The Covered Bond Report

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vdp The German Pfandbrief Banks

The Pfandbrief Roundtable 2021

Euro benchmark issuance may have eased during the pandemic, but fiscal and monetary policies have supported the Pfandbrief's quality and afforded issuers attractive alternatives, with the German product now well positioned as the world emerges from the crisis, according to participants in our latest annual roundtable, held this summer in association with the vdp.

Neil Day, The CBR: Issuance of euro benchmark Pfandbriefe is down, in line with the wider covered bond market. How does this fit in with overall Pfandbrief trends?

Jens Tolckmitt, vdp: If you look at the overall issuance figures, we have fared quite well in the Pfandbrief market. In 2020, we had €60bn overall, including benchmarks and smaller issues. In the first half of 2021 we saw €39bn, and we expect full-year issuance to again be close to 2020 volume, at €60bn. So, it is not that issuance itself is depressed.

Clearly, we still have — perhaps even more so — the big elephant in the room, which is the ECB, which has an effect on issuance, and in particular issuance into the market, rather than giving it to the central bank to get liquidity. I was nevertheless quite astonished to see that issuance was holding up quite well at year-end 2020, even if a major part was being given to the central bank to get liquidity. So, I'm not that negative if you look at the overall issuance.

Yes, benchmark issuance is down on last year. We saw €8bn in the benchmark segment in the first half of 2021, whereas in 2020 the corresponding figure was €12.75bn, and 13 transactions this year compared to 17 last year. Regarding the reasons for this slowdown, perhaps my colleagues from the banks can expand on that.

Day, The CBR: Indeed. Bodo, you've been relatively active in euro benchmarks compared with other issuers in the past year. What's behind your level of activity, and how does it compare with previous years?

Bodo Winkler-Viti, Berlin Hyp: Last year we issued three benchmark-sized Pfandbriefe*, which compares to four in 2019. This partly reflects our new lending in 2020 still being at a very high level, albeit a bit lower than in 2019 — bear in mind that everybody lost at least one full quarter of new business last year, the second quarter.

Jens mentioned the ECB, and the TLTRO III conditions can be very favourable if you reach the lending benchmark that is set, and for that reason most banks have of course taken part in this opportunity. Berlin Hyp has done so, too, but only to a smaller extent as a replacement for market covered bond issuance; rather, we used it to refinance our securities portfolio instead of doing so via inter-bank repos. So there has not been such a big difference in Berlin Hyp's market issuance pattern.

In 2021, we have already been in the market with three benchmark deals in the first half of the year, and we are not yet done for the year. We did not participate in any new tranches of the TLTRO III this year, and we do not intend to do so. I think it is rather the task for banks now to think a little bit more about their exit from them, because if the ECB stops these favourable conditions, nobody wants to see everybody coming to the market in 2023 and huge amounts of issuance then — that would not be beneficial for the covered bond market at all.

Day, The CBR: Götz, in contrast to Berlin Hyp, pbb has been quiet in euro benchmarks, at least, although you have been active in other markets. What explains your

Roundtable participants:

- Timo Boehm, senior vice president and portfolio manager, Pimco
- Vessela Krmnicek, senior director, covered bonds, Fitch Ratings
- Götz Michl, head of funding and debt investor relations, Deutsche Pfandbriefbank AG (pbb)
- Jens Tolckmitt, chief executive, Association of German Pfandbrief Banks (vdp)
- Thorsten Walz, head of treasury, Bausparkasse Schwäbisch Hall
- Bodo Winkler-Viti, head of funding and investor relations, Berlin Hyp AG
- Neil Day, managing editor, The Covered Bond Report, and moderator

level of activity in different funding options in the past year?

Götz Michl, pbb: We have not issued any euro benchmarks this year*; we really focused on issuance in foreign currencies — Swedish kronor, sterling, and US dollars. We need these currencies to match the asset pool as we do business in Sweden, the UK and the US; additionally, we save the cross-currency swap.

We participated in the TLTROs. With the rate of minus 1%, funding through the TLTROs is very attractive in comparison to capital markets funding. One portion of TLTRO funding replaces covered bond funding, so the funding for our assets, for this portion we use our own Pfandbriefe as collateral. We had limited funding needs for our real estate business, so we didn't issue too many own-use Pfandbriefe. The refinancing risk for the TLTRO is therefore manageable. We have the bonds and a substantial amount of cash ready to repay the TLTRO. However, as Bodo said, it is important to plan the repayment process.

So, as I mentioned, we focused primarily on foreign currencies, taking advantage of attractive issuance windows. As the price differential between the foreign currencies and euro Pfandbriefe was pretty small, we pushed euro funding towards later into the year. We may issue a euro benchmark in the third or fourth quarter. It is very important for us to maintain our investor base for euro Pfandbriefe.

Overall, we have done a little over €1.3bn of Pfandbrief funding so far. This volume is somewhat normal for six months, taking the focus on foreign currencies into account.

Day, The CBR: Thorsten, a year ago we hadn't even seen Bausparkasse Schwäbisch Hall in the euro benchmark market. But you have now launched a debut issue and already followed up on that, which somewhat goes against the trend of issuers doing less. What explains your move into benchmark Pfandbriefe?

Thorsten Walz, Bausparkasse Schwäbisch Hall: For us, the situation is a little bit different to my colleagues.

First of all, we do not need to use our own issues for ECB funding because, at

Thorsten Walz, BSH: 'As a new issuer, the focus is currently rather on building up our own curve'

the moment, we already have enough collateral for the TLTROs. The other thing is, for us as a new issuer, the focus is currently rather on building up our own curve. We therefore used our collateral pool to start with issuing benchmarks. We issued our first benchmark last October, and the next in April, and we will try to at least maintain this pace, as well as focusing on market issuance and not using Pfandbriefe as central bank collateral.

I would note that, as a German Bausparkasse, foreign currency is not an option for us — we are restricted by law from taking on any currency risks. So we are focused on building up our curve in euros.

Day, The CBR: Did the overall lack of issuance provide a supportive backdrop to your issuance?

Walz, BSH: Yes, that was very good for us. There was really high interest from investors, right from the start, and with the second issue it was even greater — we issued a €500m deal and something like €1.7bn of orders came in, which is really strong demand. That helped us to be very quickly accepted in the market.

Day, The CBR: What has been your stance towards covered bonds in the past year amid the historically low amount of issuance? Are they still of interest?

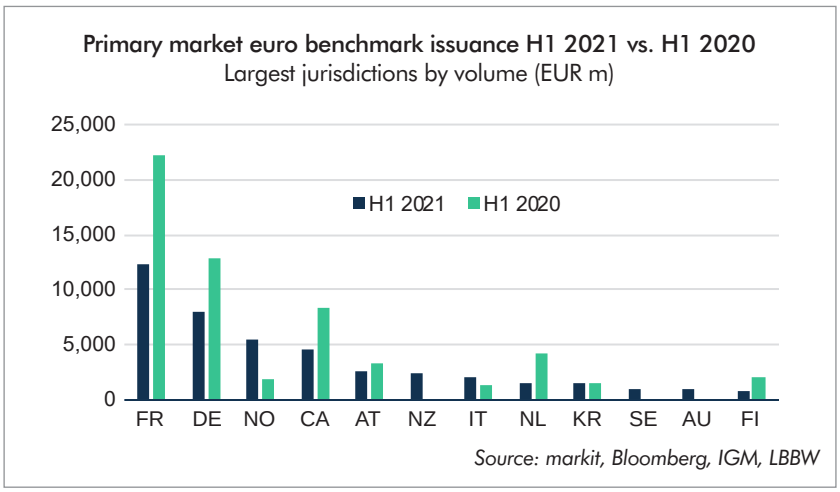
Timo Boehm, Pimco: For us, the very good thing is that the technical support on the covered bond side remains very favourable. The TLTRO take-up that has been mentioned clearly plays a very important role in overall covered bond supply. We saw a very high take-up of TLTROs in March, and take-up was then much lower in June, but we can assume that the ECB wants to continue to provide favourable conditions for banks. This in turn means that covered bond supply in the coming year might grow, but we shouldn't see any surprise growth in supply — we wouldn't expect volumes to double, or anything like that. So, from the technical point of view and from the spread point of view, covered bonds may trade at more or less stable levels, which is quite favourable for us, since we are maintaining our covered bond book.

It's fair to assume that investments in covered bonds will not grow for now because of their spread, because of their relative and absolute value, which is currently kind of a problem. The German covered bond legislation is very attractive, but it's hard to earn money for clients with the Pfandbrief. It has to compete with the new issues we are seeing in the agency sector, for example. We expect quite high supply from the European Union this year and going forward, and it remains to be seen how the relative value between covered bonds and this agency supply will play out. Covered bonds may well be quite expensive right now, given they have a lower degree of liquidity and that the market is already very tight. So, from that perspective, I wouldn't expect market participants to increase their exposure in covered bonds right now.

We are still looking for opportunities in the market. We try to participate in new issues if we can achieve a certain pick-up versus our positions, and we are maintaining our exposure in the covered bond market.

Day, The CBR: Vessela, from a rating agency standpoint, what is notable in the issuance trends we have seen in the past year?

Vessela Krmnicek, Fitch: It was interesting to observe that Pfandbrief issuers used different bond maturities for different purposes. The two factors mentioned already, namely the negative yields for short and medium term Pfandbriefe and the attractive short term funding provided by the ECB's TLTRO III led to the issuance of short term retained Pfandbriefe and pushed the issuance of the publicly-placed benchmark Pfandbriefe towards longer maturities. The average maturity for newly-issued benchmark Pfandbriefe had increased to almost nine years as of end-2020 from almost seven years two years earlier, so a much longer maturity for all the publicly placed Pfandbriefe. Interestingly, these two diverging trends nevertheless left the weighted average residual life of all outstanding Pfandbriefe stable, at about 5.5 years, which already very well matches the weighted average life of the cover pools



securing Pfandbriefe. It will, however, be beneficial for the ALM of the programmes to return to greater use of maturities in the four to seven year range, which we expect to happen once the current circumstances subside.

Michl, pbb: It is a question of the issuer's business model. In our case, with their rather short, three year maturity, the TLTROs are a pretty good fit for our commercial real estate lending business. In previous years, we were pushed toward longer maturities because swap rates were negative and we wanted to provide a positive yield. These Pfandbriefe were actually too long for our asset pool, we produced longer funding in comparison to our assets. We really lacked euro Pfandbriefe with three or four years' maturity. With the TLTRO we have now been able to fill up this maturity bucket. Of course, for a residential mortgage lender with maturities of up to 20 years on the asset side, the TLTRO is too short. These banks would produce a rather high mismatch in their ALM profile.

Day, the CBR: Bodo, the tender and new issue that you did last year seems to exemplify that kind of trend, too.

Winkler-Viti, Berlin Hyp: Indeed, it offered a similar mix. The ALM exercise last year enabled us to increase our TLTRO take-up a little and provide some short term liquidity, and when we asked investors to tender their bonds, we indicated that we would issue a new longer one afterwards.

Early this year we had a situation not only in the German Pfandbrief market but across jurisdictions where there was no longer any differentiation between maturities. Looking at our own curve, the spread was more or less the same from one to 12 years, and of course if you are in a very favourable spread environment, as an issuer, you would rather opt for the longer liquidity. For us, as a commercial real estate lender, 12 years is enormously long; for Thorsten it is probably not. So there are differences.

Walz, BSH: That's right, that's the reason why we issued a 12 year maturity last time. Longer maturities are interesting from a risk perspective and spread perspective. As we continue our mission to build out our curve, we will have to consider what to do next. We have issued 10 and 12 year benchmarks, which could point to a shorter issue for the next one, but, as already mentioned, longer maturities could make sense as well, so we will have to wait and see.

Day, The CBR: Timo has already noted relative value issues facing covered bonds, and in May we saw a rare instance of a new benchmark struggle to cross the line. With developments in the inflation and rates outlook, with more talk about tapering in the US even if not in Europe, we may see more bouts of volatility. What are your thoughts on this and how it might affect covered bond issuance?

Winkler-Viti, Berlin Hyp: The major reason for covered bonds from the second half of May onward not attracting these big order books anymore has mainly to do with what Timo already mentioned, namely relative value. When we did our 12 year in May, that priced inside the KfW curve, and one market participant asked me: "So, you must be very proud pricing inside KfW." I replied: "To be honest, I'm just very lucky that it went through so well." I'm well aware that this does not reflect reality, how things should be. The market really became aware that there was a sort of mispricing when the first Next Generation EU public offering was nearing and the outstanding EU bond widened ahead of that first issuance, which naturally had an impact on covered bonds, too, and that was exactly when the new issue you cited hit the market.

'I'm just very lucky that it went through so well'

Götz Michl, pbb: 'The TLTROs are a pretty good fit for our commercial real estate lending'

Day, The CBR: Goetz, you mentioned that you could be going out with a euro benchmark later in the year — do you think conditions might be different by then, in terms of rates or anything else?

Michl, pbb: As you say, conditions change and sometimes the market is more favourable for covered bonds, sometimes it's less favourable. We have had a quite good year so far for covered bonds, even against the backdrop of the corona-crisis. Certainly, the window Bodo chose in May was a very good one. Let's see what happens later in the year. Given that we won't have any immediate need for liquidity, it may make sense to wait a couple of months — we would currently produce negative carry with the minus 50bp on our ECB account. Deciding on the optimal funding slot is certainly not easy — sometimes you lose, sometimes you win. Maybe it needs a couple of basis points more, but it should be possible to place a Pfandbrief.

Day, The CBR: Timo, what's your view on the rates outlook, and could it change your stance towards the market?

Boehm, Pimco: The market's expectation is that the ECB deems the current inflation issue only transitory. This would mean that we don't see any big change in their support for the market.

I agree with this view, but let's consider what would happen if it does change.

All the data from the last 10, 20 years shows that in situations where financial conditions weaken — due to a credit event or lower central bank support, for example — the German Pfandbrief always outperforms. So in such a scenario the Pfandbrief could work as a natural hedge. Even in comparison to other covered bond products, the German Pfandbrief is a low carry product. It underperforms if the market rallies, but in situations where we see, let's say, a big supply wave or a weakening in central bank conditions, it outperforms. Furthermore, the spread dispersion between different covered bond products is at a multi-year low right now. Apart from a few outliers, covered bonds globally trade with a spread difference of more or less 5bp-10bp in euro terms.

Tolckmitt, vdp: From a Pfandbrief perspective, I wouldn't see tapering as carrying any risk for our banks, because refinancing conditions should remain stable — it's more of a challenge for other covered bond markets, which is basically the flipside of what Timo just said. We have had the ECB driving the market for some years now, and every time they announced they were going to stop a programme or taper a little bit — which ultimately didn't happen — the market immediately became more attractive again from a relative value perspective for real investors. So, tapering should be considered a positive event — although I question whether that will happen anytime soon.

Regarding the impact of potential inflationary pressures, as long as the overall market moves in the same direction and it's not a specific challenge to the Pfandbrief, it's no problem.

In the past 10-12 years I have talked to many banks who have received Pfandbrief licences, and especially those relying heavily on short term funding through deposits were looking for an instrument — and they found it in the Pfandbrief — that offers them stable funding even in the event of a turn in interest rates. In such a scenario, the Pfandbrief could benefit from being a kind of anchor for those who otherwise rely on short term funding to a large extent.

Timo Boehm, Pimco: 'Our concern, if any, would be more in the direction of the housing market'

Walz, BSH: Spreads are relatively low at the moment, and that's partly because of the very strong presence of the ECB and the low supply from Pfandbrief banks.

'The Pfandbrief could benefit from being a kind of anchor'

Spreads may rise a little, especially if the ECB starts tapering, but I think it will be some time until that happens.

As Timo and Jens mentioned, it's the quality that counts, and I don't anticipate any major problems for the Pfandbrief market, but possibly more for foreign covered bonds, which are extremely close to Pfandbriefe on an historical basis these days and could widen in the future.

Day, The CBR: What, if any, impact has the pandemic had on collateral and/or issuer credit quality. We're well over a year into the pandemic, and hopefully coming out the other side — has the impact been as big as might have been feared?

Krmnicek, Fitch: The collateral and Pfandbrief credit quality have remained fairly stable. No Pfandbrief ratings have been downgraded since the pandemic started. Although there are currently 11 Pfandbrief programmes where the issuers' ratings are on outlook negative, only the Pfandbrief ratings for three programmes are also on outlook negative because these have no buffer against an issuer downgrade — the remaining programmes have an average buffer against an issuer downgrade of three notches, so they are well protected in terms of overcollateralisation cushion and in terms of buffer against issuer downgrade.

To put that into the context of all covered bond programmes we rate, over the past year 10 out of about 100 rated covered bond programmes were downgraded. For three of them, the reason was that the issuer was downgraded, and for seven, the sovereign was downgraded, so none were downgraded because of the worsening of the collateral quality or insufficient overcollateralisation.

In order to easily track the two main reasons why covered bond ratings are shielded from the effects of the pandemic — the buffer against an issuer downgrade and the OC cushion — in March 2020 we started to publish on a monthly basis the "Covered Bonds Protection Dashboard", which includes this information among others. And when looking at the Pfandbrief programmes we rate, both cushions have remained on average stable since the pandemic started.

Day, The CBR: Timo, are you relaxed on this front?

Boehm, Pimco: I don't know if I would say relaxed. Let's put it this way: we didn't see any kind of impact in terms of spread due to the pandemic. The number of non-performing loans remained quite stable during the crisis, and overall the pandemic was quite well managed. Our concern, if any, would be more in the direction of the housing market. As I mentioned before, we don't expect this to see an increase in yields, but were this to occur, then the already very stressed housing market could for sure become an additional problem.

Day, The CBR: Thorsten, what is your view on this?

Walz, BSH: Especially in Germany, the private housing market has performed extremely well. The pandemic rather had a positive impact because everybody was sitting at home, looking around and realising that they needed another room for the home office or they got other ideas for improvements to their living situation. We see strong demand from our clients, business is going very well, and so we are relaxed on this issue when it comes to our cover pool, which includes around 90% owner-occupied properties and almost 80% single and two family homes. Regarding the question whether there may be a bubble in the housing market, we don't see that — yet. Maybe the situation is a little bit different in some hotspots like Munich or Frankfurt, but it's not a general problem for the time being. So the quality of our cover pool is good and not negatively affected by the pandemic.

Day, The CBR: With the work from home trend, is commercial real estate possibly more vulnerable than residential collateral, Bodo?

Winkler-Viti, Berlin Hyp: First of all, the pandemic damaged the commercial real estate sector overall less than many had feared. We have seen a stable development so far in the office sector in Germany. So having people sitting at home has not automatically led to companies giving up their entire office space. We feel that — in some places and in some sectors — going forward there will be different behaviour at work, a different sort of use of the office. Even if it's very likely that after a possible end to the pandemic more people work from home, the need for the office is still there. You need it from a social point of view — working together has a social function, too, and many companies are very aware of that. At the same time, offices will be differently equipped compared to before the pandemic — you will allow for more space each individual employee in order to have hygienic conditions and the like. Thus, offices should not be the major concern in the CRE sector.

The outlook is a little different when you look at what have been perhaps the two most vulnerable sectors within CRE during this pandemic, namely hotels and shopping centres.

Starting with shopping centres, the pandemic was more of a catalyst of a development that had already started: online shopping. Even in a country like Germany, where everything is always very traditional and maybe a little bit slower in developing than in other countries, it advanced here, too. The pandemic forced people to do more online and those who had previously been hesitant saw that it works quite well. We're positive that there will be shopping centres in the future, but not as many as we have today, and probably not too many in non-prime locations anymore.

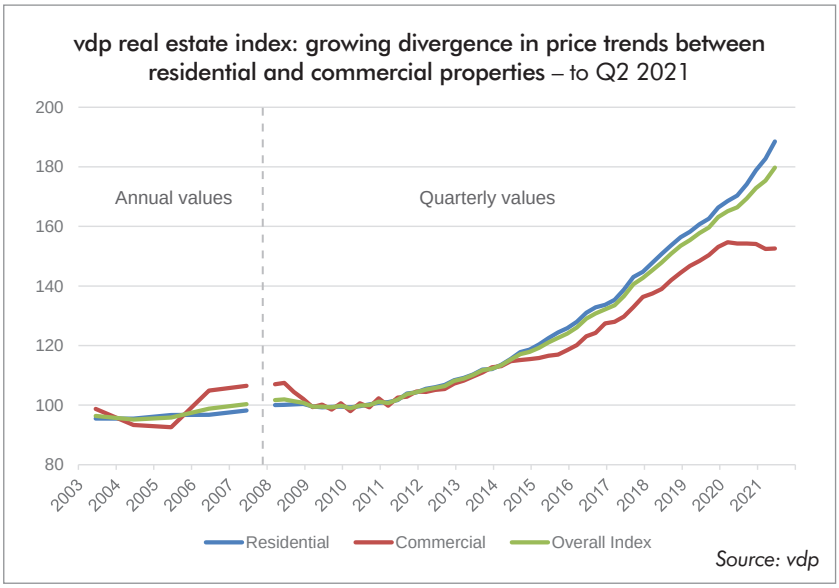
Turning to hotels, we have seen that now that restrictions have been lowered, the first thing that people want to do is travel. So for holiday hotels, the longer term impact of the corona pandemic might not be that big. For business hotels, the outlook is a bit different. Although meeting in person is much nicer and creates more of an atmosphere, at the end of the day we all learned how well platforms like WebEx work. On top of that, climate change mitigation issues become more and more urgent and have also been very prominently discussed during the pandemic and we all know

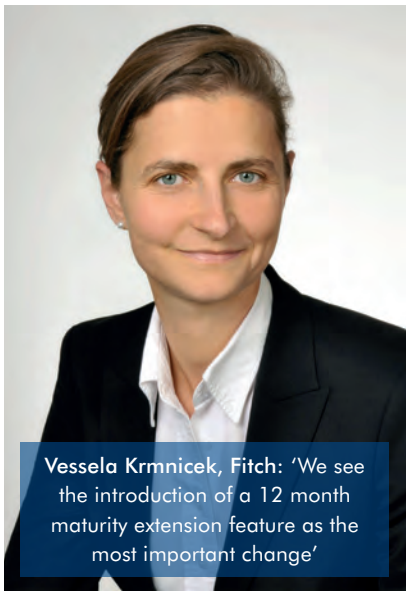
Bodo Winkler-Viti, Berlin Hyp: 'Some of these pure business hotels will no longer be necessary'

that we need to adjust our behaviour. Therefore some of these pure business hotels will no longer be necessary.

Tolckmitt, vdp: I fully subscribe to Bodo's thoughts on the different asset classes within commercial real estate, perhaps adding that logistics is working very well, for obvious reasons.

I can also share some of the insights that we at the association have gained. From the onset of the pandemic, we started to survey loan deferrals among our institutions, and they have always been extremely low. The maximum was 2% of the portfolio, and it is well below that now — we actually stopped surveying loan deferrals because they are not currently measurable, so to speak, which





Vessela Krmnicek, Fitch: 'We see the introduction of a 12 month maturity extension feature as the most important change'

is certainly a positive observation.

With regard to provisioning, there was some in the last year, but this was more forward-looking provisioning on a general level, not because banks had so many NPLs that they had to provision for — we haven't seen any rise in problematic loans.

You asked about cover pool collateral. It is always worth bearing in mind that the cover pool comprises loans valued at the very conservative mortgage lending value (MLV), and only 60% of the MLV may be refinanced via Pfandbriefe. Now, the MLV today for a commercial property is more often half the market value, and 60% of this half of the market value is in the cover pool. Therefore I don't believe that there will be any problems in the cover pools. This is a very important additional factor that every investor needs to understand, and which holds even if there are fluctuations in the market, which we don't currently see. Our research subsidiary vdpResearch monitors price developments on the German property market and we don't see major price developments, except from what Bodo just said, but on a very limited scale. But even if we did see major downward trends, there is no danger for the cover pool.

Our banks have started to look at their portfolios, whether to revalue some property, and my understanding is that to a certain extent, with regard to market values, that has actually happened, but with regard to MLVs, there have been very, very few revaluations of property. So when it comes to the cover pool, there is additional safety.

Winkler-Viti, Berlin Hyp: It is indeed important to highlight the MLV concept. At the same time, this increasing difference between market values and MLVs is a challenge for lenders, because in the end it means that less and less is available for refinancing via Pfandbriefe. This concept is super-strict, as this MLV only knows one direction — you can reduce it, but you can never increase it, even if the market value goes up — but that limits you in covered bond funding.

Tolckmitt, vdp: That is why we are working on amending the MLV requirements.

Day, The CBR: The Pfandbrief Act has just been amended, including the transposition of the EU Covered Bond Directive into national law. What are the key changes and has the Pfandbrief been improved?

Tolckmitt, vdp: We certainly believe that with each amendment, Pfandbrief quality improves yet further. From an investor perspective, the first important message is that the Pfandbrief Act was the first national covered bond law to be amended, and it's now fully CRR-compliant — my understanding is that is not the case in some of the other countries, at least from the very beginning — and so we are done, in that respect. Why was this important? Because we strongly believe that the new definitions on the European level of what a covered bond is are the prerequisite for keeping the prevailing preferential treatment in place. Therefore this is of real value to investors — we now have a stricter framework on a European level and they can be sure the Pfandbrief complies with it, and hence that the preferential treatments remain in place.

> 'When it comes to the cover pool, there is additional safety'

We have also made changes on a national level, namely maturity extension and some in relation to property insurance. The property insurance changes make it a little bit easier for issuers to comply with the law, because some of the new provisions actually reflect what the insurance industry is willing to offer, which was not necessarily the case beforehand. The maturity extension is simply a feature that makes it even easier for the cover pool administrator to manage the liquidity in the pools if such a need arises, and so that is also a positive message to investors.

Further to what we mentioned about amending the MLV regulation, we are in parallel amending the regulations around the Pfandbrief Act, which investors will also profit from. This is a work in progress, but it is not a prerequisite for complying with the European standards.

Day, The CBR: Vessela, what do you make of the impact of the changes, if any, on Pfandbrief quality going forward?

Krmnicek, Fitch: With liquidity being an important focus in Fitch's covered bond rating criteria, we see the introduction of a 12 month maturity extension feature as the most important change of the Pfandbrief Act. We welcome this change, as well as the fact that Pfandbriefe continue to benefit from the already existing 180 day liquidity protection. The regulator decided to keep the calculation unchanged, which means that it is still based on the expected rather than extended maturities of the bonds. The discussions during the consultation period showed that the Pfandbrief issuers would have preferred this to be relaxed, but it was not. We see this as a strength of the law, because it would facilitate payment continuity of interest during the extension period, should the extendible maturity feature ever be used.

There will be no rating impact from the Pfandbrief Act amendment. How-

ever, the improved liquidity protection leads to increased buffers against issuer downgrades, so the Pfandbrief ratings will be more robust, and for some Pfandbrief programmes we rate the changes lead also to lower overcollateralisation levels for the respective rating.

Day, The CBR: Timo, are you happy with the changes, including the maturity extension change, which affects covered bonds you've already bought rather than what you can choose going forward?

Boehm, Pimco: We try to evaluate a covered bond or a Pfandbrief by thinking from the end, so we try to understand what happens in the case of default, and from that perspective, as Jens already mentioned, the maturity extension was for us the most important thing to observe. We think this change in the Pfandbrief Act was done very well. Why is that? You can introduce maturity extension in different ways and indeed we see it handled differently in an international context, and the good thing with how the Pfandbrief Act was amended is that there is no issuer discretion for a maturity extension. This is quite important. We need to make sure that only the cover pool administrator can extend the maturity in case of default, and here an extension will only apply if the cover pool administrator decides, and not the issuer. Why is that important? If you have a hard bullet maturity, you can think of it as "pay the covered bond or die", and a soft bullet maturity is more like "pay, pay later or die", so from that perspective, you have more room to provide payment for the investors, and this is a quite positive thing to add.

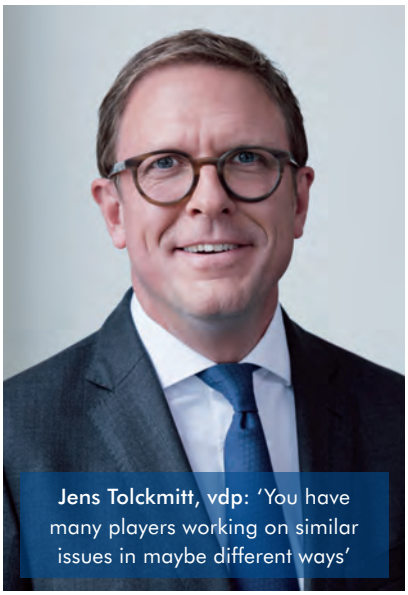
But there is one other aspect that is quite important in the new Pfandbrief Act, and this is how to deal with the liquidity provisions. This was not changed, but it is important to note that the 180 day liquidity provision we already had in the German Pfandbrief Act continues to be calculated on the basis of the legal maturity of the Pfandbrief, rather than trying to leave it to the extended maturity. It therefore continues to provide quite high investor protection.

Day, The CBR: The green and social bond markets continue to grow, with more players from the covered bond market. There have also been key developments in the shape of the EU Taxonomy and related initiatives. You've previously been critical of the way some of this has been handled, Jens — is it a help or a hindrance?

Tolckmitt, vdp: It is helpful, because, firstly, there is a need to push sustainable finance overall, and secondly, there is a need for a framework that can be referred to in any private initiative to provide assurance that this issue is being properly handled by private market participants.

What we do criticise and what has not improved, rather has actually worsened, is the fact that you have many players working on similar issues in maybe different ways, and that the regulation coming out of that is quite substantial. And not only is the sheer number of regulations that currently are being worked on large, but the volume of each regulation is also huge. Take the taxonomy, for example. As we all know, this is a set of definitions of what constitutes sustainable economic activity, and the EU has defined six goals in that respect. You can pursue one goal and you have to make sure that you do not harm the other five. So far, they have defined in detail two of those six goals, and they've already reached more than 500 pages of definitions. If you hypothetically calculate that up for all six goals, you could end up with 1,500 pages of definitions. And if you look at it closely, for the building sector you have definitions in there that actually define a maximum for how much water should run through a shower or a toilet. We don't believe that this level of detail is helpful for the industry, and that is necessarily regulated at a European level. Looking at the Green Bond Standard, today we can say that it might be difficult to meet the criteria of the GBS for those issuing certain green bonds, because it will be very burdensome. As someone in the German industry council recently put it: is raising the bar a good training method if you doubt your athlete is capable of meeting the current standard? So we are critical of the way this is being handled. We simply do not believe that it is helping the cause; it is actually standing in the way of the cause.

> 'This change in the Pfandbrief Act was done very well'

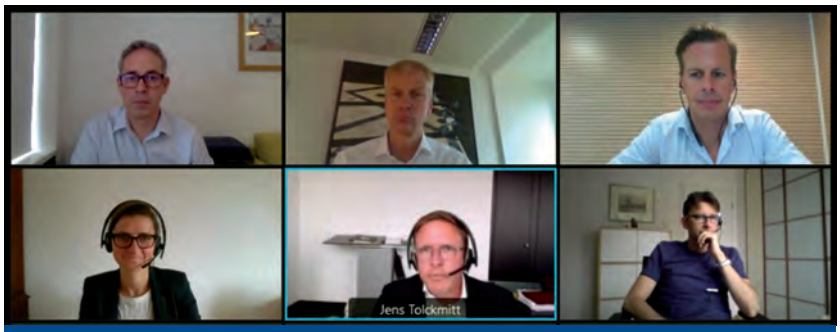


Jens Tolckmitt, vdp: 'You have many players working on similar issues in maybe different ways'

The general goal is clear, and banks support it, but more consistency and fewer actors would be helpful, and more focus on a framework rather than trying to detail everything to the highest possible level.

Day, The CBR: Goetz, pbb became a green bond issuer this year, albeit not in covered bonds. Have broader developments affected your approach to the market? Can we expect to see a green Pfandbrief from you?

Michl, pbb: It will depend on two things: the number of Pfandbrief benchmarks we will issue, and, more importantly, the "greenium". We want to use our green portfolio in the most effective way. Generally speaking, the greenium



The roundtable took place on 25 June, with participants invited to join via video or telephone, and to make minor updates to their comments ahead of publication. *Berlin Hyp and pbb have since issued €500m five year Pfandbriefe, on 17 and 18 August, respectively, which are not captured in Winkler-Viti's or Michl's comments.

is higher for debt with higher spreads; so for Pfandbriefe the greenium is rather low. We have seen green Tier 2 in the market with a nice effect on pricing. We did our senior preferred benchmark in green format since the spread advantage for a green Pfandbrief is rather small. In senior preferred bonds we have a more efficient use of our green collateral.

Looking at the EU taxonomy with the, let's say, strong criteria, I expect issuers to move towards these higher standards in the future. This might also result in fewer eligible assets. In case of smaller green portfolios, it is even more important to be efficient. Consequently, the likelihood for green Pfandbriefe decreases.

It will be interesting to see what numbers banks report for their green asset ratio. Putting aside the do-no-significant-harm criteria for now, the EU taxonomy has a very simple definition of what proportion of commercial real estate should be regarded as green, namely 15%. The EU Taxonomy for real estate defines the top 15% in respect of energy demand of a market as "green". But how will that be reflected in the balance sheets of the banks? In theory they should report close to 15%, but I expect a lower number — maybe around 8%. The question will be, where are the remaining 5% or 7% lost? Most likely, it will be lack of data.

Winkler-Viti, Berlin Hyp: Yes, data is key. Here, one also has to be a little bit self-critical, because Germany has in the past not been very good at recording data and making it available. When it comes to the energy efficiency of buildings, it becomes very apparent, even more so with commercial real estate than residential. It's incomprehensible that, unlike many countries, we still do not have a central register where every EPC is recorded and even in some cases made available publicly.

Within banks' property portfolios, I expect the figure to be less than 15%, not so much due to the technical screening criteria, but rather documentation and real proof of a few of the DNSH criteria.

Furthermore, the 15% figure refers only to the eligible threshold within the technical screening criteria for one single type of business, namely financings for the acquisition or ownership of existing buildings built before the end of 2020. In the building sector alone, there are six other defined activities, including two major ones, renovations and new buildings. Both are unlimited — there is no reference to any 15%.

'We expect ESG covered bonds to outperform'

And then there are, of course, a lot more activities named in the EU taxonomy that do not refer to buildings at all. So maybe this 15% might be relevant for a bank focused on commercial real estate, like pbb or Berlin Hyp, but more universal banks have multiple portfolios with multiple businesses available.

Coming back to the taxonomy itself, how is that to be seen? We at Berlin Hyp welcome it. The good thing about it is that it provides a common language for an important topic where so far everybody speaks in different languages and with different definitions. You can always find scope to criticise its content — for one this criterion is too strict, for the other that criterion is too weak — but in the end, the European Commission has at least provided something that seems like more than just a solid basis. And now, in the upcoming years, we will have to learn to live with it, and to apply it to what we do.

By the way, nobody tells you or expects you to only do business that is provided for by the taxonomy. It is just a means to classify your activities as being sustainable or not, and it's good to have one common framework in place across Europe to help in deciding that.

Boehm, Pimco: From an investor's point of view, the times where ESG was just playing a minor role in portfolio construction are definitely over. Although, as Goetz just mentioned, current spread deviation between green and non-green covered bonds is rather low these days, we expect ESG covered bonds to outperform going forward.

We appreciate that the latest EU taxonomy proposal took into account market participants' objections. However, we think that on the regulatory side we are still early in the process of developing and adopting ESG standards, and progress will be made going forward.

Krmnicek, Fitch: Currently Fitch does not differentiate between green mortgages and non-green ones in its analysis because of the lack of historical and loan-by-loan data evidencing differences in performance, which means that for now we do not have different assumptions for green mortgages — this could of course change in our future analysis once more data is available.

In 2019, Fitch introduced the ESG relevance scores for covered bond programmes. The scores indicate the relevance and materiality of ESG factors to covered bond ratings. ●

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