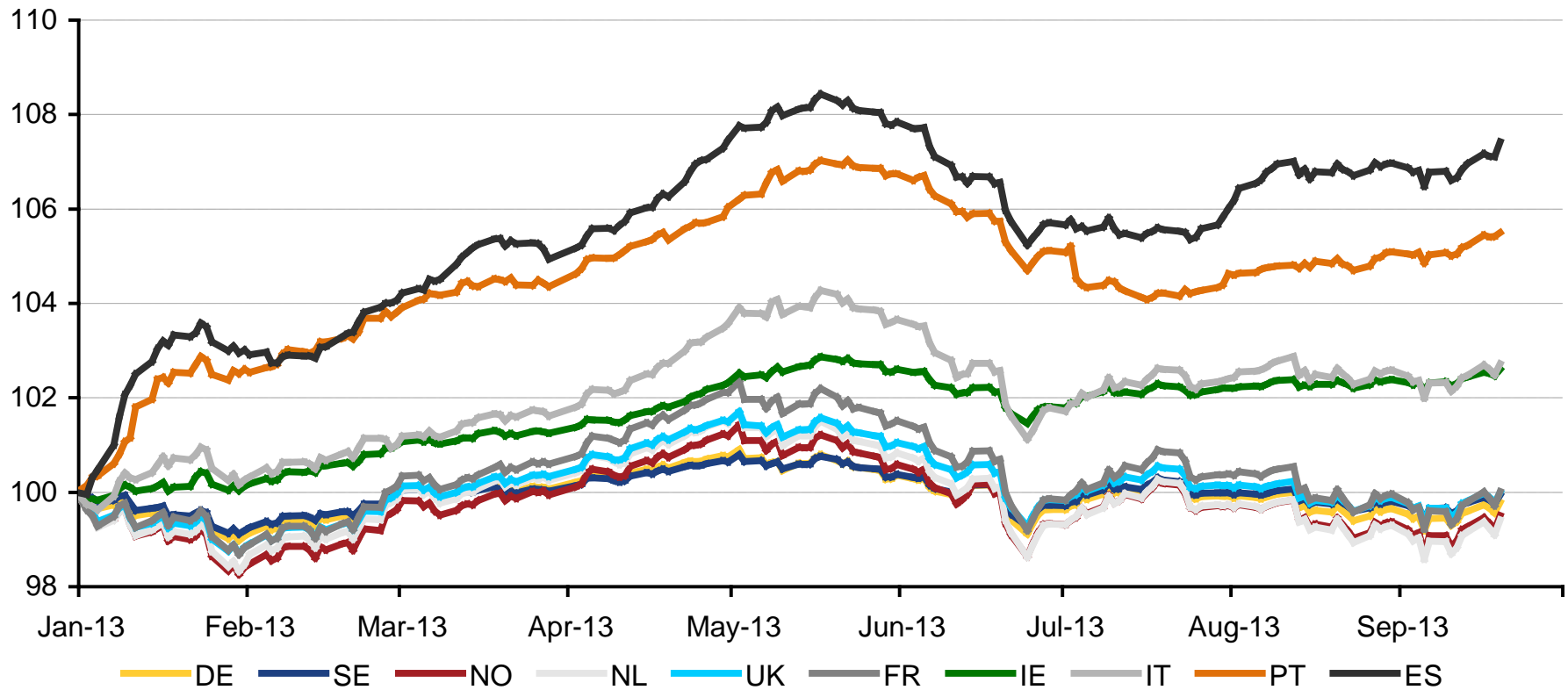




## Covered Bond Update

# A mixed picture when looking at returns

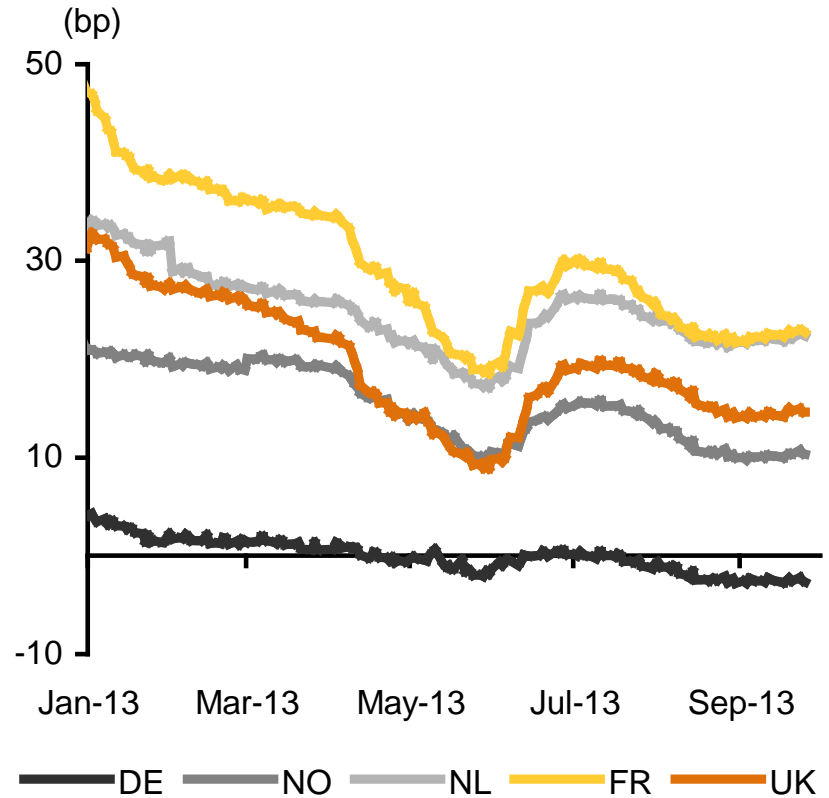
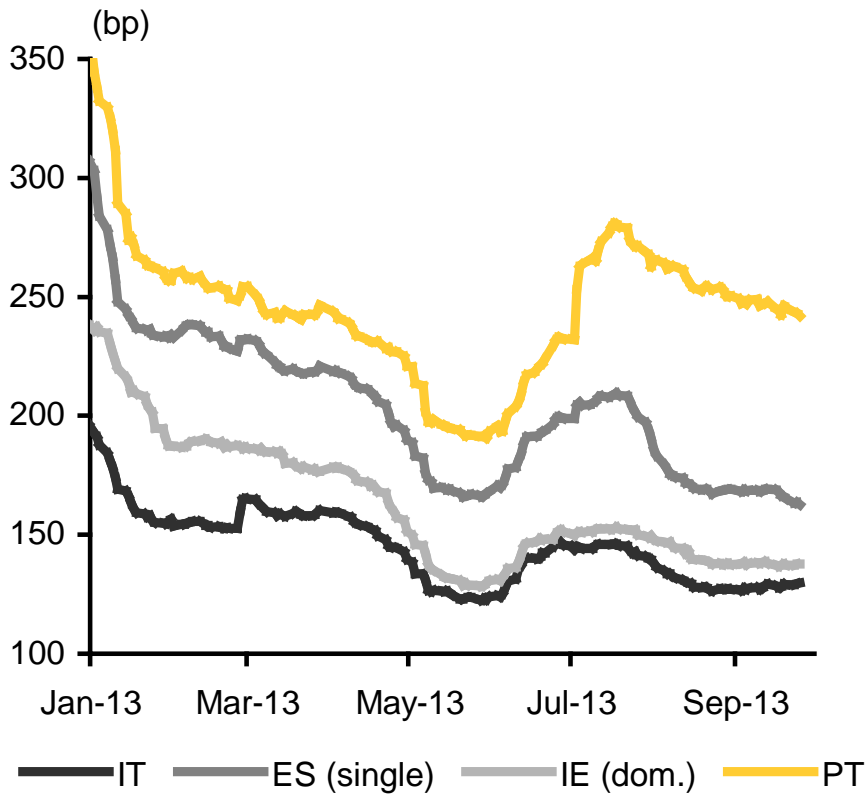
## iBoxx performance indices by covered bond country



Source: Commerzbank Research

## However, spreads have performed quite solidly

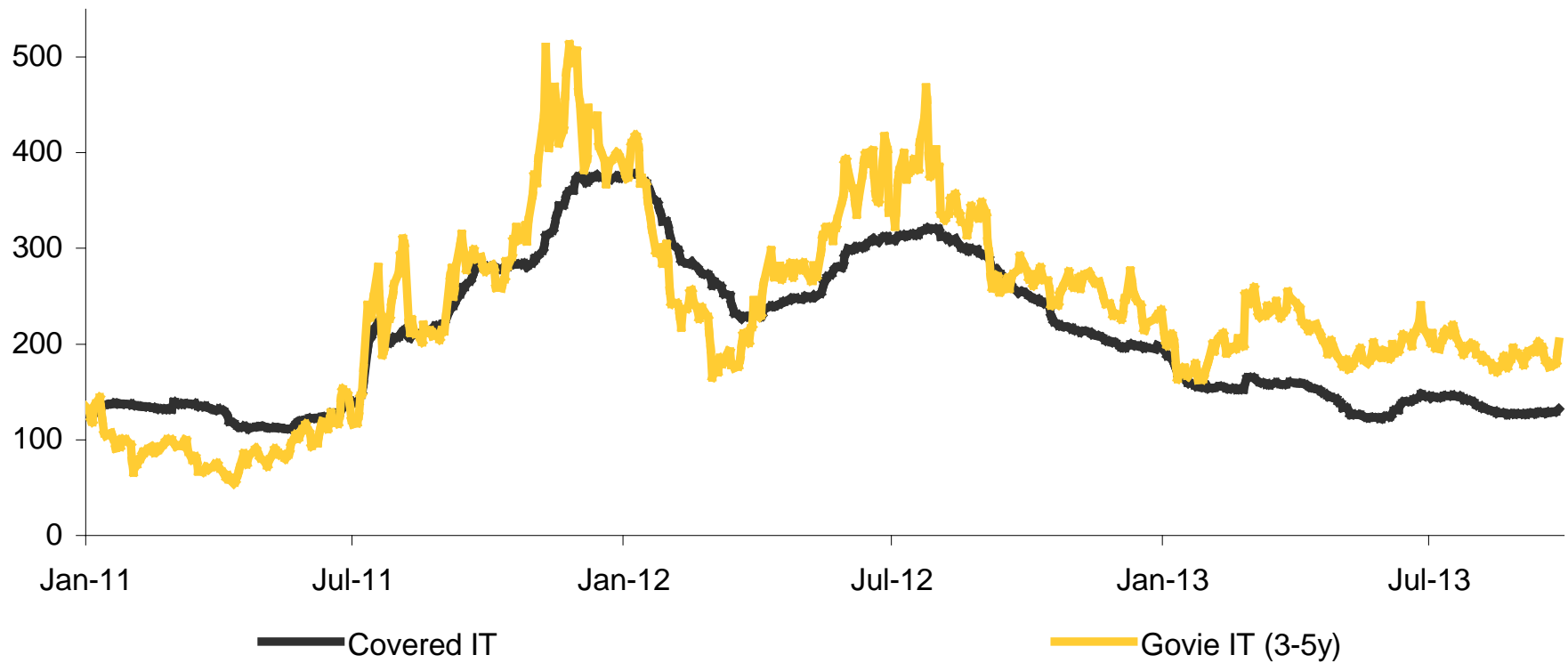
### iBoxx swapspreads by covered bond country



Source: Commerzbank Research

# Still trading below govies

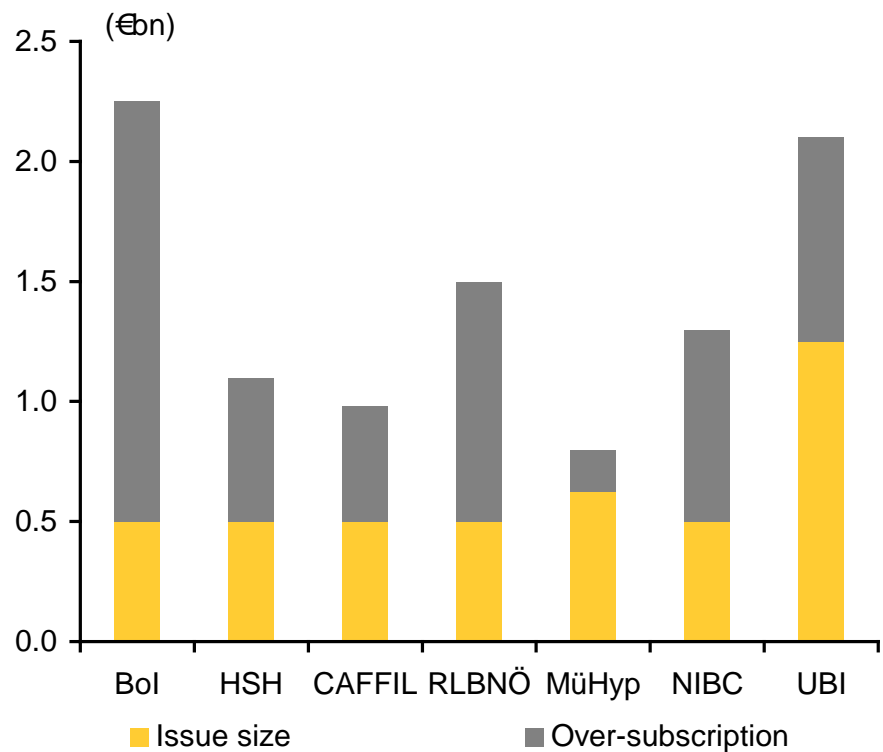
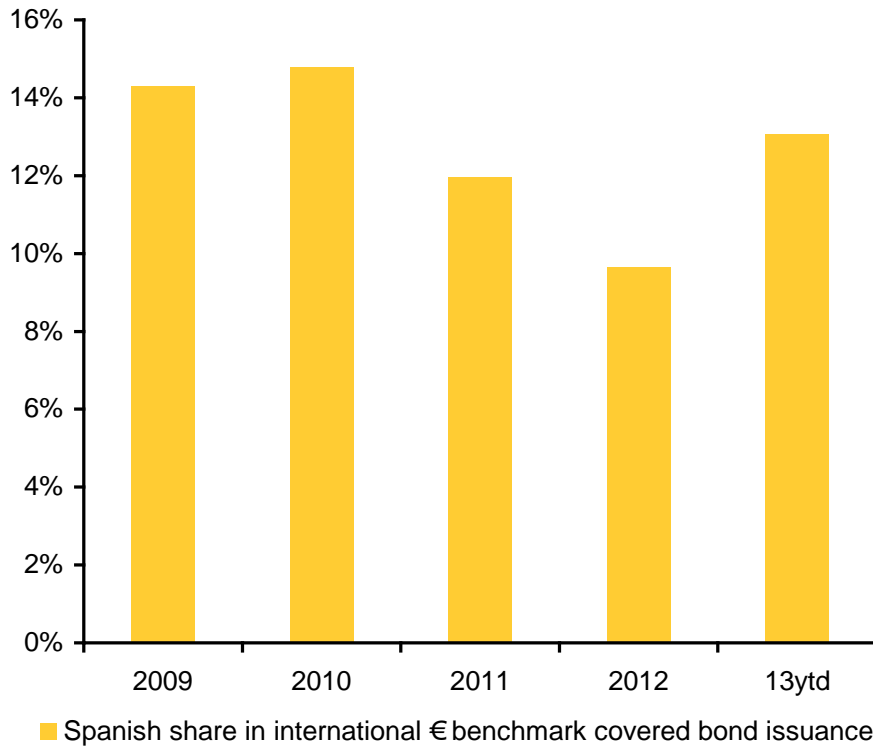
... not only in peripheral markets



Source: Commerzbank Research

## How about market access?

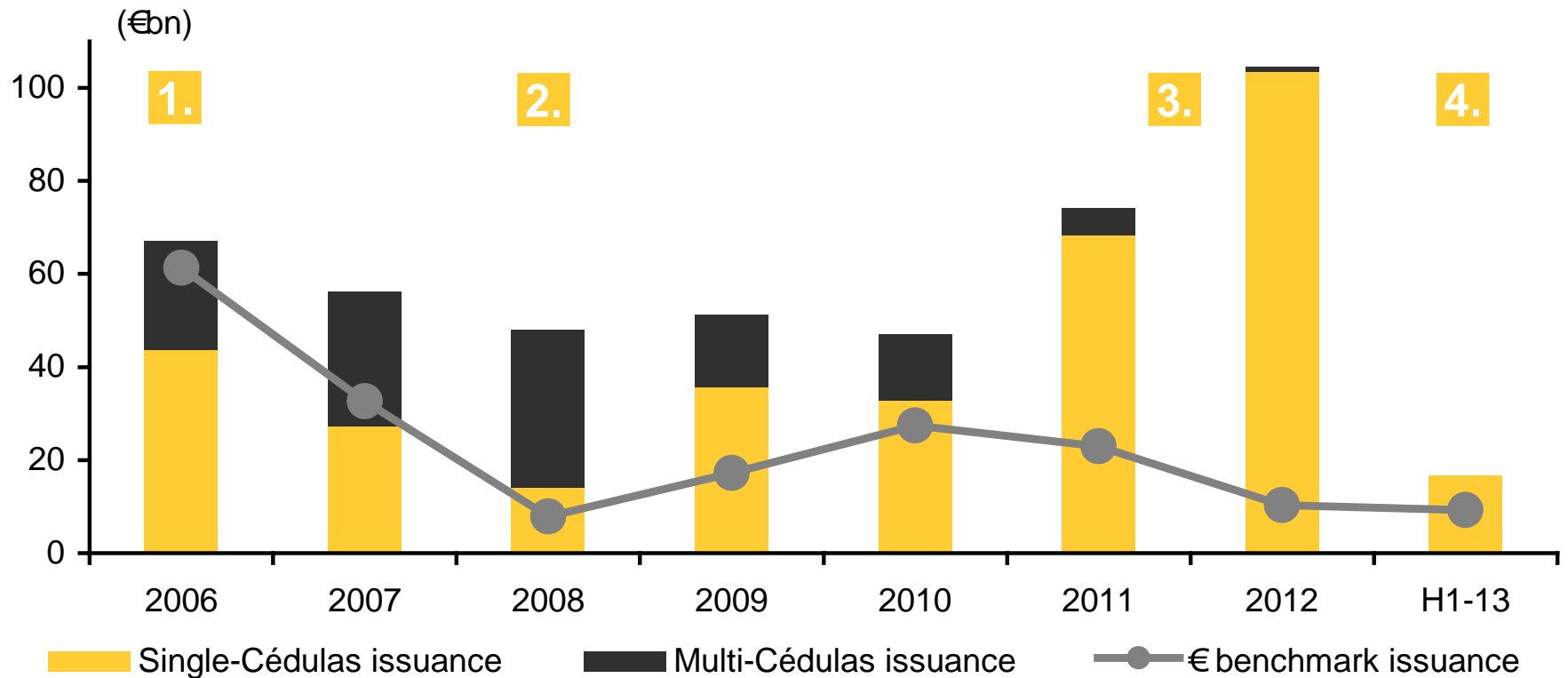
Market sentiment has shifted from a pure seller's market towards a better equilibrium of supply and demand



Source: Commerzbank Research

## Case study: Spanish Cédulas Hipotecarias

After two waves of retained issuance, new volumes have fallen considerably

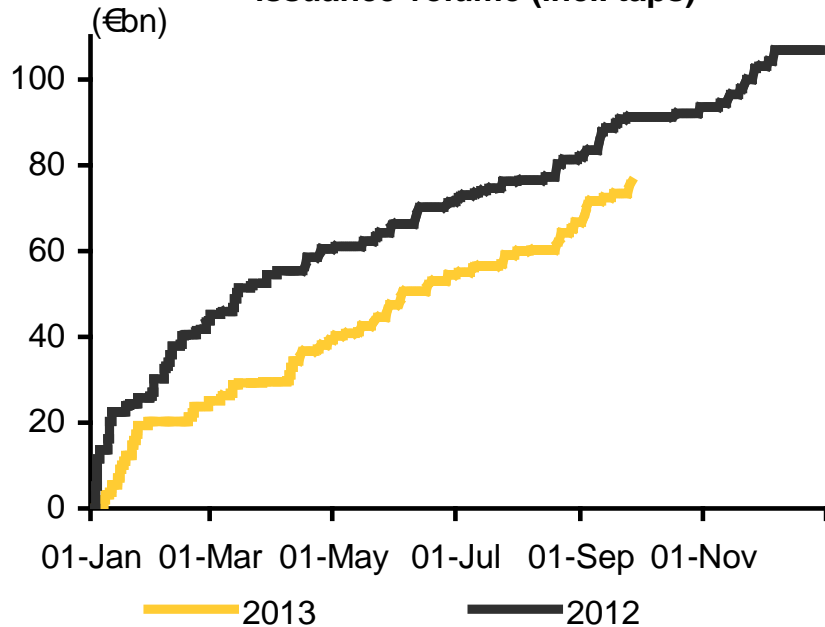


Source: AHE, Commerzbank Research

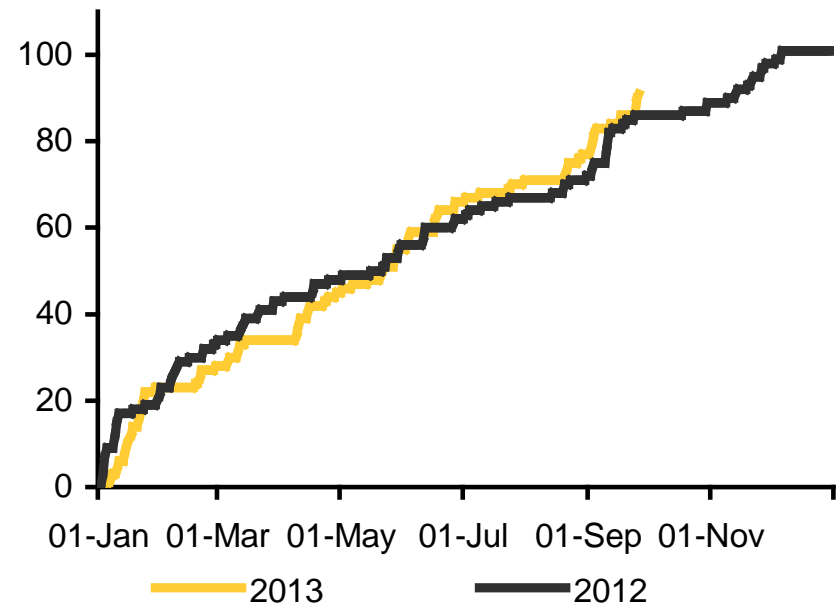
# More of less

The share of sub-Jumbo deals has never been higher

Accumulated €benchmark covered bond issuance volume (incl. taps)



Accumulated number of €benchmark covered bond deals



Source: Commerzbank Research

## Plenty of reasons

### For example...

- › Surplus O/C already at relatively low levels
- › Banks in deleveraging mode
- › Downturn of public-sector financing business
- › Pressure on several housing markets
- › Asset quality issues
- › Focus on deposit base, senior and sub debt
- › Ample central bank liquidity
- › Smaller newcomers
- › Stricter ALM guidelines



## Less newcomers but including some interesting new structures

How to... 1) overcome rating constraints, 2) use covered bonds for other core assets



Aktia



MEDIOBANCA



Banca popolare dell'Emilia Romagna

# NIBC's conditional pass-through structure

## Some pros and cons

### Pros

- + Stable AAA/AAA ratings with the least possible ties to the bank's credit quality.
- + Therefore, low risks of regulatory or internal rating limits being broken.
- + Lower loss risks compared to forced stress sale of pool assets. More flexibility for decision takers.

### But

- Higher complexity.
- The higher ratings do not mean better issuer or pool quality but are basically due to methodological reasons. This results in lower rating transparency in comparison to other programmes.
- Lower liquidity provision and over-collateralisation likely.
- Repayment may take longer than in the case of bullet structures. Long legal maturities may imply accounting difficulties for individual investors.
- Smaller group of investors might be negative for liquidity.

### Neutral

- Legal registration, therefore also UCITS- and CRD-conform including all resulting advantages.
- We expect no negative surprises in terms of index categorisation.

Source: Commerzbank Research

# Moody's reacting to bail-in proposals

## Upgrades of 1-2 notches expected

### The current methodology

<b>Step 1: anchor point</b>	Senior unsecured rating	+ 0 notches
<b>Step 2: upnotching</b>	based on TPI table	

### The proposed adjusted methodology

<b>Step 1: anchor point</b>	the higher of a)	Senior unsecured rating	+0 notches	if unsec.senior + sub.	<5%
			+1 notch	debt / total liabilities...	>5%
<b>Step 1: anchor point</b>	... and b)	Adjusted Baseline Credit	+0 notches	if unsec. senior + sub.	<5%
		Assessment	+1 notch	debt / total liabilities...	5-10%
			+2 notches		>10%
<b>Step 2: upnotching</b>	based on unchanged TPI table				

Source: Moody's, Commerzbank Research

## The ECBC Covered Bond Label

... is supposed to...

- › ... establish a clear **perimeter for the asset class** and highlight the core standards and quality of covered bonds
- › ... increase **transparency**
- › ... improve **access to information** for investors, regulators and other market participants
- › ... improve **liquidity** in covered bonds
- › ... position the covered bond asset class with respect to upcoming **regulatory challenges**

# 1) “Clear perimeter for the asset class”

## Checklist

- › Structured covered bonds, SME deals, Aircraft covered bonds etc. excluded
- › Otherwise, however, UCITS criteria offer little protection against credit dilution
- › Non-European covered bonds also excluded for the time being

## Survey feedback

- › Only a first step
- › Minimum standards expected to increase over time

## 2) “Increasing transparency”

### Checklist

- › National reporting templates defined
- › No international harmonisation yet, reporting standards can deviate substantially
- › After some initial hiccups, frequent reporting seems to have been established by now
- › Limited market penetration (e.g. in Germany, Austria, Belgium)

### Survey feedback

- › Further international standardisation of reporting templates and of underlying data desirable (LTVs, NPLs etc.)
- › Loan-level data typically not required

### 3) “Access to information”

#### Checklist

- › [www.coveredbondlabel.com](http://www.coveredbondlabel.com) website established featuring links to pool reports and bond details
- › No pool reports on the Label website itself
- › No programme docs etc.
- › Limited market penetration

#### Survey feedback

- › Increasing penetration required

## 4) “Improve liquidity”

### Checklist

- › No effect measurable so far

## 5) “Position covered bonds for regulatory challenges”

### Checklist

- › Under discussion



## Issues for discussion

- › A harmonisation of covered bond laws and practices across Europe?  
Shouldn't we start with a standardisation of some 'basics' such as the form of special supervision, cover calculation practices, insolvency proceedings etc.?
- › Transparency is a moving target!  
In addition to further harmonisation, new requirements will become relevant along the way (eg info on maturity structures, amount of bail-in-able debt etc.).
- › Chicken and egg?  
The Label will only become truly relevant once it gains regulatory acceptance, which seems to depend on the Label's market relevance though...

This document has been created and published by the Corporates & Markets division of Commerzbank AG, Frankfurt/Main or Commerzbank's group companies mentioned in the document. Commerzbank Corporates & Markets is the investment banking division of Commerzbank, integrating research, debt, equities, interest rates and foreign exchange.

**The relevant research analyst(s), as named on the front cover of this report, certify that (a) the views expressed in this research report accurately reflect their personal views about the securities and companies mentioned in this document; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document. The research analyst(s) named on this report are not registered / qualified as research analysts with FINRA. The research analyst(s) may not be associated persons of Commerz Markets LLC and therefore may not be subject to NASD Rule 2711 and incorporated NYSE Rule 472 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst.**

**It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price.**

#### **Conflicts of interest**

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together "Commerzbank") and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document\*:

\*Updating this information may take up to ten days after month end.

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts:

[https://research.commerzbank.com/portal/en/site/equity/disclaimer\\_1/index.jsf](https://research.commerzbank.com/portal/en/site/equity/disclaimer_1/index.jsf) \*

\* Updating this information may take up to ten days after month end.

#### **Ratings & Definitions**

Explanation in terms of the ratings used are available at

<https://research.commerzbank.com/portal/en/site/equity/ratingsdefinitions/index.jsf>.

#### **Explanation of valuation parameters and risk assessment**

Explanations in terms of the valuation parameters, the valuation system and the associated risks are available at: <https://research.commerzbank.com/portal/en/site/equity/valuationparametersriskassessment/index.jsf>.

#### **Disclaimer**

This document is for information purposes only and does not take account of the specific circumstances of any recipient. The information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever.

The information in this document is based on data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. The opinions and estimates contained herein reflect the current judgement of the author(s) on the data of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.

Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions.

By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

# Disclaimer (contd.)

## Additional notes to readers in the following countries:

**Germany:** Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by the German regulator Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Lurgiallee 12, 60439 Frankfurt am Main, Germany.

**United Kingdom:** This document has been issued or approved for issue in the United Kingdom by Commerzbank AG London Branch. Commerzbank AG, London Branch is authorised by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and subject to limited regulation by the Financial Services Authority. Details on the extent of our regulation by the Financial Services Authority are available from us on request. This document is directed exclusively to eligible counterparties and professional clients. It is not directed to retail clients. No persons other than an eligible counterparty or a professional client should read or rely on any information in this document. Commerzbank AG, London Branch does not deal for or advise or otherwise offer any investment services to retail clients.

**United States:** This document has been approved for distribution in the US under applicable US law by Commerz Markets LLC ("Commerz Markets"), a wholly owned subsidiary of Commerzbank and a US registered broker-dealer. Any transaction by US persons must be effected with Commerz Markets. Under applicable US law; information regarding clients of Commerz Markets may be distributed to other companies within the Commerzbank group. This research report is intended for distribution in the United States solely to "institutional investors" and "major U.S. institutional investors," as defined in Rule 15a-6 under the Securities Exchange Act of 1934. Commerz Markets is a member of FINRA and SIPC.

**European Economic Area:** Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA.

**Singapore:** This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor as defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore ("SFA") pursuant to section 274 of the SFA.

**Hong Kong:** This document is furnished in Hong Kong by Commerzbank AG, Hong Kong Branch, and may only be received in Hong Kong by 'professional investors' within the meaning of Schedule 1 of the Securities and Futures Ordinance (Cap.571) of Hong Kong and any rules made there under.

**Japan:** Commerzbank AG, Tokyo Branch is responsible for the distribution of Research in Japan. Commerzbank AG, Tokyo Branch is regulated by the Japanese Financial Services Agency (FSA).

**Australia:** Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order 04/1313. Commerzbank AG is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under the laws of Germany which differ from Australian laws.

© Commerzbank AG 2013. All rights reserved. Version 9.13

### Commerzbank Corporates & Markets

#### Frankfurt

Commerzbank AG  
DLZ - Gebäude 2,  
Händlerhaus  
Mainzer Landstraße 153  
60327 Frankfurt  
Tel: + 49 69 136 21200

#### London

Commerzbank AG  
London Branch  
PO BOX 52715  
30 Gresham Street  
London, EC2P 2XY  
Tel: + 44 207 623 8000

#### New York Branch

Commerzbank AG  
2 World Financial Center,  
31st floor  
New York,  
NY 10281  
Tel: + 1 212 703 4000

#### Singapore Branch

Commerzbank AG  
8, Shenton Way, #42-01  
Singapore 068811  
Tel: +65 63110000

#### Hong Kong Branch

Commerzbank AG  
29/F, Two IFC  
8 Finance Street  
Central  
Hong Kong  
Tel: +852 3988 0988