



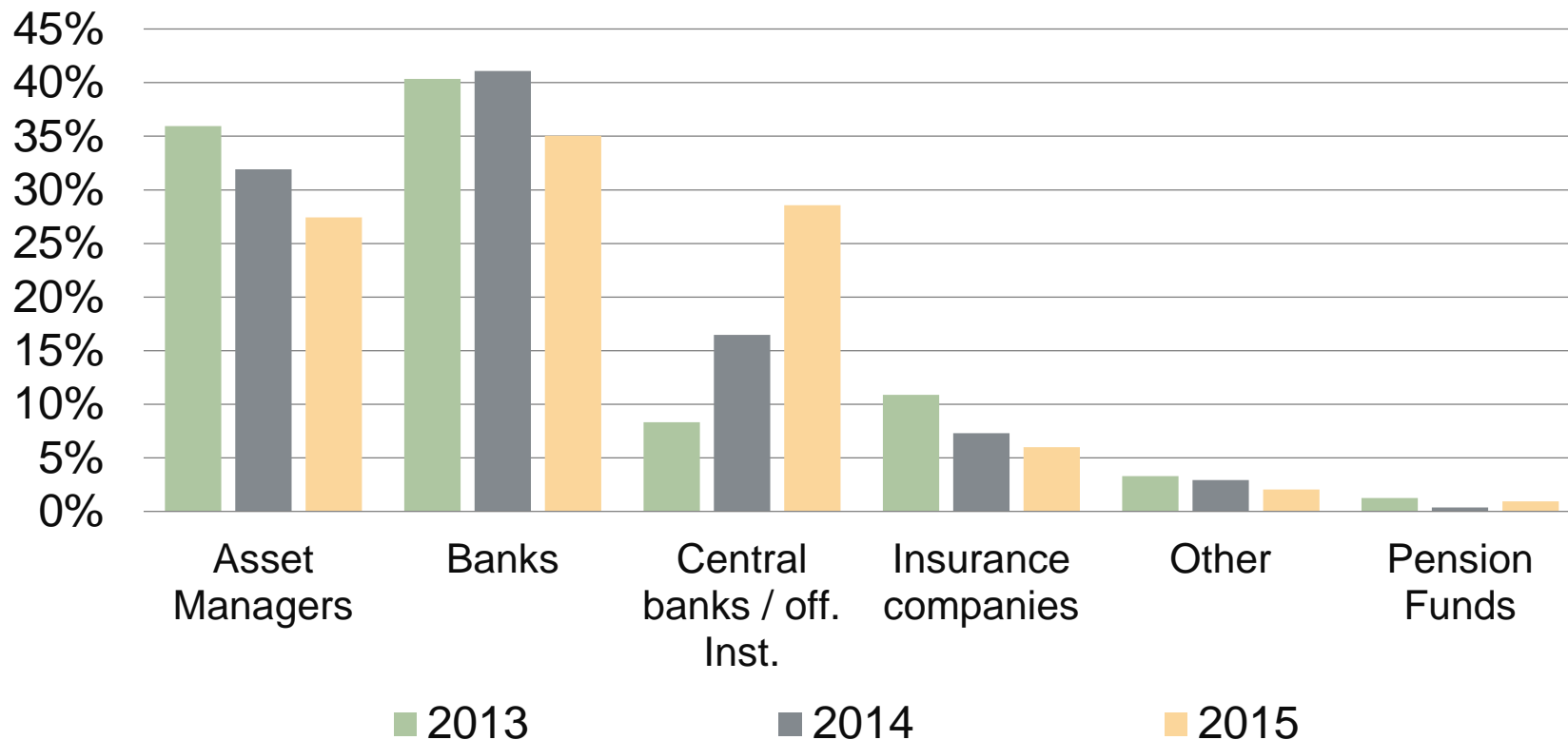
ECB Bond Market Contact Group

**Impact of the APP on euro area and
global financial markets**

Dr. Frank Engels
Frankfurt am Main
30 June 2015

Asset managers like Union Investment are most affected by CBPP 3

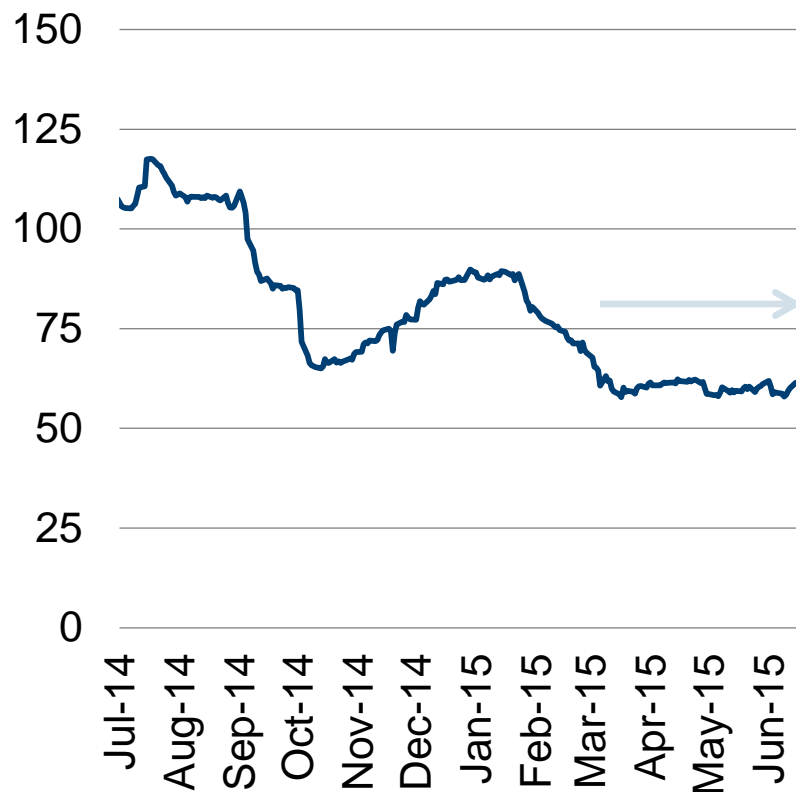
Share in primary deals by investor group



Source: Bloomberg, Credit Agricole, ECBC

The longer monotonous purchases exist, the more it complicates proper market pricing

Min-Max-Spread



- After the announcement effect of CBPP 3 and the adjustments in finding NIPs in Q4 2014, Min-Max-Spread did not move despite current rates volatility and changed risk assessment
- In portfolio construction or VaR models the real underlying (spread) risk in Covered Bonds isn't reflected properly and dragged down artificially with unnecessary consequences
- A rather flexible approach should be adopted, i.e. a gradual reduction in purchasing to reflect supply situation

Source: iBoxx Covered Bonds, sub-indices on country basis. Shown is difference between lowest and highest ASW

The ABSPP shows unexpected effects on spreads and new issue volumes

- Effects on spreads might be temporary
 - Spreads of eligible and non-eligible paper tightened right after the announcement of the program with strongest effects on peripheral ABS
 - ABSPP volume is far lower than the market expected, which lead to spread widening in peripheral ABS (Portuguese and Spanish RMBS being most effected)
- New issue market is shrinking in EMU countries
 - Overall growth in European new issuance is coming from UK RMBS as well as CLOs
 - Placed ABS issuance in EMU is shrinking since 2014, while retained issuance is down for 2015 compared to 2014

Market mechanism is adversely affected by the combination of TLTRO, ABS-repo and ABSPP

- Issuance for funding is too costly – low incentive to issue publicly placed ABS
 - Cheap funding via TLTRO has diminishing effect on ABS new issuance
→ same mechanism as with FLS in UK and dropping RMBS new issuance in 2012/2013
 - Combined with cheap repo facility for retained ABS, publicly placed ABS is far too expensive
→ strongest effect for peripheral ABS: new issuance mainly in core countries, peripheral issues mostly retained
- Demand and pricing
 - Investors demand for new issue is high: even very tight Dutch RMBS more than two times oversubscribed on average
 - ABSPP's current focus in new issuance is on core assets like Dutch RMBS and German Auto ABS, peripheral ABS are scarcely purchased
→ steering function is not used for peripheral ABS
- Issuance for regulatory capital
 - Placing mezzanine tranches necessary for capital efficiency, but regulatory treatment is far too punitive → no incentive for investors

Combination of ABS-repo and ABSPP has high potential to revive the market even after TLTRO

- Currently, the ECB seems to keep lending alive through TLTRO and retained ABS repo only but not by increasing placed issuance
- Due to cheaper funding costs by retaining ABS for repo a potential exit of TLTRO will only lead to an increase of retained ABS but not help placed issuance
- The combination of ABS-repo with ABSPP could be much more powerful:
 - Including a minimum amount of publicly placed paper of the same issue (for example 50%) in the requirements for repo eligibility could be very positive to the market:
 - increase in placed new issue while controlling retained ABS volume
 - ABSPP could well support the placement of the minimum amount
 - efficient market pricing with cheap repo funding at the same time
 - marketable structures will be created*
 - incentive to publicly place ABS will increase

*a lot of retained ABS are not marketable due to their unusual structure, e.g. fix rate tranches of retained Dutch RMBS only benefiting the originator; retained ABS that has been placed afterwards needed to be restructured first

Issues for discussion

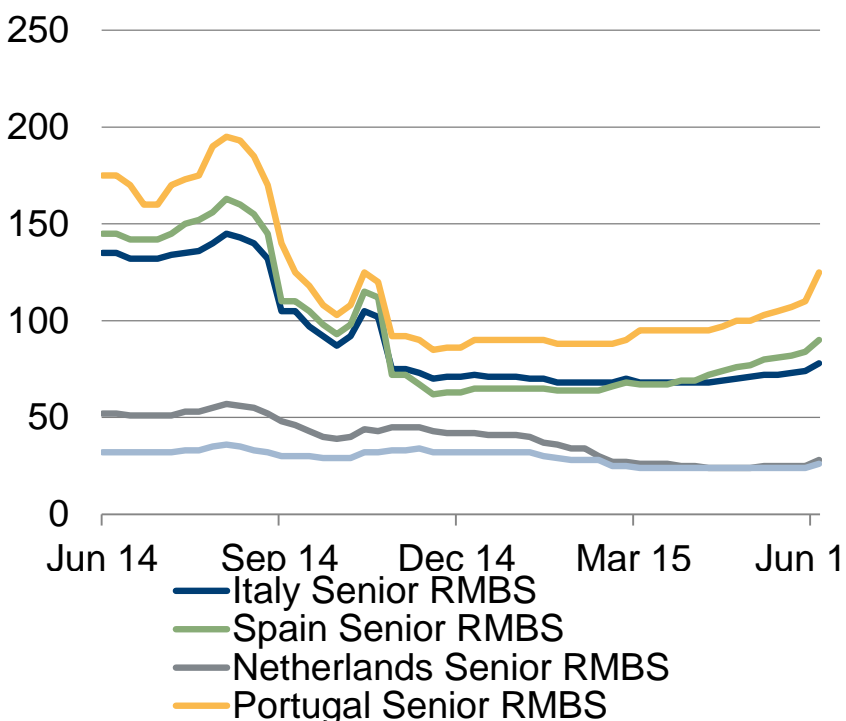
1. What are in your view the long-term implications of the APP for the European and global financial markets, including market structure and volatility?
2. Do you see any conflicts between the APP programme and (i) other ECB's liquidity-providing operations, and (ii) liquidity regulations?
3. In view of EBA's public hearing on 26 June, what are in your view the implications from Qualifying Securitisation for ABS markets and for new issuance?

Appendix

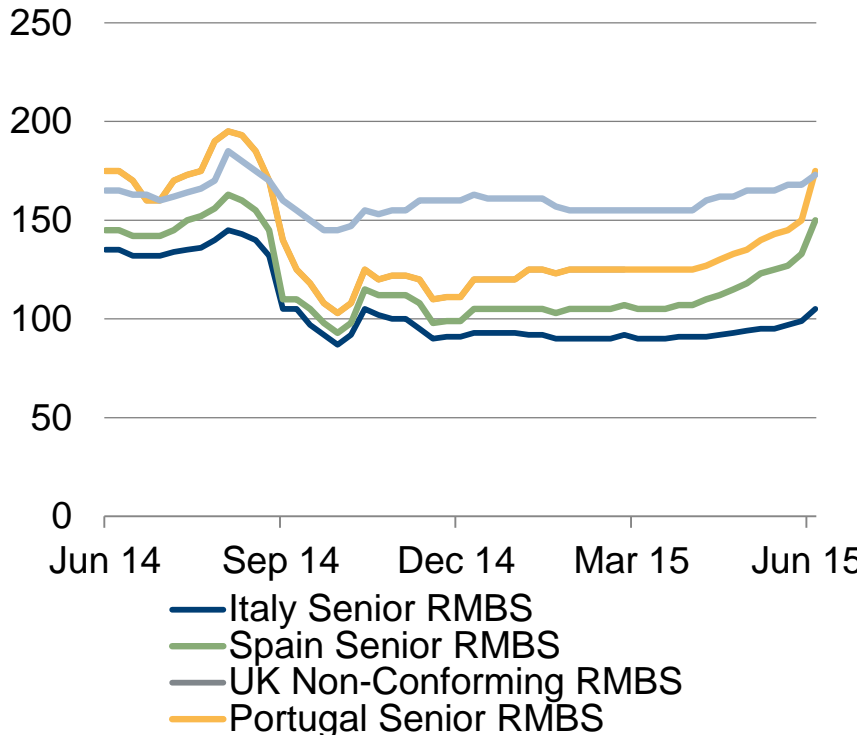
The ABS purchase programme already considerably affected the markets prior to its implementation

- Disappointing volumes support peripheral widening

Spread development of ABSPP-eligible ABS



Spread development of non-ABSPP-eligible ABS

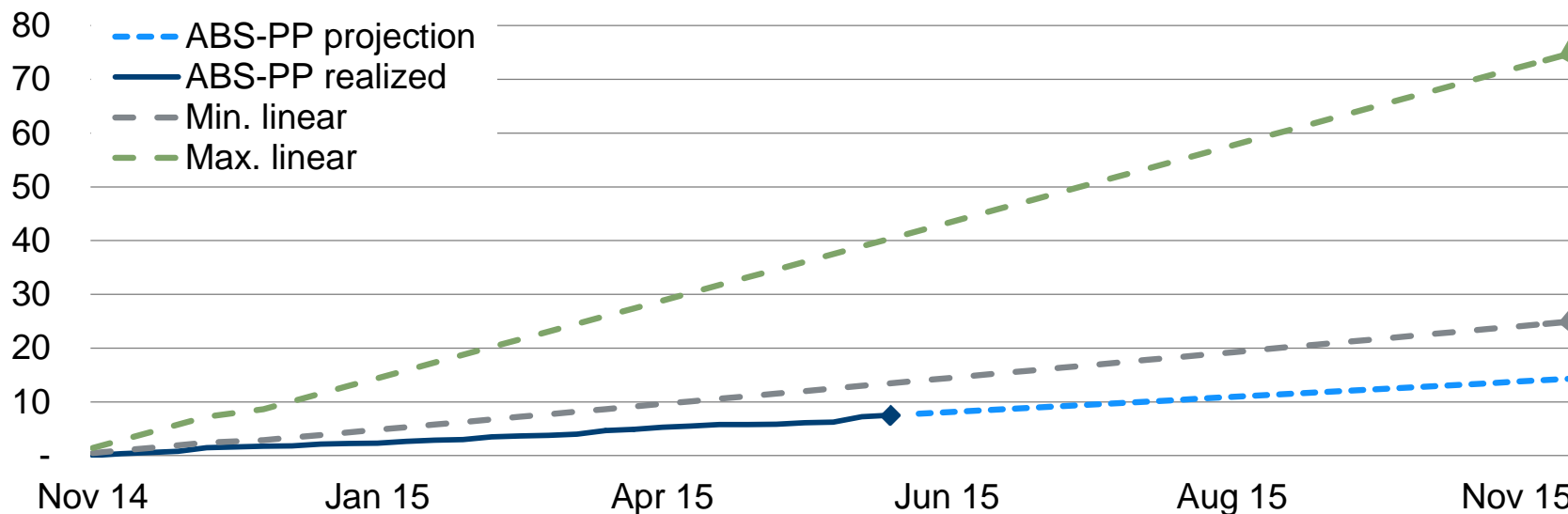


As at 5 June 2015
Source: J.P. Morgan

The ABSPP did not meet market expectations and is lagging behind the speed of the covered bond program

| ABSPP purchases in EUR | Barclays | Jefferies | J.P. Morgan | Nomura |
|------------------------|------------|--------------|-------------|------------|
| Time horizon | 12 months | 12-18 months | 12 months | 2015 |
| Expectation | 50-70 bln. | 30 bln. | 75 bln. | 25-35 bln. |

ABSPP realized versus expected volumes (in billion euros)



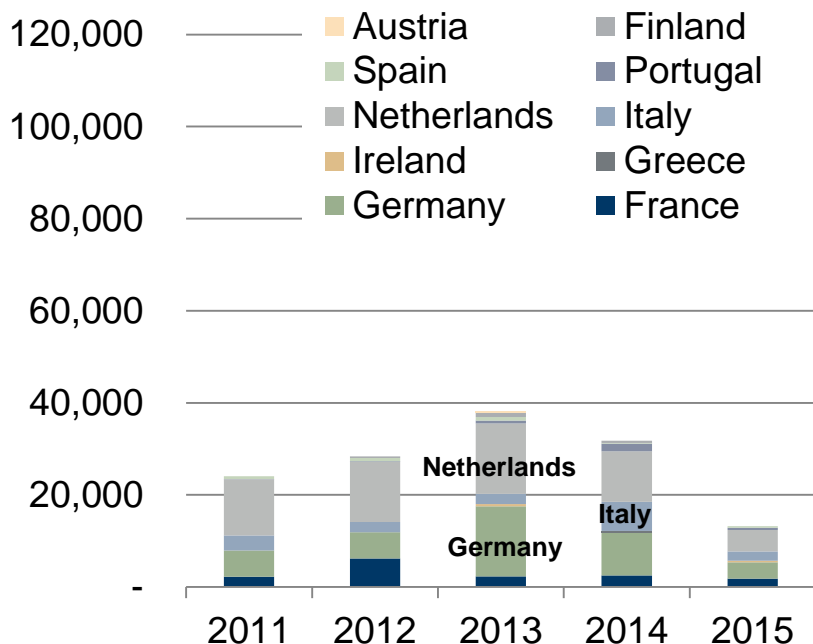
As at 21 April 2015

Source: Bloomberg, JP, Nomura, Barclays, Jefferies

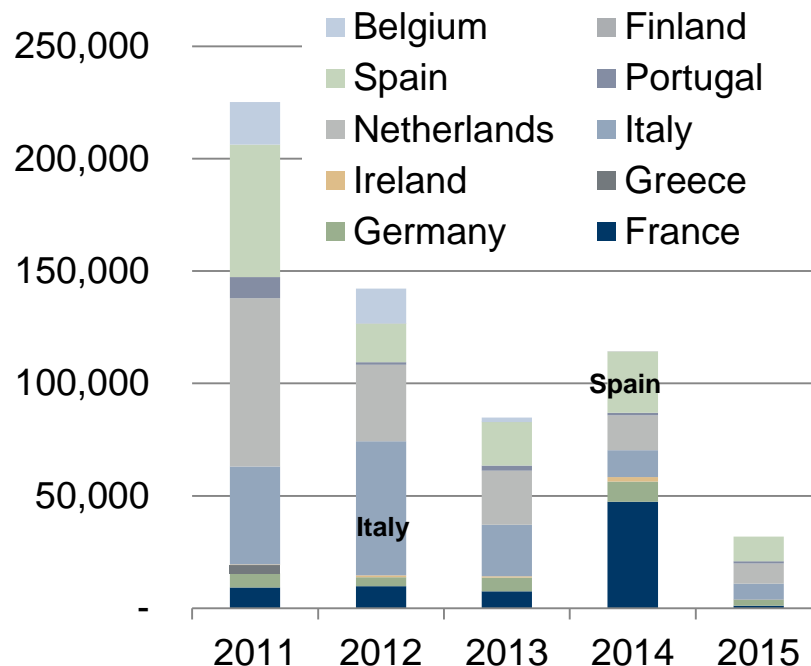
The EMU new issue ABS market for placed issuance is shrinking

- Placed new issue is shrinking and mainly consists of core ABS while Spanish paper can only be found in retained ABS

New issue volume of placed ABS for EMU countries, in mln. EUR by country



New issue volume of retained ABS for EMU countries, in mln. EUR by country

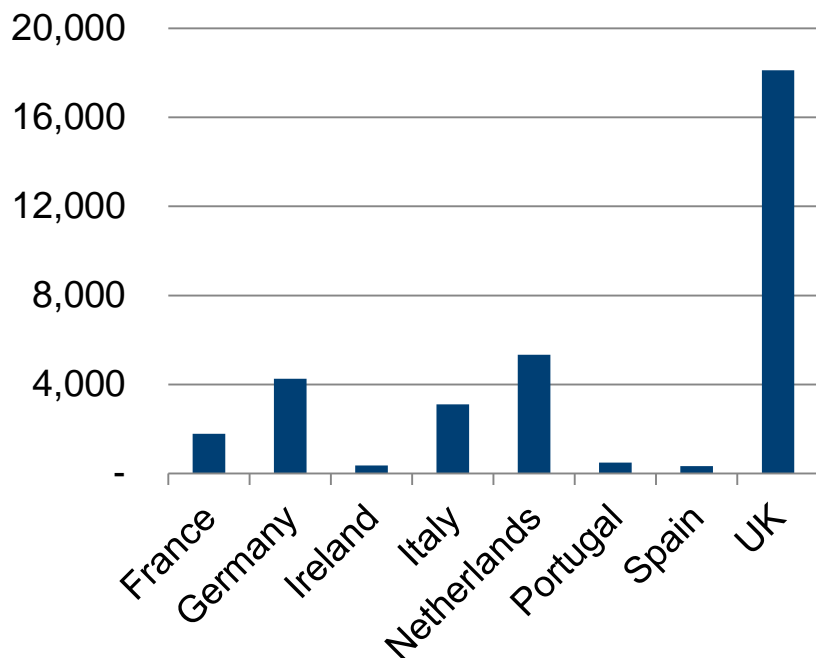


As at 11 June 2015
Source: J.P. Morgan

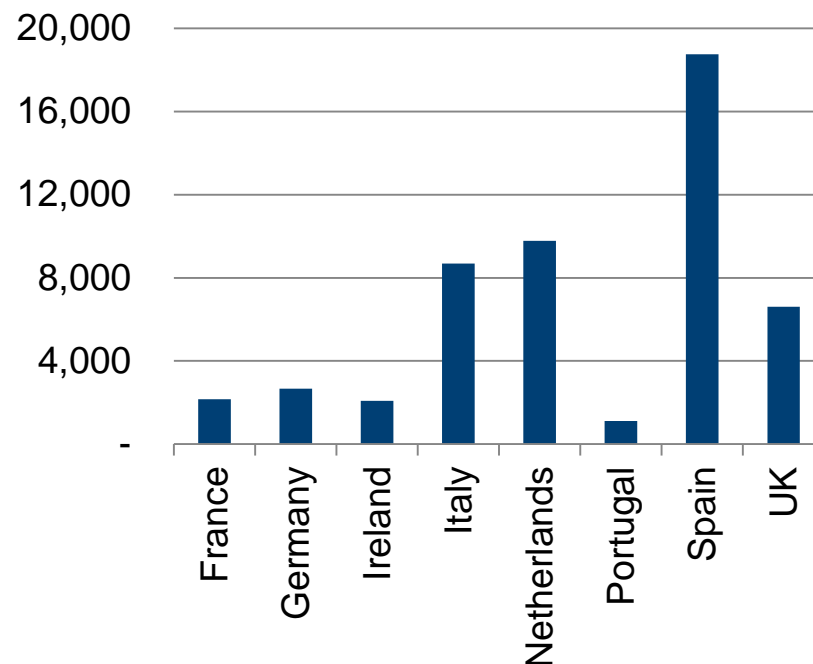
The ABSPP did not change the overall dynamic created by the combination of cheap ABS repo and TLTRO

- Spain clearly dominates retained issuance while UK clearly outnumbers EMU placed ABS issuance

New issue volume of placed ABS since the inception of ABSPP, in mln.



New issue volume of retained ABS since the inception of ABSPP, in mln.

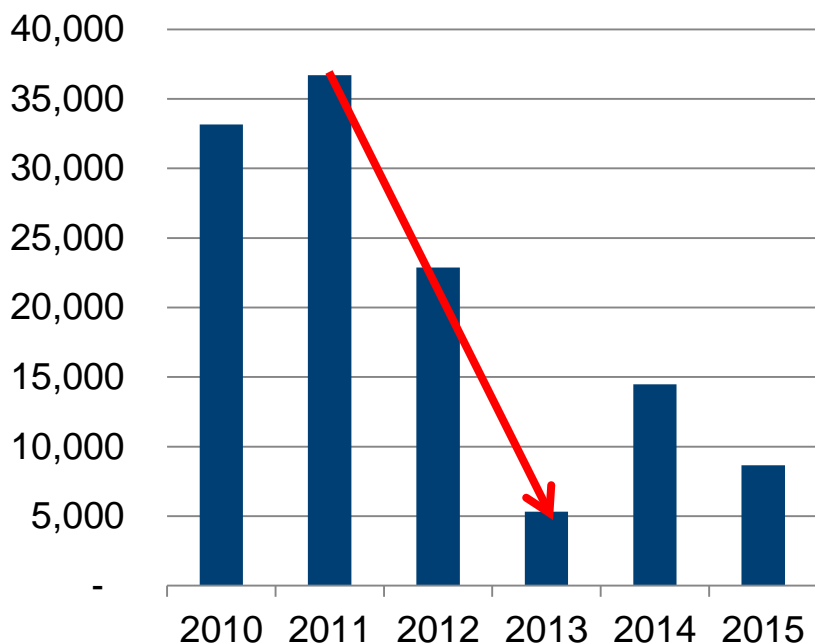


As at 11 June 2015
Source: J.P. Morgan

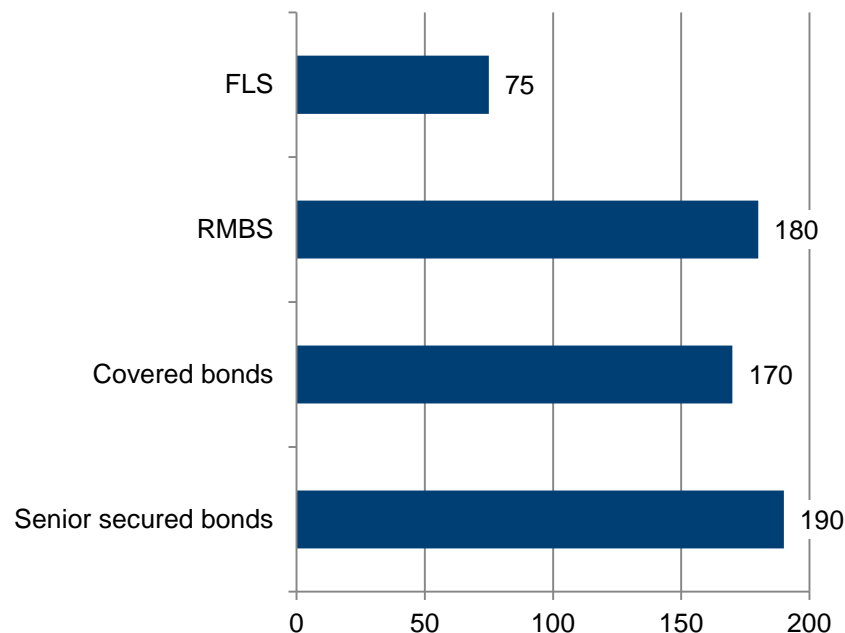
UK RMBS issuance has been brought down by FLS and is recovering since the amendment of FLS

- FLS started in 2012 and brought UK RMBS volume down. End of 2013 the FLS has been amended to exclude mortgages and include SME lending

New issue volume of placed UK RMBS, in mln. EUR



Estimated total bank's funding costs as per November 2012, in bp

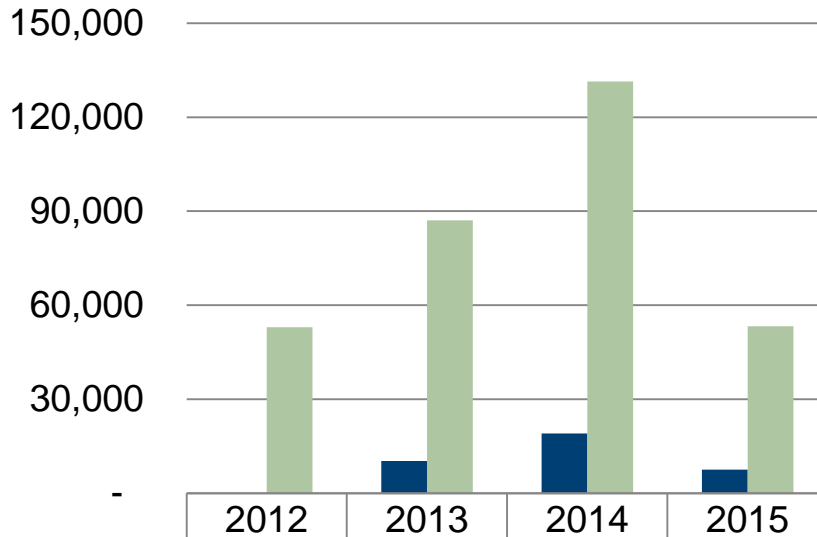


As at 11 June 2015
 Source: J.P. Morgan, Bank of England

European placed issuance is largely dominated by CLOs and UK ABS

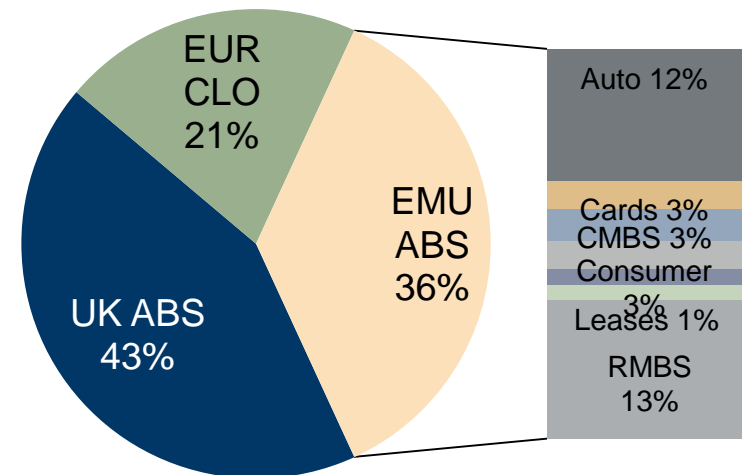
- Placed European CLO volume climbs to more than half of the overall placed EMU ABS volume while US CLO issuance is clearly outnumbering the combined European ABS and CLO market

New issue volume of placed UK RMBS, in mln. USD



| | | | | |
|-----------------|--------|--------|---------|--------|
| ■ European CLOs | - | 10,338 | 19,111 | 7,539 |
| ■ US CLOs | 52,989 | 87,088 | 131,423 | 53,298 |

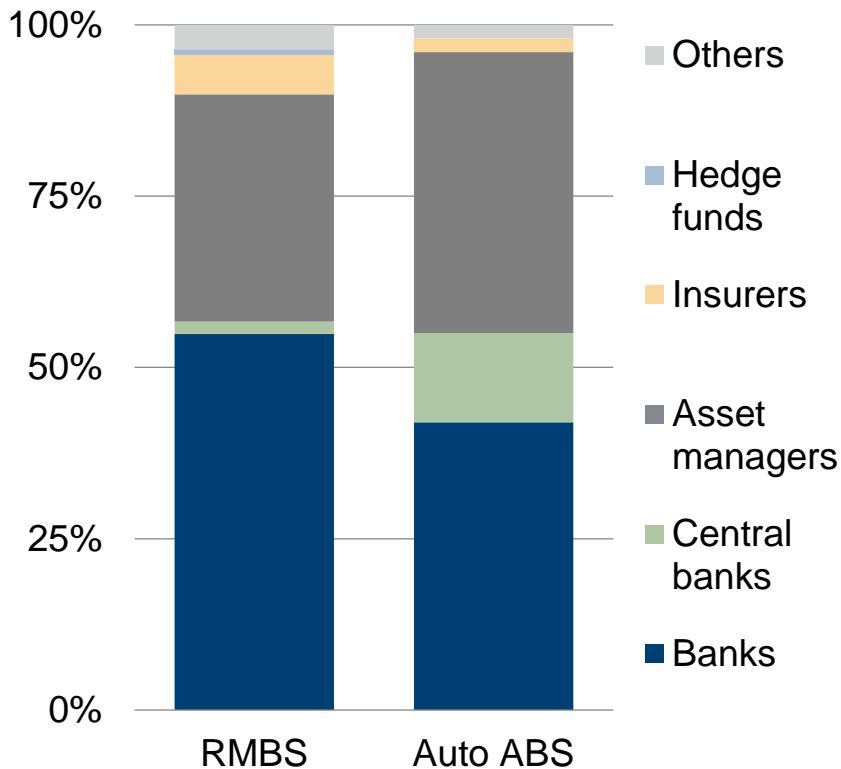
Distribution of placed new issuance in Europe



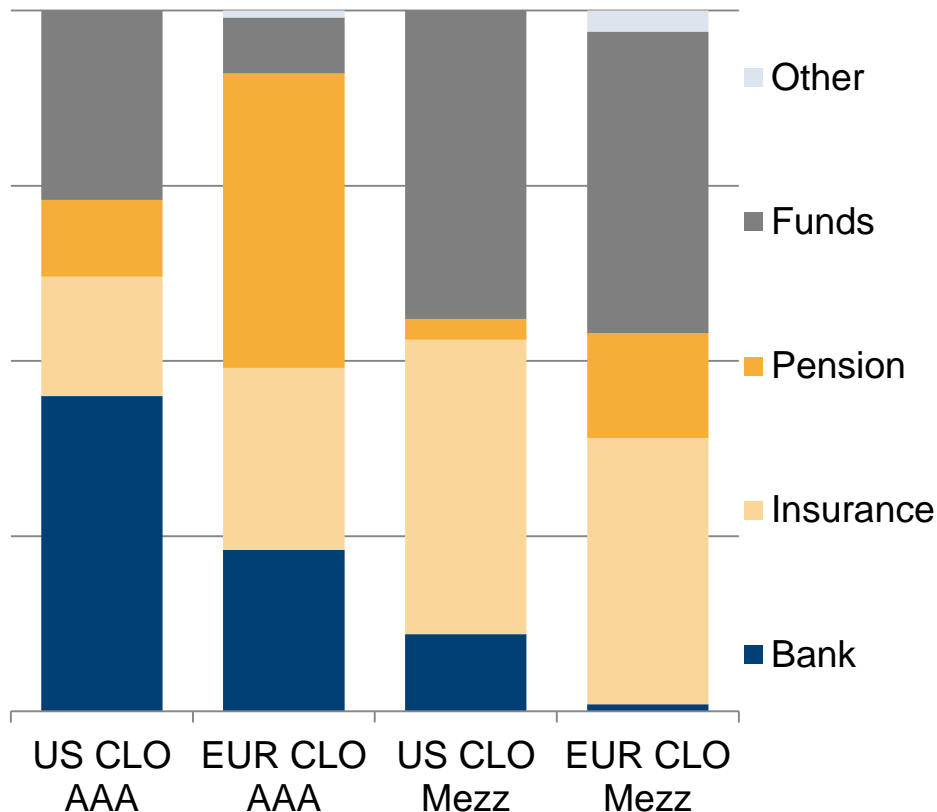
As at 11 June 2015
Source: J.P. Morgan

The investor base is balanced between active and buy and hold accounts – much healthier than before 2008

Breakdown of investors in new issues



As at 7 February 2014
Source: J.P. Morgan



As at 22 April 2015
Source: Citi,
Funds meaning Asset Managers and Hedge Funds

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