 30bp-40bp more, whereas in the senior unsecured space investors were demanding pick-ups of 100bp-200bp compared to pre-crisis levels because of the uncertainty — that's a huge difference and highlights the importance of the Pfandbrief product.

Concerning Aareal's funding plans, we were in the fortunate position that at end of last year we reduced our risk assets by nearly €1bn. We therefore entered this crisis with a huge liquidity surplus and were very relaxed and could easily dispense with our initial plan to issue a benchmark Pfandbrief. Looking at the market development to date, it was a good idea to wait and see, because spreads are much lower than they were at their peak.

'We participated in a TLTRO for the first time'

We had to recalculate our whole business expectations for the year, both for the asset side and for the liability side. One result was that we decided not to call our outstanding AT1 and hence not to issue a new one. We also revised our planned loan generation.

And finally, there was the news of the TLTRO III with quite cheap prices, and we participated in a TLTRO for the first time. This led to a complete revision of our funding plan for the year. We expect to reduce our funding activities dramatically compared to the beginning of the year, especially regarding Pfandbrief issuance, because the TLTRO is an instrument even Pfandbriefe can't compete with.

Day, The CBR: Have DKB's funding plans for the year also changed in light of the crisis?

Anna Stawowy, Deutsche Kreditbank: Yes, indeed. As has already been mentioned, in the face of the corona-crisis, instruments like the TLTRO have provided financial institutions with a historic opportunity to refinance themselves at low cost. This also directly influences issuance behaviour, because issuers have to consider their capital markets activities carefully, and at DKB we have unfortunately had to suspend our issuance plans. We have a golden rule to come to market with at least one benchmark transaction a year, potentially in green or social format, and we have done so for the past four years, issuing our first green bond in 2016 and since then having issued two green and two social bonds. However, unfortunately, we have not been able to do so thus far this year. We will nevertheless monitor the development of interest rates and spreads over the second half of the year, and potentially look at longer tenors, which could be more attractive than short term maturities, for issuing a benchmark before year-end.

Although we are currently not in a position to issue, DKB already had a quite comfortable liquidity situation before the TLTRO, as we are nearly 70% funded by deposits, and now we are even more comfortable. This is an important point to note, that issuers' specific funding sources — if they are wholesale or retail-funded — make a big difference to how their funding plans will develop in light of the corona-crisis.

Day, The CBR: UniCredit came to the market after LBBW, with a longer maturity — how did this fit in with your developing funding strategy?

Holger Oberfrank, UniCredit Bank AG: The TLTRO was a big game-changer, for us, too. Sascha mentioned the increase in self-retained covered bonds — we are part of this game, because in order to prepare ourselves for the crisis, we participated quite heavily in the TLTRO.

At the same time, we were closely observing the market, and as has already been noted, Pfandbrief spreads were

rather stable. I recall that at one point in March, for example, after Bavaria announced a big issuance programme, Pfandbrief spreads were somewhat tighter in the secondary market than Länder paper, reflecting the lower liquidity and very stable investor base. But if we had gone to market with a new Pfandbrief in March, April or May, the new issue premium that would have been necessary would probably have had a disruptive impact on secondary levels.

As soon as we saw that market spreads on covered bonds and Pfandbriefe in particular were more or less back to pre-corona levels, we decided to go for the 10 year transaction. Otherwise you end up with a very, very big cliff three years down the line. So we want to already diversify our funding sources, and having 10 year funding at pre-corona levels was quite attractive.

Clearly, having taken the TLTRO money and the liquidity from the ECB, our funding plans are somewhat less aggressive for the second half, so we will probably go to the market a bit more selectively. However, those self-retained covered bonds that have been pledged to the Bundesbank for the TLTRO will successively be replaced by new loans that are being granted, and therefore the cover pool will become available as time goes by, so we anticipate that we will be regularly on the market again.

Day, The CBR: Karlo, how do you view the high volume of retained issuance?

Karlo Fuchs, Scope Ratings: It came as something of a surprise to me that — as Sascha's comments reflect— the Germans are number one in retained issuances this year. Clearly, this shows that there is no stigma to ECB funding. It is positive — the Germans are just doing what the Italians, the Spanish and everyone else has already done, namely printing retained covered bonds. It's the easiest collateral you can generate. It's the most competitive funding that you can get from the ECB, so why not take it?

At the same time, we're always looking at credit quality and we fear that too much retained issuance makes it difficult for other investors. Some regulators already have voiced that it might be more beneficial to use a different covered bond programme for retained issuance.

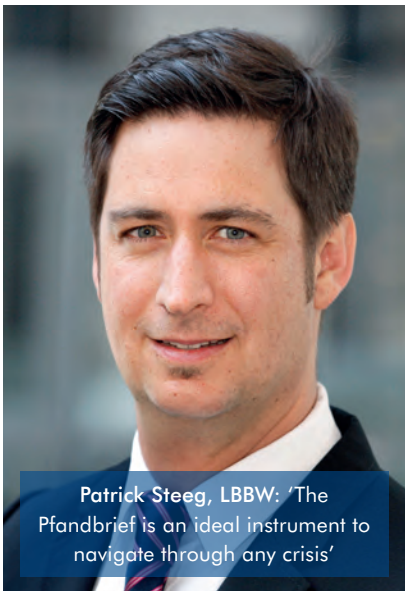
Ultimately, the ECB is a very passive investor when it comes to making decisions — that's what we saw in the GFC. They were sitting on positions they needed to work out and it took them quite a while to find a way how to agree to make changes. That's one of the dangers of retained issuance. Too much ECB participation can be to the detriment of other investors and slow down processes. As a rating agency, we're looking at investors' interests, so what does retained issuance mean? Typically, it's floating, it's short dated, and everything that reduces the haircut. To a certain extent, it puts investors at risk of time subordination. That's why we don't like to see too high a share of retained issuance out there.

But there are two sides to the coin when it comes to ECB involvement. Purchase programmes and the impact on covered bond spreads is beneficial for the banks. Public issuance allows banks to take care of regulatory considerations, like NSFR, by issuing in maturities beyond the TLTROs.

'The ECB measures have to be seen from two sides'

But the low spreads we are seeing really wean investors off taking a credit view. Having covered bonds seen as a rates product again is something that makes me uneasy, because in the end, we are sitting in front of a wave of challenges. Even though the expectation is that Covid won't really turn into a widespread credit crisis, we're going to see some shake-outs. That means that we are also going to see spread widening. If you have bought the covered bonds at current spreads, you're inevitably going to lose out in the end.

That's why the current ECB measures really have to be seen from two sides.



Patrick Steeg, LBBW: 'The Pfandbrief is an ideal instrument to navigate through any crisis'

For now, they are very beneficial, and if you didn't take advantage of them as a bank, you would be stupid. But when it comes to the other side, the long term impact of crowding out investors and investors sitting on mispriced investments, the jury's still out.

Day, The CBR: Mehdi, what are your views on the pros and cons of the ECB measures, and the way they've affected covered bonds?

Abdi, Actiam: Because of the Covid-19 crisis and to calm markets down, the ECB came up with its new Pandemic Emergency Purchase Programme, which is of course really big. And looking at the size of covered bonds within this, it has been approximately 10%. The announcement of PEPP supported the market, not only covered bonds, but all fixed income, and actually all markets, including equities. So the main pro of the overall programme was that spreads tightened again and there was again a lot of demand for covered bonds, and if you are long covered bonds in such a situation, you profit from that.

But looking ahead, the problem I foresee is reduced liquidity in covered bonds. When there is new supply in the market, the ECB participates in it. And as of half year, we are almost 30% down on 2019 covered bond issuance volumes, which means there is already reduced supply because of the Covid

pandemic. There will still be more supply going forward, but it will not meet the expectations there were at the beginning of the year. The ECB's presence in the primary market will therefore contribute to decreased liquidity in covered bonds.

And although I'm positive on covered bonds for this year, as Karlo mentioned, there will come a moment when we see spreads widening, also in the covered bond market, given the outlook for the economies and companies in the West. Everything is driven by the central banks, but if they stop their programmes, that could hit a lot of markets, including the covered bond market.

Day, The CBR: Sascha, can you give some colour on what Pfandbrief supply we can expect for the rest of the year?

Kullig, vdp: As I mentioned earlier, we have already seen issuance of roughly €46bn in H1 this year, and this is almost exactly the amount that our member banks had expected to be issuing for the whole year. It is quite clear to me that we cannot expect another €40bn of issuance for the rest of the year. I could imagine that quite a few Pfandbrief banks won't be very active for the rest of the year, but we already heard today that some of them are still considering entering the market. But certainly the activity in the benchmark segment will probably remain a little bit muted compared with other years.

Day, The CBR: As has been mentioned, this isn't a crisis caused by the banks, but a real economy crisis. How might that be affecting the collateral side of covered bonds?

Kirsch, Aareal: In our overall asset book including the cover pool, the effects on cashflows are rather low. Regarding the cover pool, I'm not aware of even one single payment not being made or loan restructured. Indeed, I've been impressed by just how few discussions we have had with clients about restructuring loans. We finance hotels and retail, and some of it was

Alexander Kirsch, Aareal: 'I'm not aware of even one single payment not being made or loan restructured'

closed during the crisis, and it's quite positive to see that the impact on the cashflow side has been almost negligible.

We assume a continuous normalisation of the global economy from mid-2020 onwards followed by a significant recovery in 2021-2022. So, from a medium term perspective there should not be a huge negative impact on valuations.

'There will come a moment when spreads widen'

Looking at our figures to the end of March we published an average LTV in our asset pool for our mortgage Pfandbrief of 33.5%. So, from my perspective, there would be lot of leeway for negative impact on prices before this would cause any major impact on the real asset quality for investors in Pfandbriefe.

Oberfrank, UniCredit: Like Aareal, the effect so far on the cover pool in terms of payment moratoriums is close to zero, absolutely negligible. Three-quarters of our cover pool is comprised of residential mortgages and most of that is located in the south of Germany, and still there are a lot of people who want to come to this region — even if the crisis has hit us and we are spending time working from home, I have no expectation that prices in Munich and the surrounding areas will decrease. If anything, I expect this to continue and the outstanding business case to be alive and kicking.

Fuchs, Scope: There are two stories on the mortgage side.

Do I have worries about anything backed by residential collateral? No, none whatsoever. As long as we have the lower-for-longer interest rate environment and still the pent-up demand for additional dwellings, nothing very significant is going to happen on the residential side. As we have seen in other parts of Europe, residential prices in Germany barely budged and simply continued on their trajectory. Basically, the only blip has been that turnover has thinned, because — as mentioned before — people were not able to register or visit properties. Those operational challenges are over and that's why it's likely we are going to see a continuation of the upward trend in residential house prices.

Where everybody is getting a bit worried is the extent to which the crisis is becoming a wake-up call for offices, because, surprisingly, working from home worked extremely well for most. For those who always thought, you need X amount of office space, because you need to make sure that everybody can be in the office at the same time, this thinking will clearly change. Behaviour will change and over time this will have an impact on demand. This is more of a longer term trend and there will be pockets of risks out there in different sectors.

It's positive to hear from Aareal that on the leisure side, on hotels, there hasn't been a lot of bad news. But let's face it, although we are through the first wave of Covid, it's not yet clear if and when any vaccine will arrive. Until then we are always at risk of another wave coming, with further lockdowns. While you might have had a functioning airbag in the beginning, whether it can be reused remains to be seen.

Having said that, am I worried about commercial real estate in Germany? I need only say 35 letters: Beleihungswertermittlungsverordnung (regulation on the determination of mortgage

lending values). That gives you a lot of security, since market prices can fluctuate greatly before impacting the full recovery of a defaulted loan.

That's also why, as a credit analyst, the first layer of risk I look at is who is running the cover pool. And that's why you have to see to what extent the current crisis will impact the banks originating the mortgages, maintaining them, and of course issuing the covered bonds.

The jury is still out on whether the current interest rate environment is a make or break one. Just as in the retail sector, banks have a lot of bricks and mortar, and these branches are now potentially redundant. People have seen they can do business remotely. Profitability of banks will be impacted and those that don't react will see their costs escalating. In the current rates environment, there's not much profit to be made in mismatching deposits with long term loans, so a lot of business models will be put to the test.

That's why the first risk will come from the bank side, from how they manage their business models, but also from the knock-on effects if and when the impact of the support measures, such as the moratoria, run out. Only then are you going to see whether today's precautionary IFRS 9 provisions were sufficient or not. That's where asset quality issues will kick in, with bank ratings being impacted. This is also when the need for the cover pool, a.k.a. your airbag, is going to rise again. Of course, that's what we need to look into already today.

Day, The CBR: Turning to the recovery we will hopefully see, various market participants have suggested Pfandbrief and other covered bonds could have a significant role to play, citing, for example, the increase in Pfandbrief issuance post-unification, and a future role for European Secured Notes (ESNs) in helping fund SMEs. What do you make of this?

Kullig, vdp: We have already heard from Patrick that the Pfandbrief is an ideal instrument to navigate through the crisis, and indeed, the Pfandbrief is and will remain one of the pillars of funding for the recovery once the economy picks up.

But whether or not the public sector Pfandbrief could play a more important role is a very difficult question and I'm not that sure about that. Certainly, there is a huge increase in public deficits at the federal and at the regional or local level, so there are definitely greater funding needs on the public sector side. However, it very much depends on whether local and regional authorities tap capital market directly or borrow from banks very much like the traditional business banks have done so far with local authorities in particular. If they increase their loans from banks, then certainly the public Pfandbrief could expect a revival. However, it is unclear to what extent this will happen, so I do not expect a huge amount of newly modelled Covid-19 Pfandbriefe like in other countries. The eligibility criteria for German public Pfandbriefe are also quite strict, as you need to have irrevocable and unconditional claims against public authorities. So, it's not that easy to construct or invent any new models and to use them for cover assets.

'A lot of business models will be put to the test'

Regarding European Secured Notes, to be honest, interest in ESNs in Germany has so far been quite subdued. There was some interest in infrastructure. There was very little interest regarding SME funding. In any case, it would take time to build up a new product like ESNs, so I do not see just how they could support the recovery from this crisis in Europe — unless it carries on for several years. In the short term, I do not expect that ESNs would be of any help. That doesn't mean that we do not support such ideas. There might be a time in the future when ESNs could become interesting for German banks, too, but we already heard today that German banks do not face any liquidity problems. And neither do SMEs in Germany face any liquidity shortage, as far as I'm aware, so there's not such a big need for that instrument.

Sascha Kullig, vdp: 'It would take time to build up a new product like ESNs'

Oberfrank, UniCredit: From the UniCredit side, perhaps I can give a bit more colour from different jurisdictions, such as Italy.

This ESN product would be an asset class that has to somehow nudge in between the classical Pfandbrief covered bond and senior preferred, and pre-Corona this was a very tight spot, I would say — there was not much of a spread differential there. But if elevated spreads were to persist for a long time and we saw a stable spread differential between covered bonds and senior preferred, there might be the chance for the ESN to establish itself somewhere in between. From my point of view, it's simple economic arithmetic: if you anticipate as an issuer that you can save a bit of money vis-à-vis say the senior preferred alternative, then this might become attractive in relation to SME corporate loans and so on. And you might even put a social label on it, so a Covid-19 ESN might be something worth discussing. But in the end, since we are now back to the pre-Corona levels in terms of spread, I would also support Sascha's idea that at least from a German point of view, it's not super attractive at the moment.

Anna Stawowy, DKB: 'In the face of the pandemic, social bonds have gained in importance'

Day, The CBR: The crisis has put a lot of focus on the social side of things and we've seen the Covid-19-related social bonds being issued. There is also a lot of talk about a "green recovery", a "green deal" and the like. How do you see green and social bond issuance developing?

Stawowy, DKB: Perhaps I can start with our plans. We have just updated our social and green programmes, so in that respect are capable of issuing in both formats — although, as I mentioned, the current conditions have slowed our funding activities.

On the green bond side, the financed projects are aligned with the new EU Taxonomy, according to ISS-ESG, our second party opinion provider, who conducted an updated review of them. The technical criteria of the taxonomy are quite challenging, alongside the implementation of minimum social safeguards and the "do no significant harm" criterion. ISS-ESG also confirmed that our updated framework is aligned with the current draft of the EU Green Bond Standard. We are one of the first issuers to do this, which is quite a good signal to the market and the direction we should be taking. I should, however, note that when we issue green bonds, this is to refinance our wind and solar projects, which is outside the defined Pfandbrief universe.

The situation is very different on the social bond side, where DKB has shown that there is value in combining the covered bond and social bond formats. This is particularly relevant in relation to the previous question, about the role of covered bonds in the response to the crisis. In the face of the pandemic, social bonds have gained in importance, with several having been issued as a response to the Covid-19 crisis, and we hope that this will be a catalyst for social bonds in the coming months and years.

When it comes to market initiatives, it's quite important for us to further develop the Green and Social Bond Principles (SBPs), and also sustainability-linked bonds, which have become more prominent with their own working group in the SBPs. We are active in this respect as a member of the social bonds working group and as the only German financial institution on the advisory council. The EU Taxonomy acts as a roadmap on the green side, and this should and could be developed also on social bond side. What should also be helpful is the definition of a catalogue of criteria for green and social Pfandbriefe, which we have worked on together with the vdp.

Overall, we have seen positive developments in these markets and I hope we remain on track, so that both green and social bonds rise in volume and frequency of issuance.

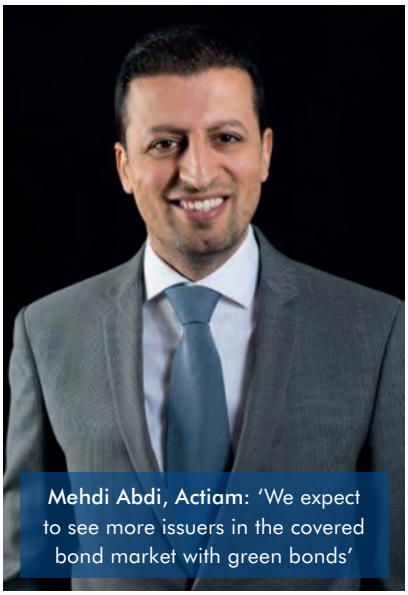
Abdi, Actiam: I'm encouraged to hear that. We at Actiam consider ourselves to be a responsible investor and as such we and our clients have a strong interest in social and green bonds. We have our own scoring methodology, which is important for portfolio managers, where green and social bonds get a higher score than non-green. There is no difference for us between social and green.

We are really happy to have seen a lot of growth in green, social and sustainable covered bonds. But there is a great need for more issuance and issuers, because if you compare non-green volumes with the green, there is still a big difference between them and the green portion is still a small portion of the total covered bond market. At the moment we have close to 30 issuers. If you look at the first half of 2020, we have seen several issuers in the covered bond market: BPCE came with a green covered bond, Korea Housing Finance came with a social, we have seen the Norwegian bank Sparebanken Vest Boligkreditt — Norway constitutes close to 20% of the ESG benchmark. We get the sense that some issuers maybe didn't come with deals because of Covid-19, but we expect to see more issuers in the covered bond market with green bonds in the next six month. So we do expect growth, but we hope that it will come faster and with new issuers entering the market.

We are encouraged by the European Green Deal initiative and the comments Christine Lagarde has been making, and what should really help is legislation that would push more issuers to come to the market. The number of participants from the investor side is also increasing, so there is a lot of demand for these green bonds, and if you look at how they are placed, they are often several times oversubscribed, so from an issuer's perspective it should be interesting to issue a green bond.

Kullig, vdp: We're at an extremely important juncture, because the Taxonomy and the Green Bond Standard could give the market a real boost, but they could also become a major problem, at least when it comes to the building sector and the issuance of green bonds and green covered bonds secured by mortgage loans. The problem is not so much the Green Bond Standard — I think most issuers are ready to comply with it. The problem lies in the Taxonomy, the technical screening criteria and the "do no significant harm" criteria. They have to be feasible, and feasible not only for developers or investors, but especially for banks. We have some doubts about some of the requirements of the technical screening criteria and if these are not changed, we could end up in a situation where hardly any issuers are able to issue green covered bonds that comply with the Green Bond Standard. This is a real danger. Therefore, we asked the Commission to change some of the requirements, otherwise they could become a problem.

Steeg, LBBW: We are contributing to the various dialogues with the relevant pro-



Mehdi Abdi, Actiam: 'We expect to see more issuers in the covered bond market with green bonds'

tagonists as the green and social bond market continues to develop. We are completely convinced that green bonds can contribute to mitigating climate change, and potentially social or Covid-19-related bonds could also contribute to the fight against the current crisis — but it's fair to say that the social bond market is very young and therefore the impact at the moment is not so high.

Sustainability has already played an absolutely crucial role at LBBW for decades, and we are completely committed to originating green and social assets and refinancing these via green and social bonds. We have been active in covered bond and senior non-preferred formats in various currencies — such as euros, dollars and sterling — and we plan to maintain our issuance in those, and you can expect a variety of further transactions from us.

Fuchs, Scope: When I observe this whole debate around ESG covered bonds, it reminds me of when the discussions around harmonisation began at the ECBC some 10 years ago. We began work without a common definition of a covered bond and only arrived at a satisfactory outcome after several years. As Sascha rightly pointed out, there are pros and cons to the Taxonomy, just as there were to harmonisation.

Take energy efficiency, for example. It's a common theme across Europe, but the definition in Germany, for example, is different from the definition in Italy. Clearly we need a common denominator.

Also, availability differs. Norway is quite advanced thanks to the digitalisation of the valuation process. To assess greenness, all they have to do is ask the valuation vendors to add a field to the information they provide, namely the energy certificate.

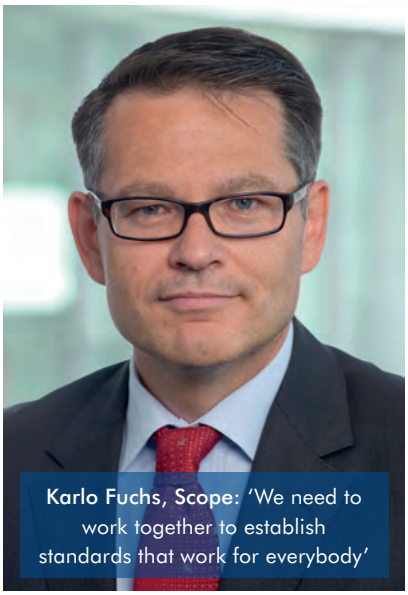
We are not yet there in most of Europe when it comes to the digitalisation and sharing of the relevant energy efficiency information. There's quite some way to go, also here in Germany. If a landlord rents out properties, energy certificates are required. They are not available to the financing banks, or, if so, are not appropriately recorded in banks' databases.

The ECBC and other bodies are meanwhile lobbying for preferential regulatory treatment for energy efficient loans. However, this is only possible if they can demonstrate that such assets are less risky. Unfortunately, we are not yet in a position where we can prove the expectations we have, namely that there's a lower probability of default, higher recoveries, and so on. That's why we need to work together to establish standards that work for everybody. On the covered bond side, we have already seen that this is achievable, that we can create a framework that extends beyond one country, and can extend beyond Europe.

In this respect, we should avoid some of the very strict views you always come across in the ESG world on what is green and what is social. We need to make sure that strict definitions do not prove to be stumbling blocks preventing us from achieving the greater goal.

Day, The CBR: Amid the crisis, implementation of the covered bond directive has taken something of a backseat in the news, but what can you tell us about how this is developing in Germany, Sascha?

Kullig, vdp: I am asked this every month, and so far, my answer has been the same each time: The Ministry of Finance is working on it, but they always tell us that other projects have priority. Nevertheless, the legislators are still on track and we expect an official draft in early autumn, but



Karlo Fuchs, Scope: 'We need to work together to establish standards that work for everybody'

we will have to see. It has already been postponed several times, although that is not a big problem — neither BaFin nor the Ministry of Finance see a need to extend the transition period. This option has been discussed at the ECBC, but here in Germany, and in my understanding also in most other countries, there is no need for any extension so far.

Regarding the amendment, no major changes to the Pfandbrief Act are necessary, just some rather technical aspects. What it will definitely include is the introduction of a nominal overcollateralisation provision. The aim of the vdp is always to construct the Pfandbrief Act in such a way that it is not only compliant with the Directive, but also fulfils CRR Article 129, so that any investor knows that if they buy a German Pfandbrief, it is CRR-compliant. Within the amended Article 129, there is a reference to nominal overcollateralisation, and so far, we don't have this in German legislation — we have net present value OC. So, this will be the main change, plus some minor changes in relation to liquidity buffers and minor adjustments when it comes to transparency.

And then, of course, we hope to finally get a legal maturity extension. We have been discussing this with the Ministry of Finance and BaFin for several years now, and we hope that this now will come to a positive end with the introduction of maturity extension to the Pfandbrief Act. ■

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