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The ECB's perspective on covered bonds

AFME/VDO covered bond conference
Berlin, 2 December 2016

The Eurosystem and covered bonds

- Asset class as collateral since the outset of the euro;
- Positive assessment expressed in classification within risk control framework: liquid => low haircut
- Seen as a stable funding vehicle; contributes to well diversified funding portfolio;
- Main private asset class mobilised as collateral in Eurosystem credit operations;
- Contributes to transmission mechanism of monetary policy to real economy.
- Three purchase programmes to alleviate funding pressure;
- Eurosystem balance sheet has currently a length of EUR 3.5 trillion. It includes exposure to covered bonds in both credit operations and outright purchases.

Broad covered bond eligibility criteria in the collateral framework

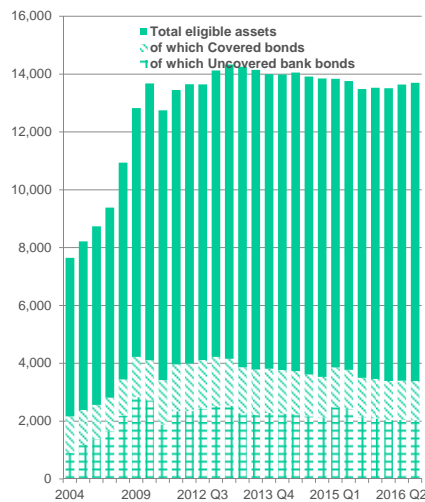
Eligibility criteria are defined by two aspects: i) collateral sufficiency, and ii) limit the Eurosystem exposure to financial risks

- **Issued:** In the EEA;
- **Admitted to trading** regulated or accepted non-regulated market;
- **Denominations:** euro but also foreign denominated covered bonds could be temporarily eligible;
- **At least BBB-** rated (one rating);
- **No limitations** as regards residual maturity or nominal value;
- Accept **covered bonds backed by ABS** but with additional criteria;
- **Two types of covered bonds** in the haircut schedule:
 - UCITS-compliant jumbo covered bonds
 - i) UCITS-compliant covered bonds other than jumbo covered bonds; ii) Other covered bonds

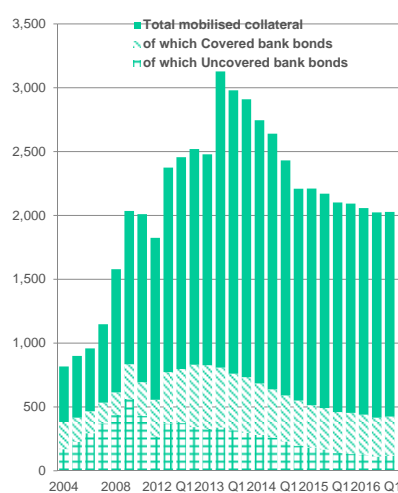
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Eligible and mobilised covered bonds in open market operations (EUR billion)

Eligible covered bonds



Mobilised covered bonds



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Recent amendments in risk control and collateral framework:
Revised haircuts as of 1 January 2017, implying slightly lower haircuts on covered bonds with credit quality step 3.

Credit quality	Residual maturity	UCITS-compliant jumbo covered bonds (category II)	i) UCITS-compliant covered bonds other than jumbo covered bonds; ii) Other covered bonds (category III)
Step 1 and 2	[0-1)	1.0	1.0
	[1-3)	1.5 – 2.5	2.0-3.0
	[3-5)	2.5-3.5	3.0-4.5
	[5-7)	3.5-4.5	4.5-6.0
	[7-10)	4.5-6.5	6.0-8.0
	[10 -)	8.0-10.5	9.0-13.0
Step 3	[0-1)	7.0	8.0
	[1-3)	9.5-13.5	14.5-15.0
	[3-5)	13.5-18.5	20.5-23.5
	[5-7)	14.0-20.0	23.0-28.0
	[7-10)	16.0-24.5	24.0-30.0
	[10 -)	19.0-29.5	24.5-32.0

Recent amendments in the risk control and collateral framework (2)

- As of 1 July 2017, minimum disclosure requirements for covered bond ratings issued by credit rating agencies accepted in the Eurosystem credit assessment framework.
 - to ensure that credit ratings are up to date;
 - to enhance transparency of covered bond ratings accepted by Eurosystem.
- In the second half of 2017, risk control measures for retained covered bonds with extendible maturities will be adjusted (e.g. soft bullet and conditional pass-through covered bonds)
 - to take into account the additional risk which results from the use of such securities by the issuer itself and to ensure a level playing field between securities with comparable risks;

Eligible CPCB and soft bullet CBs in the collateral framework (% of total eligible CBs)

	November 2015	November 2016
Soft bullet	28.4 %	34.6 %
Conditional pass-through CBs	1.4 %	3.0 %
Other covered bonds	70.2 %	62.4 %

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Covered bonds as part of the expanded APP



- Third covered bond purchase programme (**CBPP3**) in operation since **October 2014**.
- **Current CBPP3 holdings: around EUR 200 bn**
- Contributes to overall APP purchases of EUR 80 bn per month.

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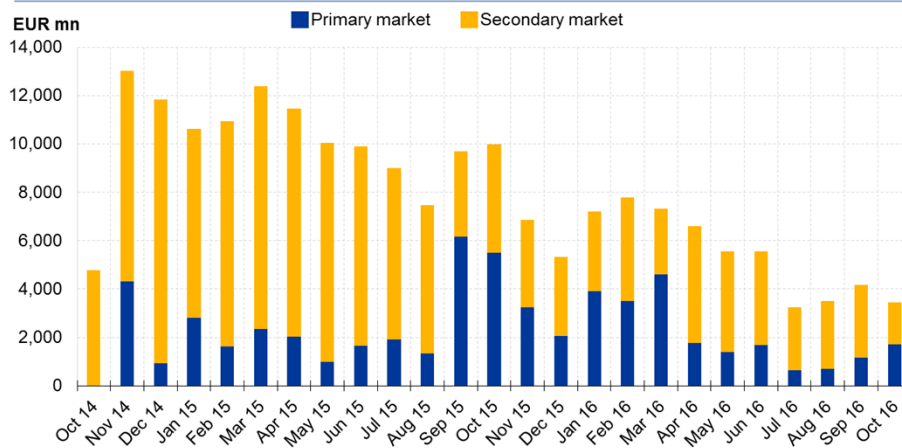
CBPP3: objectives and challenges

- **Enhance the transmission of monetary policy**
 - Being part of APP => lower funding costs of real economy in general
 - Reduce spreads on covered bonds
 - Rebalancing channel: investors have changed mandates and moved into other asset classes
- **Support credit provision to the real economy**
 - Substantial increase in covered bond issuance after start of CBPP3...
 - ...though slowdown more recently
- **Counterparty concerns**
 - Possible market distortions, liquidity, weakened investor base...

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Purchase volumes have declined...

CBPP3 monthly purchases

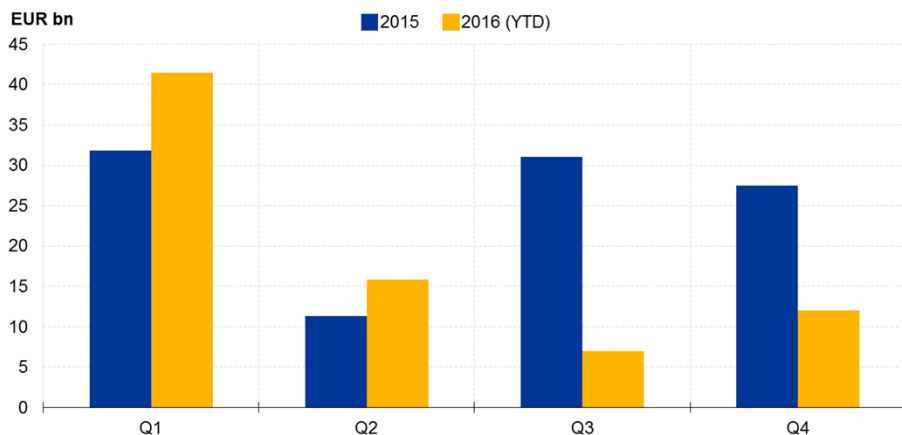


Sources and notes: ECB website and ECB calculations. Reported volumes are net and at amortised cost.

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...along with issuance after a strong first quarter

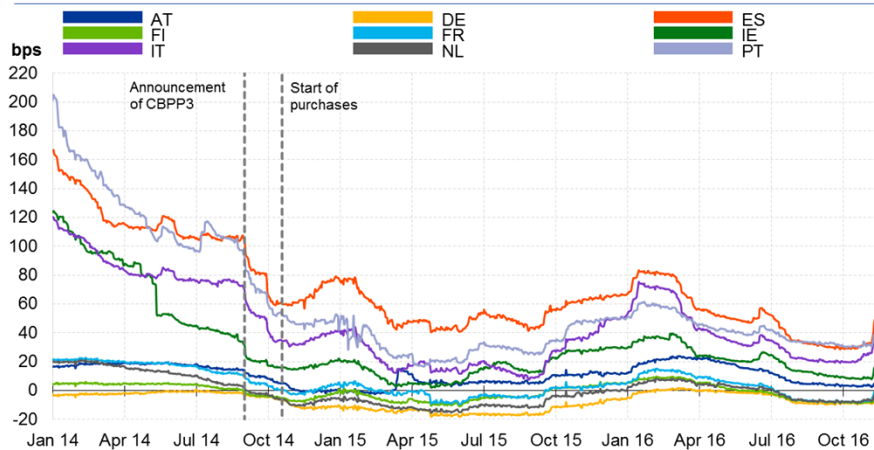
Quarterly primary market issuance of euro area covered bonds



Sources and notes: ECB calculations. The chart focuses on CBPP3-eligible issuance only. It does not include taps or private placements.

Spreads remain at low levels despite the recent uptick

Covered bond asset swap spreads



Sources: iBoxx and ECB calculations. Last observation: 23 November 2016.

CBPP3: Outlook

- Eurosystem will **remain active** in covered bond market...
 - Primary and secondary market purchases. Purchases are intended to be carried out **until the end of March 2017** and in any case **until** the Governing Council sees a **sustained adjustment in the path of inflation** consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term.
 - Reinvestment phase: “we decided to reinvest the principal payments on the securities purchased under the APP as they mature, for as long as necessary. This will contribute both to favourable liquidity conditions and to an appropriate monetary policy stance. The technical details will be communicated in due time.”(ECB President, 3 December 2015)

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CBPP3: Outlook (cont.)

- ...and **responsive to counterparty feedback** (where possible)
 - Continue **bilateral and public dialogue** with counterparties and issuers
 - Conduct of purchases so as to **minimise dislocations**
 - ❖ Eurosystem active in all euro area covered bond markets
 - ❖ Primary market: weighing volume objectives against crowding-out risks
 - ❖ Secondary market: purchases based on offers received
 - ❖ ECB adjustments to securities lending facility in April 2016
 - **Monitoring of market liquidity** conditions
 - ❖ Range of liquidity indicators (volume and price-based measures)
 - ❖ ECB as co-ordinator maintains market intelligence by being active in all jurisdictions

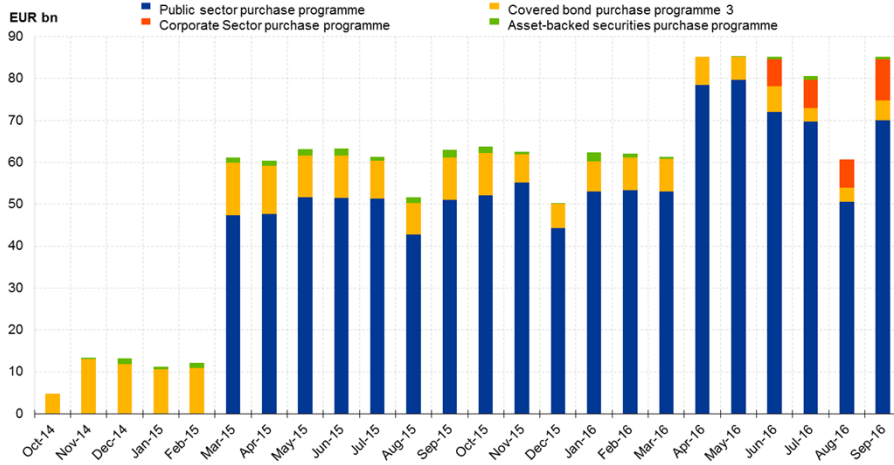
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Thank you for your attention.

Background slides

The ECB's Asset Purchase Programmes

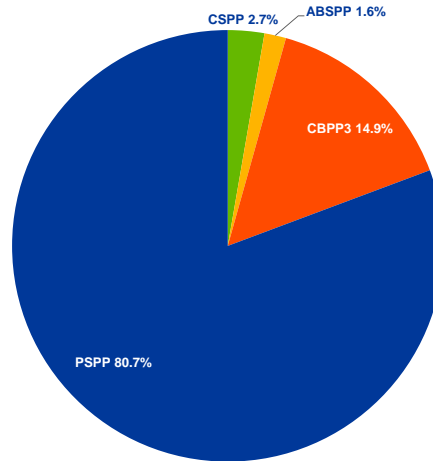
Development of monthly purchases across programmes



Source: ECB website. Last observation: September 2016.

The ECB's Asset Purchase Programmes

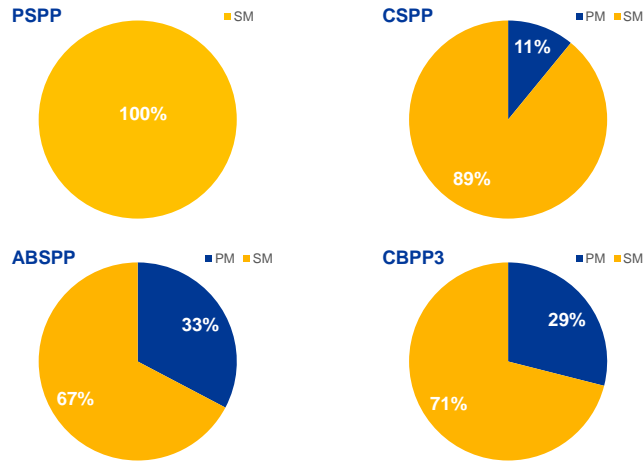
APP shares
per programme
Total: > 1.3 trillion
(October 2016)



Source: ECB website, APP includes SMP and CBPP I/II.
Last observation: 24 October 2016.

The ECB's Asset Purchase Programmes

Share of purchases in primary and secondary market



Source: ECB website. Last observation: September 2016.