The Covered Bond Report

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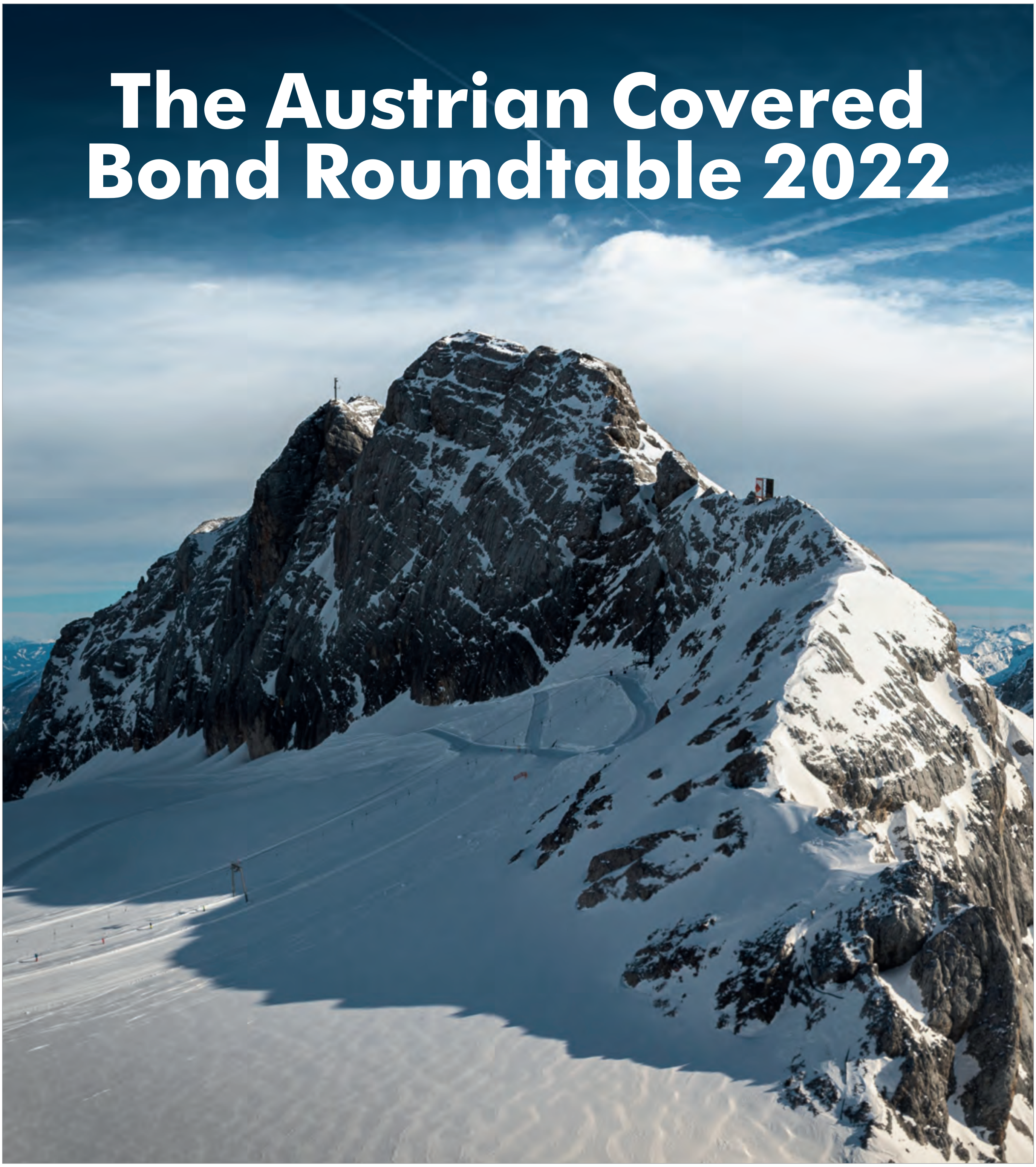
The Austrian Covered Bond Roundtable 2022



NORD/LB

The Austrian Covered Bond Roundtable 2022

Austrian banks have navigated markets rocked by macroeconomic and geopolitical shocks to issue bumper volumes of covered bonds, including green firsts, ahead of unification of the country's legislation. In this roundtable sponsored by NORD/LB, representatives of different sides of the market gathered in Vienna last month to discuss the latest developments.

Neil Day, The Covered Bond Report: It's been a very unpredictable and challenging year in many ways. We've emerged from the pandemic, but been hit by the Ukraine crisis and high inflation. In spite of that, covered bond issuance has already surpassed last year's volumes, with Austrian issuers particularly active. How have market developments compared with expectations, and what explains covered bonds' rebound?

Frederik Kunze, NORD/LB: We have witnessed very particular developments when it comes, of course, to the geopolitical tensions. But even before that, there was an accumulation of unknowns we hadn't anticipated at the beginning of the year — we even had a strong start to the year before inflation started skyrocketing. At that point, we saw heightened uncertainty around monetary policy in the Eurozone, with the Fed already moving, and risk premiums went up, with spreads and yields rising. That's always a situation that favours covered bonds. Then we had this specific additional pressure on risk premiums with the attack on Ukraine, which naturally led to a very high level of anxiety in the market and a lot of market participants just shying away. The covered bond market then came back in business quite fast compared to other markets. Issuers had previously focused on senior unsecured, for example, where competitive funding had been available, while investors had been happy or forced to take on more risk. But they then turned their attention to more safe haven assets, and this is then the hour for covered bonds, because of their dual recourse and greater security, while rates are less volatile than for other instruments. This trend was also reflected by issuance in shorter tenors than longer. So we both saw some catch-up in volumes from the crisis of the previous years, as well as some pre-funding in uncertain times.

Day, The CBR: Gernot, how have you coped with developments? What has been your position vis-à-vis covered bonds and duration?

Gernot Hauzenberger, Kepler-Fonds: First of all, we have a good portion of covered bonds in our strategic asset allocation. If we look at funds with government bonds, SSAs and covered bonds, covered bonds typically make up around 40% of these, which is already a pretty strong view on them as an asset class. This year, we also upgraded our position to around 45%, because we think with interest rates rising and swap spreads widening, covered bonds really offer an attractive pick-up against government bonds, while still being quite stable. On one side we have seen all this new issuance coming out, most of which has been priced pretty attractively, offering good new issue premia; on the other side, the secondary market hasn't really been affected by that. However, recently we have been reversing our overweight a bit as the pick-up against core government bonds has narrowed. But we still like our position there and given all the uncertainties about some other asset classes, covered bonds continue to be an attractive investment for us.

Regarding duration, we have favoured the five to seven year part of the curve, because looking at the spread to the swap curve there has been almost no steepness — even if it came

Participants *(above, left to right)*:

Philipp Bank, head of sustainable bond origination, NORD/LB

Federico Pezzolato, associate director, sustainable finance business manager, ISS Corporate Solutions (ICS)

Markus Payrits, head of liquidity management, Hypo NOE AG

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

Robert Musner, head of treasury, Oberbank AG

Christoph Zoitl, head of treasury, HYPO Oberösterreich

Gernot Hauzenberger, fund manager, Kepler-Fonds Kag Mbh

Frederik Kunze, covered bond analyst, floor research, NORD/LB

back a little bit during the course of the year — whereas in government bonds you have at least some steepness. So, you don't get much benefit out of going longer in covered bonds.

Day, The CBR: Issuers have also had to contend with the unanticipated developments. Have you diverged from your funding plans for the year?

Robert Musner, Oberbank: Yes, we changed our plan a little bit. Our initial thought for this year was to issue a senior bond first, but because of the Ukraine crisis, it became much more difficult and spreads were much wider. So we went for the more secure paper, the easier issue. Furthermore, and particular to Austria, the new covered bond law that will come into force on 8 July is a reason why most of the Austrian banks have been issuing before that date. The third point relates to the ECB: as the year progresses, they will be buying a smaller amount of covered bonds. So the combination of these reasons explains why we changed our plan and issued the covered bond. As for the second half of the year, we will monitor what happens and decide what we want to do accordingly.

Day, The CBR: Markus, Hypo NOE mandated a covered bond just ahead of the Russian invasion but ended up issuing only recently. How did your strategy evolve?

Markus Payrits, Hypo NOE: Our plan was first to come with a senior transaction and then to follow this with a covered transaction. But as you have mentioned, the Ukraine crisis arose and the market for senior unsecured transactions shut down. So we decided to switch the timing, thinking, OK, at least a covered bond is a safe haven product and it should work. But we wanted a longer dated bond, seven to 10 years, and at this time, it wasn't possible to print a seven year transaction. So we switched back to a shorter senior transaction and issued a few weeks later. This was a very good decision, because there was a good market window for short-dated bonds and it was a very successful transaction. We then waited

Robert Musner, Oberbank:
'Especially as a smaller issuer, it is particularly important to find the sweet spot for the investors'

another month and recently printed the seven year covered bond out of our mortgage pool, and we were absolutely happy with the outcome.

Day, The CBR: Christoph, you are entering the market now. Was that in line with your initial plan, or did you also adapt to market developments?

Christoph Zoitl, HYPO Oberösterreich: For sure, we changed our plan. We are not the biggest bank in Austria, and in the past we issued one sub-benchmark every second year, but now we are going to issue annually. And for us, taking into account the anticipated development of our lending, the best timing this year would have been September. But what with the whole situation, especially the ECB, we moved the sub-benchmark covered bond into the first half of 2022.

Central banks are still the biggest game-changer. As serious as this terrible war is, the market can cope with it much better than it can deal with uncertain central bank policy. Typically, if you have two days when the markets are closed, everybody revaluates the situation, makes some adjustments in what they expect in terms of spread, and then you can start issuing with safe products like covered bonds. But what we have seen from the end of last year — when most of us made our plans for 2022 — is that, even if we expected rates to go up, central banks were behind the curve on inflation, the war broke out, and now TLTROs are running out — we would have expected there to be a lot of senior funding to replace TLTROs, but with the new rates situation, maybe many banks will stay in TLTROs and try to reallocate their funding plans. So the central banks make a huge difference.

Day, The CBR: Robert, was the maturity you issued affected by market developments? And Gernot mentioned that new issue premiums have typically been quite attractive — were you a bit more pragmatic in that respect?

Musner, Oberbank: Our original plan was to issue a 10 year bond but all the transactions close to us had a maturity of up to five years. Therefore, we chose a compromise and went for seven years. Especially as a smaller issuer, it is particularly important to find the sweet spot for the investors and despite some discussions with our lead banks it was the right decision. It went very well and was our best trade up to now.

It's always a question of timing. If we are coming in a bad time — the same name with the same product, perhaps 2bp wider — it doesn't work.

Payrits, Hypo NOE: One point we saw on our covered transaction last year is that a re-offer order is no longer a re-offer order. The order book had grown very well to over €1bn and a lot of these orders were "at re-offer", but then we made the final spread change and a significant number of the re-offer orders were deleted. This highlights the spread sensitivity among investors.

Day, The CBR: Austrian covered bond supply has been second only to France and Germany among EU jurisdictions — perhaps you welcome that if you are weighted towards covered bonds, but is it affecting the level at which you are willing to buy?

Hauzenberger, Kepler-Fonds: Yes, that definitely has an influence on our appetite for Austrian covered bonds. The first transactions came at pretty attractive levels and we participated, not expecting a flood of Austrian issuance to come, so we have already filled our portfolios with Austrian covered bonds. As a consequence, our participation rate has come back a bit recently, not that we think the issuer or the pricing is bad, but just because we have already participated in a lot of Austrian covered bond new issues and the cash available for them has run a bit dry. One good thing from a diversification point of view, at least, is that it's always a different issuer coming to the market.

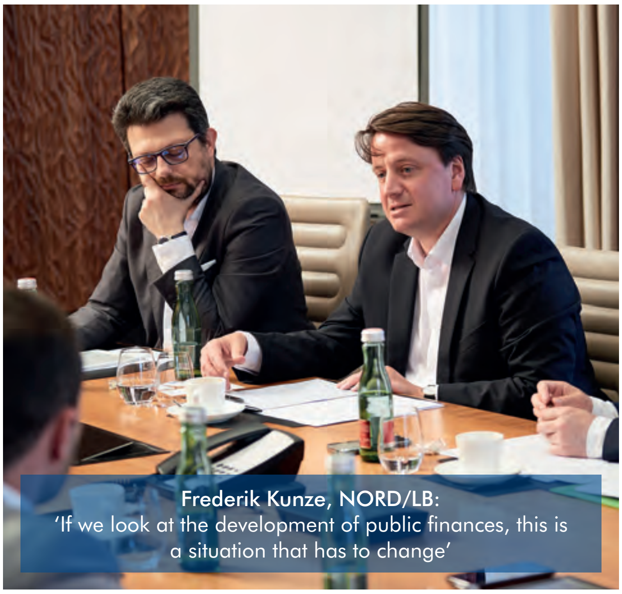
Day, The CBR: Looking ahead, what are your expectations regarding the ECB, and how that might impact covered bond spreads and volumes?

Kunze, NORD/LB: The most important factor has already been mentioned, namely the ECB. If we look at what they have done in past years, through the various crises, they have dealt with the covered bond market in two ways. On the one hand, they have reduced supply with the TLTROs, while on the other hand, they had a lot of demand via the purchase programmes and crowded out real money investors. These measures are now going to be unwound, step by step. The purchase programme will end 1 July, but there will still be reinvestments, so we don't expect a very strong impact on spreads from the demand side. Having said that, a lot of it is already priced in, and even though we have seen more supply in the market, so far there has been a lot of demand from investors stepping into covered bonds as they exit more risky asset classes, such as corporates. So we do not expect this situation to lead to much appreciation in spreads — maybe just a few basis points, although perhaps a bit more for longer tenors.

What will be more interesting is seeing how the TLTRO measures will run out and how this then affects covered bond spreads. The biggest tender, of roughly €1,200bn, will mature in the middle of 2023, and we will see how much issuers will fund via covered bonds before that — although we assume that not all of the TLTRO volume will need to be refinanced because it includes a lot of opportunistic behaviour, a lot of hot air, that doesn't need funding. As we have heard before, the funding schemes of issuers might have changed substantially — less unsecured issuance, less central bank liquidity, and also in some jurisdictions, less deposits. During the Covid-19 crisis, we had forced and precautionary savings, i.e. higher deposits, but this will now change — also because of inflation, with private households potentially having to use their savings, maybe to buy property which is still very costly, and with higher interest rates affordability is also an issue. So, much more covered bond funding will be necessary in the coming year compared to previous years.

This should then lead to spread widening, in combination with more differentiation in spreads between covered bond jurisdictions as investors take a different view of risk. An Italian OBG, for example, will widen further than a German or a French covered bond. This is what we expect in the first half of 2023.

Hauzenberger, Kepler-Fonds: We always look at covered bonds from a relative value perspective, comparing them to government bonds in our government and SSA portfolios, and from that perspective they are still attractive. Spreads between covered and government bonds have narrowed recently, but they are still attractive, and as long as that remains the case, we will continue being well invested there. We think that swap spreads of covered bonds could widen a bit with some negative technical factors being around the corner, like the ECB going away, TLTRO refinancing and also, as was mentioned, risks around economically weaker jurisdictions like Italy. At the moment we don't have a lot of investments in Italian covered bonds due to the fact that they are too tight compared to the better rated regions, such as Germany and France. So, we agree there will be a bit of differentiation between the countries, and also between issuers — look at RBI's latest transaction: at the start of the year they could print at nearly the same level as every other Austrian bank, but now they have to offer around 15bp of pick-up. This shows that, apart from the name, which is in the news a lot at the moment, investors have also started differentiating a bit in respect of cover pools. RBI's is not triple-A, it's only Aa1, the cover pool is mainly commercial, and also more than 10% in eastern Europe — these are all factors that investors are pricing in and want some higher spread for, which wasn't the case at the start of the year. With the ECB leaving the market, these factors will become a bit more pronounced as we go through this year, and also the start of the next year.



Frederik Kunze, NORD/LB:
'If we look at the development of public finances, this is a situation that has to change'

'Much more covered bond funding will be necessary'

Day, The CBR: What impact might macroeconomic developments have on cover pools and/or the credit quality of issuers?

Kunze, NORD/LB: First of all, I would say that investors should always take a closer look at the cover pools before investing, just to know what they comprise. In Austria, for example, there's a very transparent way to get close to this information, which is good. And then, of course, they should have a closer look — given that we are discussing changing macroeconomic circumstances, with rising rates — at things like affordability. What might the effect on the housing market be? It's always good to have a look at LTVs, indexed or unindexed, and if the cover pool is well balanced and seasoned. Then when you have this level of information you can see what the impact of a sudden move in rates is on one covered bond or another, and whether they will be well shielded against it. Maybe the exposure to a certain region is too high, while a higher share of residential assets tends to make them somewhat safer. And ultimately, this should be reflected in a difference in spreads.

But we do not expect a situation where rating agencies will lower or downgrade covered bonds from some specific region en masse. They may put them on watch and take a closer look, but one importance of the covered bond is that — as long as the crisis is not too severe — you can add collateral, you can manage the overcollateralisation ratio. And so we don't really need to be afraid that there's a big problem on the horizon.

That said, if we look at the development of public finances, this is a situation that has to change. We cannot go on from one year to the next saying, it's a special year, we have to do something, we can take on more debt. It is important to return

Philipp Bank, NORD/LB:
'If we take a look at climate transition in relation to private households, more and more conflicts will arise'

to fundamentals and have a market where investors see that public debt is not piled too high.

Day, The CBR: Turning to sustainability topics, the war has also brought energy and related issues into focus, after the Covid-19 pandemic had brought social issues to the fore. How has thinking regarding ESG evolved?

Philipp Bank, NORD/LB: I think the war showed us that the most important point will be the "G", not the "S" or the "E". But, yes, the new discussions regarding the energy transition show us that this topic — the "E" — will remain important in the future. I'm not sure whether the "E" will be more important or the "S", because if we take a look at climate transition in relation to private households, more and more conflicts will arise because an energy transition is not possible for every household — it's only achievable if you have a higher income and I'm not sure if governments can support everyone through this transition. Some governments are doing so in respect of cars, where some subsidies are available, but I'm not sure whether that's possible when it comes to green buildings for lower income families. We should perhaps discuss with investors and SPO providers whether to try to adapt energy efficiency or transition targets so that there is linkage to salaries. Because when it comes to NZEB buildings, for example, I don't think that's achievable for all families who would like to buy or renovate a home. This will become increasingly important, particularly with the higher interest rate environment.

Day, The CBR: Federico, what's your take on this? What's driving the market and what new developments are you seeing?

Federico Pezzolato, ICS: In the last couple of years we have experienced incredible growth in the market regarding not just covered bonds, but all types of sustainable finance transactions. Volumes in the first months of 2022 are definitely lower compared to last year because of all the various macroeconomic elements that we have already discussed. However, we are continuing to work at more or less the same pace as last year, so issuers are probably just taking their time to better prepare their frameworks and strategies, waiting for the right moment to approach the market with their transactions. So these thematics are definitely here to stay.

There are a number of initiatives at the moment aimed at driving the market's growth in a better ordered way, given that there is a confusing variety of taxonomies, regulations, etc. And the war has introduced some further elements into discussions. Among others, the topic of the "just transition" is definitely on the table at the moment. Subsidies for cars, for example, are a good way to support the transition towards cleaner transportation, but they target a segment of the population that can afford a private car, so maybe we should look again at the general means of transportation. So the debate is ongoing, with new and sometimes confusing elements, but this is positive in some ways.

We are also seeing more sophistication when it comes to structures. Our analysis is not currently influenced by whether we're talking about a vanilla bond or a covered bond, apart from the analysis of the assets we run, but going forward, we will probably see more differentiation between instruments. For instance, ICMA is talking about the launch of a new set of guidelines for commercial paper, which has so far been treated as an ordinary bond, even if it isn't.

> 'The topic of the "just transition" is definitely on the table'

Day, The CBR: Gernot, is ESG becoming more prominent in your activities? And has Ukraine influenced your approach? For example, some have even gone so far as to argue that armaments manufacturers could now be considered suitable for ESG funds.

Hauzenberger, Kepler-Fonds: Developments in the direction of ESG, becoming more and more high profile, had already started before Covid or the start of the war, and are part of a longer term process. We are really having to look at all the EU regulation coming in — SFDR and the new MiFID scheme, for example — and to adjust our products so that they are compliant with the new rules and also to satisfy our customers when it comes to ESG.

Regarding armaments, we are not reviewing our approach to defence firms, because you always have the problem, where do you draw the line between a weapon that is only used for defence and one that could also be used by an aggressor? And once it is produced, who is it sold to? Those are not straightforward questions and since it is difficult for the firms to provide the relevant information and even more difficult for someone to judge if the defined lines aren't crossed, we say, hands off the weapons industry for our ESG funds.

However, we are reviewing a related matter: for our strict ESG funds, where we have an exclusion criterion whereby governments are excluded if they invest more than 2% of their GDP for defence. We are now rethinking this in light of the Ukraine crisis.

Day, The CBR: Robert, Oberbank issued the first green covered bond from Austria. How does that fit in your overall strategy? And have you faced any challenges?

Musner, Oberbank: Other Austrian banks issued green bonds in other formats, but we indeed did the first green covered bond out of the country and we made very good experiences with this. It has also a marketing aspect, but for us it was a very important step. As a bank we are committed to environmental protection. We have an ambitious environmental strategy that we are really focused on and we are continuously working to reach our targets. At least half of our issuances should be green bonds.

Establishing the framework involved various aspects. We had to understand how to get the relevant data out of our systems, work together with our clients and with the second party opinion provider.

So it was a first step, but just for residential mortgages. That's the easier part, because all essential and comparable data are available, but now we have to tackle more difficult steps. We are a bank that mainly finances the industry. Therefore, this segment is very interesting and important for us, but it is more difficult because of data challenges. We are working to get the appropriate information, but there is much more work to do. And it poses difficult questions, for example, if somebody is building a factory and increasing their production, is it environmentally friendly or not, and how do you calculate the impact?

Day, The CBR: You mentioned the marketing aspect — how did the deal's reception compare to how your other deals have gone?

Musner, Oberbank: As I mentioned, our last trade — which wasn't green — was our best trade. ESG helps — around 28% of our green covered bond was bought by dark green investors, and maybe half of them wouldn't have participated if it hadn't been a green bond — but for now it doesn't really help you get cheaper funding. Timing is still most important. As a sub-benchmark issuer, you really have to focus on investor sentiment and gain their trust. It is very important to convince them through a longer period.

Day, The CBR: Christoph, you have also issued a green covered bond. What is your thinking in this area?

Zoitl, HYPO Oberösterreich: ESG is one of the core elements in our strategy, which was why it definitely made sense for us to create a framework for issuing green covered bonds.

Christoph Zoitl, HYPO Oberösterreich:
'Green bonds are not the best product for financial markets to transition into a green future'

For us, the starting point was the green covered bond to bring the framework to life. But more important was developing ESG products for our retail clients, as we are a very retail-focused regional bank, and we only issue once a year. We now have around nine ESG products for our retail clients.

I would say that we are seeing a change in the market right now. Everybody can issue green senior, covered, Tier 2, or whatever, and so it's not a big advantage in terms of marketing or reputation. It's more the other way around: if you're not able to issue green, you face a "brownium", so to speak. And now that everybody can issue green, how can you really know what is a really good green product? We therefore focus our ESG strategy on the whole bank. We clearly want to issue green products for our clients if they demand them, but I think green bonds are not the best product for financial markets to transition into a green future.

Day, The CBR: Markus, what is Hypo NOE's approach to green bonds?

Payrits, Hypo NOE: We have decided to issue only green senior unsecured bonds for the moment. As I mentioned before, the covered bond is a safe haven product and you still have the participation from the ECB, so it will work most of the time. But we saw many more investors involved in our green senior unsecured transaction than for a normal issue, so the dedicated green investor base is more important for us in such a transaction. Spread sensitivity is not so high and some new and bigger accounts were involved.

Kunze, NORD/LB: It's an interesting point Christoph made, that it's important to have green bonds but that the issuer plays a bigger role. We also get questions from conventional covered bond investors about the issuer's general approach to ESG, because really what interests them is how the issuer is doing not only on the product side, but in products other than just the bond.

Gernot Hauzenberger, Kepler-Fonds: 'We look at what the company as a whole is doing ESG-wise'

Bank, NORD/LB: Yes, it's a good point, because I think that in the near future we will view green bonds like transition bonds, saying, OK, that was a first step by the issuer in improving its sustainability rating, for example. I agree that the overall sustainability performance of the issuer will become more important.

To answer the question of how green bond issuers can differentiate themselves, this is only possible if we take a look at the selection criteria. However, it would be beneficial to investors to have some harmonisation, for example, among Austrian issuers.

Another point that could be focused on in future is social covered bonds, whether public sector or mortgage-backed — these could be very interesting. And it would also be interesting to see if social bonds would have an equivalent to a greenium.

Day, The CBR: Federico, would you see any strengths, weaknesses or commonalities across Austrian issuers?

Pezzolato, ICS: In general the Austrian players benefit from a very good common starting point, in that it's a market that is well developed in this respect.

The selection criteria mentioned by Philipp, for instance, and the robustness of the frameworks are aligned with market practice.

There are opportunities to further develop the market by identifying potential new areas upon which covered bonds could be based. It will also be interesting to see if, regarding forthcoming regulation, the EU Taxonomy or Green Asset Ratio will help issuers identify and construct solid asset pools, and also aid harmonisation by leading to more homogenous pools.

Day, The CBR: I understand Austria has a national hub under the Energy Efficient Mortgages Initiative — what is happening there?

Musner, Oberbank: We have the Pfandbrief Forum and we are trying to achieve harmonisation. As I mentioned, residential mortgages are the easier asset type when it comes to data and comparability. But beyond that, it's very difficult, and so there's a long way to go. I believe that all other European countries are in a similar position. The regulator gives some guidelines, but for the moment each bank has to find its way how to calculate risks vis-à-vis the borrowers. Harmonisation would be great, but we are far away from achieving it.

Bank, NORD/LB: It's unclear how beneficial this would actually be for investors. Because if you would like to compare a German covered bond and an Austrian, for example, you cannot compare the LTVs, because every bank will calculate a different LTV. And the issue is the same when it comes to selection criteria. Is it possible to compare a green building located in Vienna with one in Vorarlberg? It could be good if everybody uses top 15% or NZEB, but there are big questions here.

Day, The CBR: Gernot, how do you see Austrian issuers faring on the ESG front?

Hauzenberger, Kepler-Fonds: They are pretty good. If you look at the ISS ESG ratings, for instance, most of the firms, including the Austrian banks, fare pretty well. Many banks have prime status from ISS ESG and most Austrian companies compare favourably against their peers. Some businesses like OMV and voestalpine face high ESG risk just from the industry they are working in, but are dealing with these pretty well and therefore have been rewarded with good ratings.

They are also pretty active in trying to attend to the green bond market. However, that's a point we don't pay too much attention to at the moment, because — as was discussed before — we look at what the company as a whole is doing ESG-wise and not just a part of their projects we are financing with their green bonds. When we give money to a company, we finance everything they are doing, not only this small portfolio they get together from their overall product portfolio and label as a green bond. That's not an approach we like; we prefer to have a good look at the issuer and if the issuer fares well when it comes to ESG, we invest in it, and if not, we don't invest. But on the other hand, if it fares well, we don't differentiate between green and non-green bonds. We then invest in the bonds we like the most regarding spread and maturity.

Day, The CBR: Federico, you mentioned some of the incoming regulation in this field, while we also have further developments such as the social taxonomy. To what extent are these areas influencing the work you are doing with issuers?

Pezzolato, ICS: As has been mentioned, one of the prime motivations for issuing a green or social bond is the marketing value you can achieve in being the first-mover in a market, in your sector or whatever. So there is always this kind of interest, also supported by underwriters, in entering the market with something new. Some issuers also want to anticipate what they think will become the norm.

The EU Taxonomy has been already adopted and implemented by several issuers, including financial institutions — even if on a best efforts basis, so there are a variety of approaches to implementing what's feasible. For financial institutions, it's particularly complicated given the number of categories that are typically present in their frameworks, and hence the number of EU Taxonomy activities that need to be complied with, especially when it comes to the do-no-significant-harm principles. And some issuers are also interested in the draft EU Green Bond Standard, even if less so.

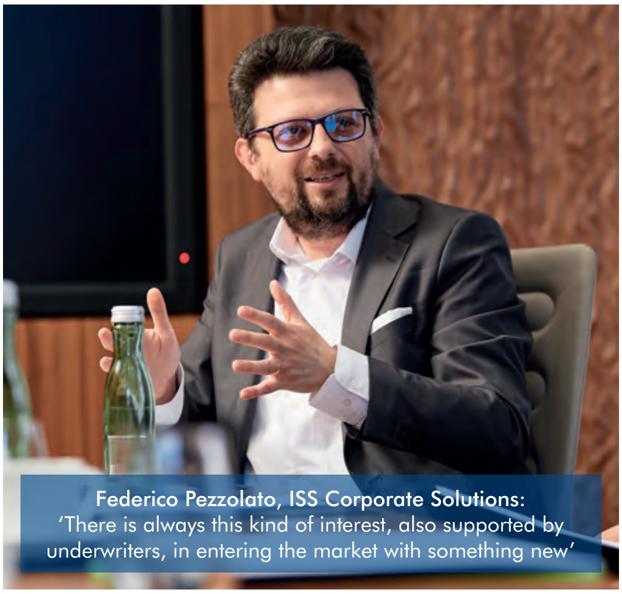
Regarding the social taxonomy, yes, there are some initial conversations around that. The fact is that we are really at the beginning of this kind of new potential regulation, so it's uncharted territory for everyone. Issuers are still developing their own approaches and we are developing our own methodology.

The area in which we expect to see the most interesting efforts in the near term is the Common Ground Taxonomy, the attempt to find harmonisation between the EU Taxonomy and the China Green Bond Catalogue and see what kind of bonds can be built around such common criteria.

Kunze, NORD/LB: As I understand it, it appears to be very demanding to fulfil all the criteria necessary to be a 100% EU Taxonomy-compliant covered bond and hence achieve the EU GBS, meaning that it's unlikely that many issuers will be able to meet the standard right away. But if investors do not look so much at the green bond itself, but at the issuer, maybe this becomes less of an issue than some policymakers would like.

Hauzenberger, Kepler-Fonds: I think we are a bit of an outlier on this question. Lots of investors look at green bonds and have dedicated portfolios where they can only buy green bonds. We have also sometimes participated in new mandates where there was an awful lot of money dedicated only to green and social bonds. For investors with such a focus on green bonds, the Green Bond Standard can be a really good thing. But from our perspective, green bonds can sometimes be seen as greenwashing or at least as "green window-dressing", because for most of the companies, it is just a question of organising data — it doesn't change anything as they are just taking projects they already have and putting them in a green bond. On the other side, as an investor, you typically have some kind of "greenium", where you most of the time get a few basis points less in spread, when compared to a conventional bond of the same issuer. So, it's not a market we like very much, even if for investors, too, there can be a marketing argument in highlighting that you have a big volume invested in green bonds.

'The harmonisation process does not make all covered bonds equal'



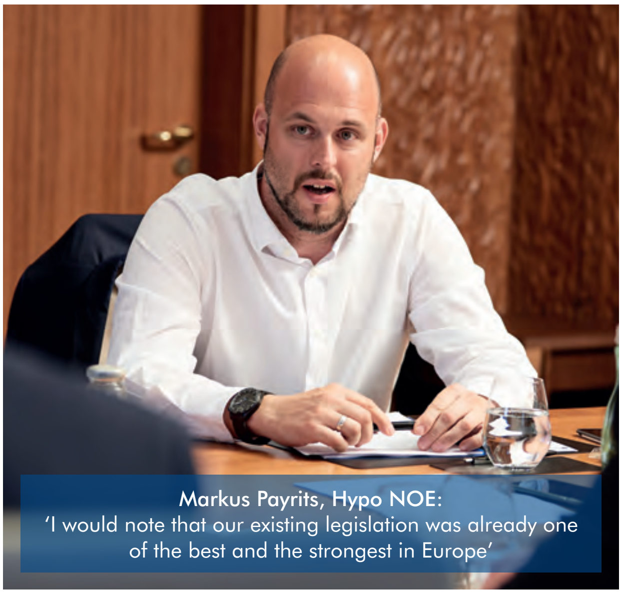
Federico Pezzolato, ISS Corporate Solutions: 'There is always this kind of interest, also supported by underwriters, in entering the market with something new'

Day, The CBR: Moving to covered bond regulation, the implementation deadline for the EU Covered Bond Directive is 8 July, following many years of development. Different countries have been preparing for this at different speeds — will Austria cross the finish line in time?

Kunze, NORD/LB: They are in a strong position to cross the line, having been in the leading pack, with their harmonisation approach published in good time. One of the most important topics is that their three laws are now combined into one. For investors who are not very familiar with the Austrian market, it's much easier if you have just one law, so this is one good point.

In general, I would note that the harmonisation process does not make all covered bonds equal, in the sense that it will not all be the same product, but the same kind of product. We have minimum standards for this product, which comes with advantages for issuers and investors. This is good news when it comes to, for example, liquidity issues, where we have really seen some improvements. Also with regards to hard and soft bullets for investors. When you talked to German investors — at least up until the latest changes to the German Pfandbrief Act — they were really keen to know how exactly a soft bullet from this or that jurisdiction works, such as the triggers, and so it's good to have transparency on these aspects, particularly in a market such as Austria, which is one of the jurisdictions where both hard and soft bullets will be possible.

So I would say that covered bond investors generally benefit from this harmonisation — although for the issuers, it's harder work because of the changes coming in. In Austria, for example, they have to decide whether to issue everything out of the same pool. I believe a lot of discussions with legal consultants and rating agencies are going on about best way how to proceed beyond 8 July.



Markus Payrits, Hypo NOE:
'I would note that our existing legislation was already one of the best and the strongest in Europe'

Day, The CBR: One of the motivations for harmonisation cited by the European Commission has been to make life easier for investors. Gernot, do you see the process as helpful? And will the Austrian product improve?

Hauzenberger, Kepler-Fonds: I think that it's mostly a positive development that there is now one law instead of three, because it makes it easier to look at an Austrian covered bond and the minimum standards it has to fulfil, rather than having to look at the details of three different laws. I think that this is particularly important from an international perspective. For example, if there's a big French investor looking at what is typically a smaller jurisdiction for him like Austria, he must look at just one law now.

From an investor's perspective, a slightly worse aspect is the higher LTV limit, which was previously 60% but is now up to 80%, even if issuers can set a lower limit for themselves. Although I think issuers will use the higher flexibility provided, they won't generally drive up LTVs in their cover pool. But still this is one point, which an investor could argue, has made things a bit worse for them. But on the other side, the liquidity buffer was not mandatory before but now you have a 180 day liquidity buffer, which should be positive for investors.

Day, The CBR: Robert, you mentioned that a reason for the heavy Austrian supply was that issuers have been keen to issue ahead of the deadline — is the move to the new legislation going to involve a lot of work?

Musner, Oberbank: It is a lot of work. We discussed some elements that were open to interpretation in the Pfandbrief Forum, and now I think we have a clear understanding regarding the main points.

First of all, I should underline that we are happy with the harmonisation, especially with the merger of three laws into one. It is a good step to a common European capital market union. We are not at one identical law, but it's getting tighter and closer. The liquidity buffer is a positive aspect for investors, as are developments in risk management, transparency, and overcollateralisation.

There's just one point I'm really unhappy with, that's the solution concerning the trustee. In Austria we now can choose between an internal and an external trustee — now we have one law, there should be no option for different kinds of trustees. But unfortunately it's too late and each bank has this choice — we wonder what the investors are thinking about this.

The positive thing for us is that we can have more cover pools. We do residential lending in the Czech Republic, for example, and we can build a separate pool rather than merging these with the Austrian and German pool, which wouldn't be good.

On hard and soft bullets, personally I expect only hard bullet structures in the future, because I don't see any advantages in soft bullets from either an issuer or an investor point of view — but it's a minor issue.

The biggest topics are in relation to the change from the old legislation to the new one and to build a common cover pool meeting both requirements — there are issues we still have to work on and to decide, for example, the LTV level and liquidity buffer. That's the challenges till 8 July. In respect of the trustee, we still have time until July 2023 to appoint one. In general, we are on our way and we think that it's positive for issuers and investors.

Day, The CBR: Are you two aligned in terms of issuing hard bullets?

Payrits, Hypo NOE: We haven't decided yet.

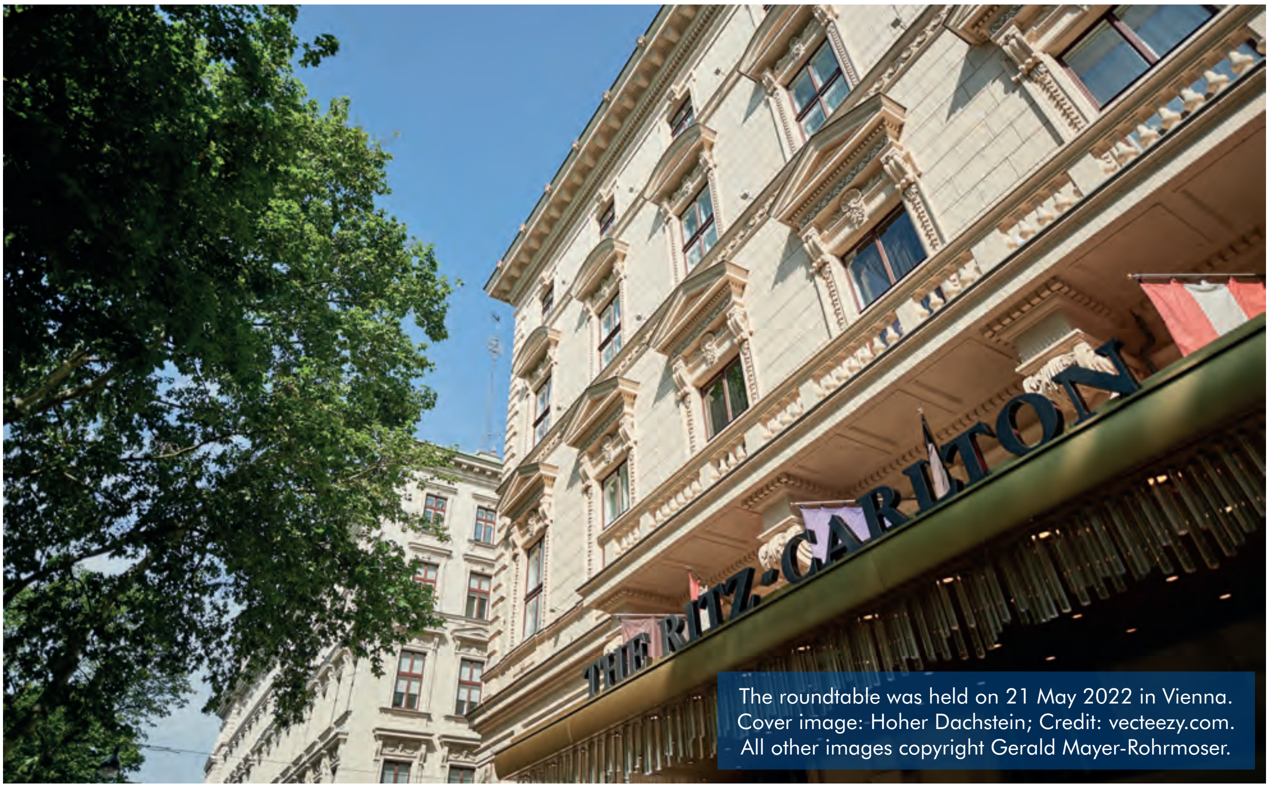
Zoitl, HYPO Oberösterreich: We only issued hard bullets in the past and we will only issue hard bullets in the future.

Bank, NORD/LB: Will the 180 day liquidity buffer make it more challenging to manage your redemption profile, particularly for smaller issuers?

Zoitl, HYPO Oberösterreich: Definitely. It's a huge change. How you deal with it depends a little on your funding strategy, how much of it is covered bonds. If I have only 5% of my funding in covered bonds, then I have enough liquidity to deal with this. We always focused on a very balanced redemption profile, and now we have a very good timeline to count the days in between.

I think the law is very good. We have to do a lot of work to implement all the new aspects, but we issued covered bonds for the last 130 years and we will issue them for the next 130 years.

Musner, Oberbank: Of course, we are monitoring our maturity profile to prevent too many redemptions in a short period. For us, it's an important point, because we are a sub-benchmark issuer and it will discourage us from issuing a benchmark — maintaining a €500m liquidity buffer is a much



The roundtable was held on 21 May 2022 in Vienna. Cover image: Hoher Dachstein; Credit: vecteezy.com. All other images copyright Gerald Mayer-Rohrmoser.

bigger challenge and more expensive than €250m. So that's a negative effect.

Payrits, Hypo NOE: I would note that our existing legislation was already one of the best and the strongest in Europe. So while it's good to harmonise, it's not that our existing legislation was bad.

A positive aspect of the new law, the Pfandbriefgesetz, is that we can all call our covered bonds "Pfandbriefe".

Zoitl, HYPO Oberösterreich: Indeed, there is an extensive part on the different names covered bonds can be called and this was a big topic in the past, that some banks were allowed to call their covered Pfandbriefe and others not. It's very good that we now have more issuers under the same law, more issues under the same name, which makes life easier for all of us.

Day, The CBR: Going back to Gernot's point about LTVs, if it's a potential downside for investors, is it advantageous for issuers?

Musner, Oberbank: Yes, it's better for us. We have mainly residential mortgages and we want to use the 80% LTV. I understand that it could be a small worsening for the investors, but I expect this will be the standard. The investors are more focussed on the rating and this will be unaffected.

Zoitl, HYPO Oberösterreich: We have an average LTV of 34% in our cover pool, so it should not be an issue if we take 60% or 80%.

Hauzenberger, Kepler-Fonds: I think it's only a small negative, just slightly worse than before — not the kind of problem where we now want something like 10bp more spread for Austrian covered bonds.

Day, The CBR: You've all been very busy issuing ahead of 8 July. How soon might we see the first issue under the new regime?

Zoitl, HYPO Oberösterreich: I think it's pretty clear that one of the big issuers will open the market, as they did in the new year, and I think that would be best.

Payrits, Hypo NOE: The new law starts in the middle of the summer, which is holiday season, so maybe we will have to wait until the end of August, beginning of September. We plan to issue a second Pfandbrief this year, but we don't know when we will get the permission to issue.

Musner, Oberbank: Each bank has to ask the authority for permission to issue under the new law, and they have up to six months' time to approve it. Therefore, we don't know who will be the first bank to receive the authorisation and when. This lack of clarity is why we issued beforehand. Maybe we will get busy towards the end of the year — we just don't know. It is to be expected that all the banks will get the approvals at nearly the same time.

Payrits, Hypo NOE: As well as being new for us, the law is new for the regulator, and they also have some issues to sort out. ■