The Covered Bond Report

www.coveredbondreport.com December 2022

The Nordic Covered Bond Roundtable

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Nordic issuers have shared in the challenges faced by global markets in 2022, while navigating domestic developments. Alongside representatives of the buyside and sponsor NORD/LB, they discuss how they fared in the past 12 months and what they anticipate for markets, macro and ESG in 2023 for our latest Nordic covered bond roundtable, moderated by *Neil Day*.

Neil Day, The Covered Bond Report: We have seen record covered bond supply in 2022. What has driven this? And how do the Nordics fit in?

Frederik Kunze, NORD/LB: It's very important to understand this year as an inflection point, or maybe even a structural break, in a lot of different fixed income markets, and especially the covered bond market. The record supply is thanks to an accumulation of uncertainties and risks in the market, right from the very beginning of the year. We had forecast a more conservative amount, around €119bn, for the primary market in euro benchmark covered bonds, bearing in mind alternative funding sources for the issuers — especially in the senior unsecured segment, for example — and of course with an eye on central bank funding in the form of outstanding TLTRO III tenders and higher deposits. Then, in light of the prevailing risks — first of all, inflation and interest rate uncertainty — we already saw some shorter tenors in the market, and then, with risks growing thanks to geopolitics, we saw much more secured funding as a reaction also to the changed demand of very many investors, which brought covered bonds to the fore. We saw that particularly after the outbreak of the war in Ukraine, with the covered bond market not being closed for a very long time. We were surprised that in the first half this issuance activity did not stop at all, with a lot of issuers coming to the market, conscious that the ECB might change course. This was also true for Nordic issuers, not only those directly affected by ECB monetary policy, but also those more taking into account general market dynamics and second-round effects. Then you of course have to bear in mind that these Nordic issuers also have their own monetary policy environment, and maybe they left this crisis mode earlier, in the sense that special central bank measures ceased. But we saw also high activity in these markets. So, in general, a very strong market this year.

Day, The CBR: Frank, how did covered bond developments play out compared with what you were expecting? And did you change your positioning vis-a-vis the asset class?

Frank Emil Jensen, Danske Bank AM: We look at euro covered bonds and Danish krone, and we can also do a little in other Norwegian currencies, but that is a small part of our activity.

We came into the year not believing that rates would go up so much. In our Danish portfolios, we were quite long duration and long covered bonds. So given how quickly rates went up, that really hurt all our Danish krone portfolios quite a lot. In our euro mandates, we were overweight covered, as I felt they were attractive compared to government bonds, but they have become even more attractive during the year. That's very nice and we are heavily overweight covereds at this time. But we are now maybe trying to scale that back a bit in some places.

Day, The CBR: Has the high volume of supply in euros affected your view of the asset class?

Jensen, Danske Bank AM: Yes, I try to be more selective in what I'm buying. There is so much out there, I could be buying

Participants in the roundtable, which was held on 28 November:

Anders Lund Hansen, head of mortgage ALM, Jyske Realkredit

Dag Hjelle, head of treasury, SpareBank 1 SR-Bank

Frank Emil Jensen, senior portfolio manager, Danske Bank Asset Management

Frederik Kunze, covered bond analyst, NORD/LB

Christian Peschel, treasury manager, Nordea

Alexander Zeidler, covered bond analyst, Moody's

non-stop, so I have to focus on what I think is most interesting. My focus has been on buying more good core Nordic names, because I'm a little afraid that, with all this issuance, maybe some of the spreads on less strong names or countries will widen more going forward than those of the more core issuers and countries.

Day, The CBR: Turning to the issuers, Christian, Nordea has been the most active across the year in euro benchmarks. How did things play out versus your projections?

Christian Peschel, Nordea: Yes, we've issued three euro benchmark transactions during this year with successful results. We've been able to deliver on our funding plan despite the high volatility in the markets. Due to the war in Ukraine, high inflation and central bank actions, we needed to have a very high focus on the timing and execution of our transactions. As a consequence, when curves were a bit flatter in the middle of the year, we went a bit longer out on the curve, doing our 10 year in September. More recently, with curves being very steep, we focused more on the shorter end, where we issued a three year green covered bond in euros.

Day, The CBR: We'll come back to the green aspect of that later on. The €1.5bn seven year that you issued in March was the first euro benchmark to test appetite for longer dated paper after the Ukraine conflict started — what gave you the confidence to go out with that trade?

Peschel, Nordea: Due to Covid-related deposit inflows and due to our TLTRO participation, we weren't active in the euro covered market in 2020 or 2021, so this was our first transaction since 2019. Therefore, we were confident that a new benchmark from Nordea Mortgage Bank would be very welcomed by the market. We had also seen markets stabilise a little after the initial shock of the Russian invasion, so we were confident that we would be able to reopen that part of the curve.

Day, The CBR: Turning to Norway, Dag, you tapped the market after what was only a short summer break for euros this year, after having issued earlier in the year. How did your funding plan develop?

Dag Hjelle, SR-Bank: We've had an almost normal year, but paying up a little and issuing a bit shorter than expected. We did our seven year in March and the market was more volatile than we had anticipated, with spreads haven gone up after the invasion. We nevertheless managed to print a nice €750m. We had planned to then issue a senior deal, but we saw that the market was pretty tough, so we then did our second euro benchmark covered bond for the year, printing €1bn in five-and-a-half years in August. We had anticipated quite a lot of supply so we were very clear that we wanted to be out early, and that paid off with a very good transaction. Since then we have issued a third covered bond transaction for 2022, in Norwegian kroner at the end of last week. Half of that was retained, but the balance was pre-funding, so we are very well funded for the first half of next year. And then our fourth

Anders Lund Hansen, Jyske Realkredit: 'Fixed income in Denmark has been equally challenging as elsewhere in Europe'

benchmark transaction of the year was a euro senior preferred in September.

Day, The CBR: Had the market improved since you opted for the covered bond instead?

Hjelle, SR-Bank: Yes, although we did have to pay up a bit. But, then again, the bank is growing, not only in mortgage lending but also on the corporate side, so we needed some senior financing, and that's what we'll also need next year.

Day, The CBR: Anders, you've issued one euro benchmark this year, also in August. How did that go and how did it fit in with your plans?

Anders Lund Hansen, Jyske Realkredit: Going into 2022, that was actually what we planned to do, just maintain our curve with a single benchmark transaction in order to remain a frequent issuer. But the second part of the year changed given that we decided to purchase the Danish part of Svenska Handelsbanken, and the banking activities there suddenly increased our funding demand, with just a bit more than €3bn in total. So we kept the doors open for a larger size than €500m when we entered the market with that long seven year deal, but on the day we were out, that was what the book could support in that maturity.

In the last two or three months, the domestic market has been quite deep and quite well functioning in the tenors we were looking for, so the majority of the Handelsbanken add-on is actually funded domestically. But of course, it has been a major change to our funding plan, suddenly purchasing assets in that amount.

So a turbulent year both in terms of funding needs, but also market volatility, has made us manoeuvre to where the liquidity was at different times.

Day, The CBR: How well did the Danish market function around the time of the Russian invasion? And what about the movements in rates Frank referred to?

Hansen, Jyske Realkredit: Fixed income in Denmark has been equally challenging as elsewhere in Europe. I imagine Frank has definitely felt some pain during the past 12 months, just like any other fixed income portfolio. That being said, we've still had a quite well functioning domestic market for tenors out to five, six, seven years, which of course has helped us fund our assets. The largest volatility has been in some of the longer dated bonds: 20 and 30 year callables have really seen spread widening. Not that it hasn't occurred in the shorter maturities, but the big swings have been in these longer maturities.

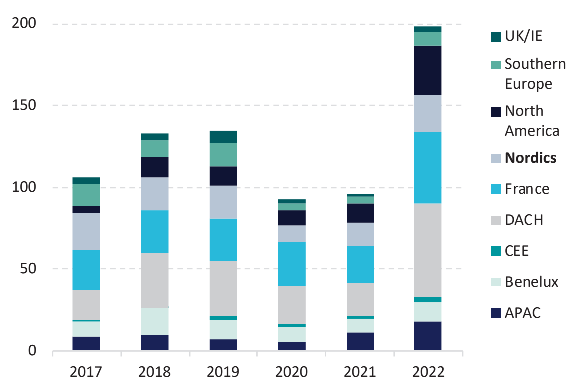
Day, The CBR: Christian, we've talked mainly about the euro-denominated debt that Nordea has issued. How have Nordea's other markets fared this year?

Peschel, Nordea: For us, the local Scandinavian markets are always a really important source of funding, because we issue our covered bonds on the back of our mortgages in the respective currencies. And the local markets not only match our currency needs, but they also offer great investor diversification. These local markets have been resilient and open also in volatile times, which is why we want to be present in all local markets. Spreads in these local currencies have increased more compared to euros, but still, the markets remain very attractive for us, and they functioned well during the entire year.

Day, The CBR: Frederik previously mentioned TLTROs when discussing alternative funding options with regard to euros and the ECB. How have parallel policy developments in Sweden perhaps affected your funding or the local market?

Peschel, Nordea: In Sweden, we've had a lot of central bank action this year, with several rate hikes, and spreads have gone markedly wider. But again, they didn't really change our funding plan that much. The plan was set, we followed through,

Euro benchmark covered bond supply (EUR bn)



Source: Market data, Bloomberg, NORD/LB and it worked very well — at slightly higher costs than in previous years, of course, but we were very happy with how the market functioned there. As in other markets, we saw some volatility, and there were parts of the year where the market didn't look as attractive, but the Swedish market is always open and always very important to us.

Day, The CBR: Frank, we've heard a few times from the issuers about paying up a bit this year. Amid all the supply there's been, have you felt that issuers have been more accommodating and flexible regarding investor needs?

Jensen, Danske Bank AM: Yes, I think so. You can see that from the maturities they issued in through the latter part of the year that have definitely been shorter, so they have tried to listen to what the investors want — we don't need that much duration anymore. That's how they can successfully come to market, by seeing where on the curve we are.

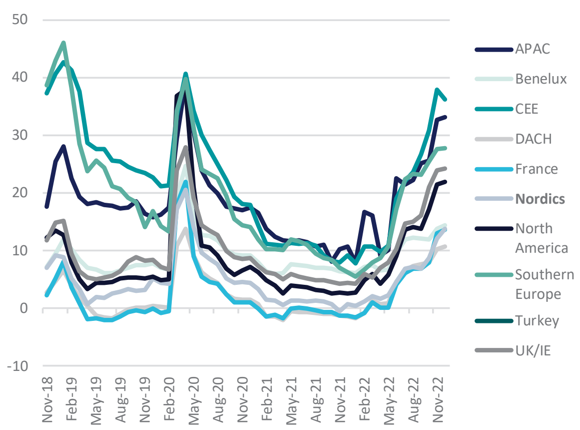
Day, The CBR: Alexander, looking at the macro picture, what were they main surprises for you and your colleagues in 2022?

Alexander Zeidler, Moody's: The two things I would highlight are, firstly, the speed of the change in monetary policy in 2022, which has been faster and stronger than many people were expecting at the end of last year, especially in the US. And secondly, the impact of the energy crisis and the cost-of-living crisis on European households, and the second-round effects that come from this in terms of GDP numbers — which will probably be more evident in 2023, actually. These have been key points for us to consider in our analysis.

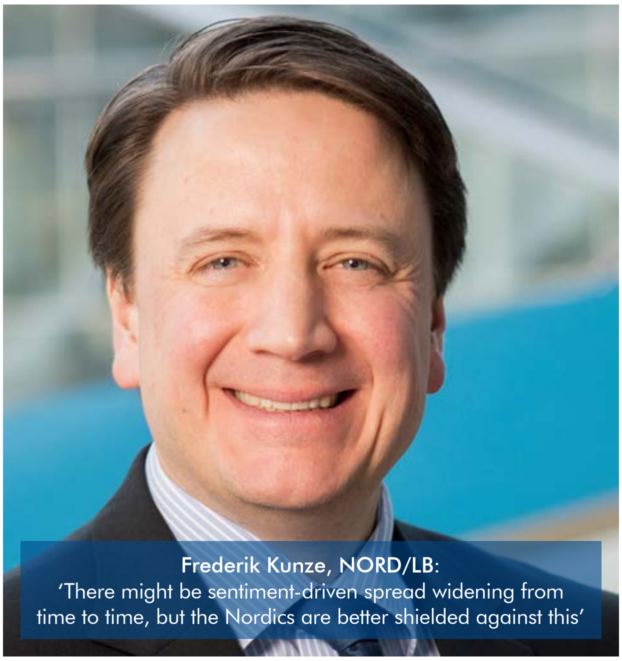
Day, The CBR: Starting to look ahead a bit more, what are you kind of expecting for 2023, Frederik?

Kunze, NORD/LB: We are often asked what the fundamental risks to the market are and, in line with Alexander's

EUR benchmark spreads (5yr, generic, ASW bp)



Source: Market data, Bloomberg, NORD/LB



Frederik Kunze, NORD/LB:
'There might be sentiment-driven spread widening from time to time, but the Nordics are better shielded against this'

remarks, there is a lot of discussion around property markets, the cost-of-living crisis and the potential impact on defaults. In this regard, we are generally optimistic, in the sense that we see stable market environments, especially in the Nordics, with low unemployment and also regarding savings levels and not over-indebted households. This is a general assumption underlying our forecast for how spreads might evolve. Regarding supply, we believe that in the Nordics we will in general see balanced supply, in the sense that at least maturing bonds will be refinanced in the euro benchmark segment, with maybe a small add-on given the fact that loan portfolios will grow — maybe not as strongly as in the past, but there is still collateral available and it makes sense to do a little more covered bond funding than just what is maturing. These technical spread drivers should lead to some more widening, of some basis points, maybe a little more for longer tenors. There might be sentiment-driven spread widening from time to time — as you cannot disconnect from general risk sentiment — but the Nordics are better shielded against this because, as has been noted earlier, they always have the opportunity to tap their domestic currencies, so don't have to rely on the euro segment — even if, for us as euro-focused analysts, we very much like to see more Nordic supply in euros.

Day, The CBR: Dag, what stage is Norway at in the macro and policy cycle?

Hjelle, SR-Bank: The macroeconomic situation is, I would say, very good. Alexander's colleagues rate Norway as one of the best countries for the time being, we have a very low unemployment rate, and so it's a good market in which to run a bank. The central bank has been increasing rates pretty fast. We expect perhaps two more hikes — if you ask me, two times 0.25%, and then we are there. That means net interest income is going to stabilise for the Norwegian banks, too. We are lag-

Christian Peschel, Nordea: 'When house prices bottom out, likely around next summer, they will still be more or less in line with pre-Corona levels'

ging behind, with high Nibor costs for our funding, and not the same income from our mortgage payers.

Day, The CBR: Are you seeing anything coming through in terms of pressure on cover pool quality?

Hjelle, SR-Bank: No. House prices declined by 2% in October, but so far in 2022, house prices in Norway are up 4.7%. And with the macroeconomic backdrop as I've just described, we do not expect any major deterioration in our pool, not at all.

Day, The CBR: Anders, what's the outlook in Denmark, and how have house prices developed?

Hansen, Jyske Realkredit: We're in a similar situation to that Dag described — looking at the outlook for the Danish economy, we're in good shape. Danish borrowers have had a high savings rate for many years, stretching all the way back to just after the financial crisis. And even though we've had an economic upturn, we've actually still had a high savings rate, contrary to theory. We are still seeing increasing employment, even at this stage, with an increase last month, so we are in a good situation there, too.

But there are some dark clouds in the horizon. The cost-of-living, the interest rate environment, etc, is putting pressure on Danish households. We haven't seen any deterioration in arrears or credit quality in our cover pool as of now, but we have kept the loan loss provisions linked to Covid 19 and are now just linking them to the uncertainty of the economic outlook.

Looking at house price developments, apartments in the greater Copenhagen area are down between 5% and 10% from the highs. House prices haven't been affected as much as apartments, but that's not only due to the economic environment, there's also a taxation element, as taxation on apartments is to be increased in the new taxation regime implemented by the Danish government.

So all in all, we are in a good place, but keeping a clear focus on what lies ahead and what could potentially impact the Danish housing market.

Day, The CBR: Christian, perhaps you can share some colour on Sweden, given that we've heard about Denmark and Norway, and Finland is more linked to Eurozone developments?

Peschel, Nordea: In Sweden, the situation is a little more challenging. We have very high inflation and a weak krona. Household indebtedness levels are high, with rather large mortgage loans and many of them floating rate, so some households are impacted by the rate hikes that we've seen. That is reflected in house prices, which are down around 10%-15% since March. However, prices are still above pre-Corona levels. Prices are also expected to continue to decline in the first half of 2023, and we at Nordea expect them to fall around about 20% in total, which is definitely significant. However, when they bottom out, likely around next summer, they will still be more or less in line with pre-Corona levels. So we're not particularly worried about credit quality in that regard. The credit quality in our mortgage books is still very, very strong, and we're not really worried about credit losses.

Day, The CBR: Frank, do you have any concerns on that front?

Jensen, Danske Bank AM: I'm a little concerned about house prices, but I'm not concerned about credit quality, because the LTVs in the cover pools are typically very low. Of course, with the rise in fixed rate mortgage rates in Denmark from 1.5% coming into the year to something like 5% now, that's quite an increase. So I'm definitely a little worried, but I'm not worried that I will not get my money back.

Day, The CBR: Alexander, what would you maybe pick out as the factors that need to be monitored more closely?

Zeidler, Moody's: I would differentiate between fundamentals, and then what this means for covered bonds. If we start with the fundamentals, for next year we expect a shallow recession for the euro area, maybe a GDP decline of 0.6%. That will have ripple effects on the Nordics, on top of the impact from the housing market, as was just described. So, on that front, we are mainly concerned about second-round effects, because historically, at least, there was quite a strong connection between the development of the housing market and the effect it has on households in terms of their savings rate and spending behaviour. Right now, we see that some households are more stretched because of rising interest rates and rising energy costs, but it's also a question of sentiment, which has deteriorated, and I would describe that as part of the second-round effect — if you see that your house price is falling, it doesn't help the mood in the household, let's put it this way.

So that's more on the fundamental side, but then we come to the question, does this mean that NPL numbers will rise significantly? There, we think it's unlikely, mainly because in our expectations, NPL numbers are much more closely linked with unemployment, and unemployment rates are clearly low, so the Nordics are coming from a good position. We expect unemployment to increase, but this will be less significant compared to many prior recessions. And even if it increases significantly, the social security systems in the Nordics are quite supportive. So that's one element that should contain NPLs, while the other is that because of the house price appreciation over the last few years, if households are stretched, most of them still have the ability to trade out, because there's enough of an equity buffer. The most vulnerable in this respect are therefore the more recent vintages, 2020, 2021 — these vintages have a much harder time trading out than the earlier ones that benefitted from the upswing in house prices. So that's why I would say, regarding fundamentals, next year will be more difficult, but in terms of NPLs, a strong rise is unlikely.

Kunze, NORD/LB: I'm on the same page as Alexander. Indeed, not every property in the cover pool has been financed at the highest possible price and the lowest thinkable interest rate, and there are big cushions for well seasoned cover pools, plus LTV limits within the frameworks, so a lot of safety buffers. And bearing in mind the dual recourse nature of the product, the first hit has to be on the issuer side, and there we do not see any big troubles ahead in general and especially in the Nordics, where we have well capitalised banks with high liquidity ratios. And aside from Finland, there are no potential risks to issuer fundamentals arising from any LCR or NSFR impacts from TLTRO III. If under a bleaker scenario there are some issues with bank ratings, there are substantial buffers against issuer downgrades for covered bonds. So over a time horizon of the next 12-18 months, we do not have any concerns about the quality of the covered bond product.

Day, The CBR: Alexander, do you and your colleagues see any pressure on bank ratings, or also on sovereign ratings that could feed through?

Zeidler, Moody's: That's one thing that sets the Nordics apart from many other covered bond markets, in that the starting point for our analysis in the Nordics is quite strong. We have very high sovereign ratings and all of them have a stable outlook, so they are really amongst the strongest triple-As in terms of sovereigns.

Regarding the banking outlook, we look ahead 12-18 months, and for most issuers, the outlook is broadly stable, even if there are idiosyncratic reasons why it's different for some. The first thing that may change would be that we change the outlook if things deteriorate more than we expect. Then

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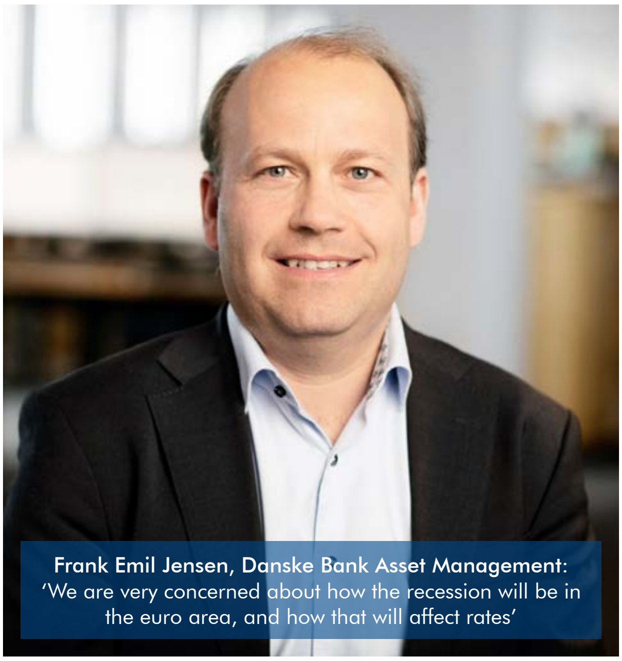
when you come to the covered bonds, the question is how much leeway do their ratings have? And there, again, you see that, for example, in Norway, Finland and Sweden, the programmes have a high leeway. That means even if the bank gets downgraded, it doesn't necessarily translate directly into a downgrade of the covered bonds. So, there are certainly buffers built in on these different levels.

Day, The CBR: Turning to issuers' plans for 2023, Anders, what you can you share about your activity and how this might reflect the anticipated macro outlook?

Hansen, Jyske Realkredit: Our funding expectations for next year are pretty similar to what we were looking at coming into 2022, so nothing remarkable, but there should again be euro-denominated paper for our investor base. It is important for us to maintain the euro curve — we are not in the euro market for opportunistic reasons, it's not important to us whether or not the basis swap is one basis point one way or the other; it's a matter of maintaining the euro market as a stable funding source for treasury, just as maintaining the local market is, too. We're looking at a euro benchmark maturity in July 2023, so we will probably already be active in the market in the second quarter. Given that the balance sheet has increased a bit, we might even look into either topping up when we do this refinancing, or perhaps doing a second benchmark at some point during 2023, so we are looking at maybe one, maybe two benchmarks in the euro market — and continuing in the domestic market as well, of course.

Day, The CBR: Christian, what, if anything, can you tell us about Nordea's plans?

Peschel, Nordea: We plan to publish our funding plans for the coming year in connection with our Q4 results, so I



Frank Emil Jensen, Danske Bank Asset Management: 'We are very concerned about how the recession will be in the euro area, and how that will affect rates'

can't share any details today. But we usually fund somewhere around €25bn euro equivalent, with half of that issued in Nordic currencies. So we expect to be, as usual, active in covered bond issuance volumes across all currencies, just as we have been in 2022.

Day, The CBR: Dag, you already referred to some pre-funding, but can you give us a broader picture?

Hjelle, SR-Bank: Sure, but before that, a quick comment related to the last question on ratings: SR-Bank is A1 with a positive outlook today, so hopefully during next year, we will have a double-A, and that would support our activity.

Yes, we are well pre-funded. But the bank is growing — one piece of news that earlier this year was that we are buying parts of Swedbank's portfolio in Norway. That is not mortgage lending, but on the corporate side, so that will increase our funding needs for senior preferred going forward. Three-quarters of SR-Bank's funding is in euros, so we will, as always, be active in the euro market. I would anticipate two benchmark covered bonds with a size aspiration of €750m, and then if the market is good, we go to €1bn, or we could be fine with €500m. And then we need some senior preferred, and also during 2023 we have to build up in senior non-preferred to be compliant as of 1 January 2024. We did a senior non-preferred benchmark in euros last year, and will probably use the euro market again for that.

Day, The CBR: So it sounds like quite an interesting and active year ahead for you.

Hjelle, SR-Bank: Interesting, yes. Probably expensive, it seems.

Day, The CBR: Frank, what are you expecting in terms of macro developments and how covered bonds are going to perform?

Jensen, Danske Bank AM: We are very concerned about how the recession will be in the euro area, and how that will affect rates — maybe rates won't go up as much as the market currently thinks. That is what we are considering at the moment, as it will, of course, influence where on the curve our money will be going. We have seen rates go down at the long end in the last couple of months and clearly if that continues, we will be looking maybe a little further out than we have done recently.

I expect covered bond spreads to widen going into next year, because of some of the ECB moves, the heavy issuance we have seen from all over Europe, and some other factors. But some of my money is invested against government bonds, and I think we will see a tightening of covered bonds relative to governments, so even though you could see we see a widening of covered spreads against swaps, it will still be attractive for me to buy covered in euros.

Kunze, NORD/LB: As Frank says, we will definitely see spread widening in the next year — not overly-pronounced, especially in the core Eurozone countries and the Nordics. Indeed, as the Eurosystem further leaves the stage, we will see what should be normal for the covered bond market, namely greater differentiation between different countries and jurisdictions, also in terms of tenor. So more widening in the countries where you expect the higher risk, perhaps due to the sovereign situation. Issuers from stronger jurisdictions will be better rewarded for their higher credit quality, with investors having to pay more for these safer areas but receive higher spreads for weaker credits. So in general, we may see healthier market dynamics, even if that comes with a small cost.

While the ECB's quantitative tightening is a technical factor contributing to general spread widening — as it buys fewer covered bonds, and offers issuers fewer alternative funding options — I would like to emphasise that fundamentals — in terms of covered bond credit quality — are not really driving spreads. It is more a question of risks around the interest rate outlook — investors want to be compensated for this risk with a higher new issue premium. Fair value also isn't clear from secondary levels, which again requires a higher spread to give investors comfort that they are not being paid too little. So the general uncertainty is driving spreads to some extent.

Day, The CBR: The EU Covered Bond Directive is now fully upon us as of this summer. It's been a decade in the making and when it was first discussed, there were some dire warnings about the potential impact on notably the Danish market. How has it ultimately impacted you, Anders? Have you had to do a lot of work or changes?

Hansen, Jyske Realkredit: We haven't had to make that many changes. Looking at the Danish mortgage set-up, we already had the soft bullet structure implemented in law, so that wasn't a big change at all. Risk weights in the cover pool are around 20%-25% and with a capital requirement of 8% of risk-weighted assets, getting an overcollateralisation level of 2% for the cover pool in the covered bond regulation is pretty much the same as what was already necessary. Indeed, as the process progressed, we could tick the boxes and see that it was going to end up somewhere where we would be very comfortable, and I must admit it has had a very limited impact on the Danish mortgage system and Danish mortgage banks. We were also one of the first jurisdictions to be aligned with the demands of the directive.

Day, The CBR: Dag, not being in the EU itself, Norway didn't have such a say in the final outcome, but is it something that you can live with?

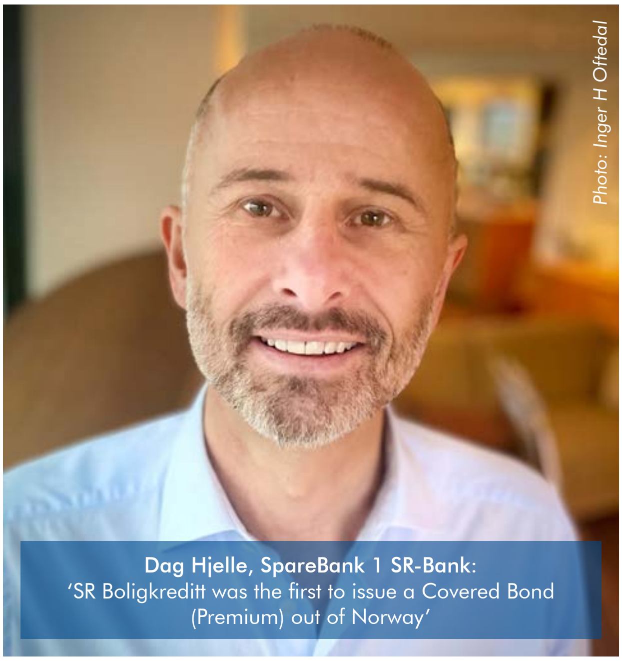
Hjelle, SR-Bank: Yes. In Norway, we are of course eager followers, adopting almost everything that is decided further south. But there was no problem here — apart from the date. We had some troubles getting a decision made, but we hit the deadline in July. And SR Boligkreditt was the first to issue a Covered Bond (Premium) out of Norway, with our August transaction. We merged the old pool into the premium, so now we issue only premium from SR Boligkreditt. So not a lot of difference.

Day, The CBR: Christian, you have had to deal with updates to four jurisdictions. What has that been like? Perhaps you could focus on Sweden and in particular Finland, where I believe the changes have been more significant.

Peschel, Nordea: As you say, we have four different jurisdictions that need to be aligned, so a lot of work went into this across the bank.

Indeed, there is a big difference in Finland. While in Denmark, Sweden and Norway implementation was done by amending the existing covered bond legislation, a new covered bond act was introduced in Finland. As a result of this, Nordea was compelled to establish a new cover pool for covered bonds issued pursuant to the new legislation in Finland. Applying the new covered bond act to legacy covered bonds would have involved more additional costs and work, so we chose to establish a new covered bond pool for all new issuance from Nordea Mortgage Bank. But everything is in place now: we have the two cover pools, one with legacy bonds under the former legislation, which is effectively in run-off mode now, and then the new cover pool for new issuances under the new legislation. The size of the two cover pools will shift over time to reflect legacy redemptions on the one side and new issuance on the other. Also, we didn't issue soft bullets before in Finland, but now we have soft bullets for all issuance after the 8 July from the new pool.

Regarding Sweden, the situation was similar to Norway and Denmark. One interesting and very important aspect for us is that Sweden is very much into tapping existing outstanding bonds and for these we operate under transitional rules. Firstly, the maturity of the covered bond has to be before 8 July 2027. Secondly, the total size of the taps done after 8 July 2022 must not exceed twice the outstanding amount at that date. Thirdly, the total issue size of the covered bond at maturity must not exceed €6bn equivalent. We need to bear those rules in mind for all our Swedish covered bonds.



Dag Hjelle, SpareBank 1 SR-Bank:
'SR Boligkreditt was the first to issue a Covered Bond (Premium) out of Norway'

Day, The CBR: Alexander, what's your high level verdict on the impact of the directive, and what were the most significant changes?

Zeidler, Moody's: Overall, the development is mildly credit positive. As you mentioned, it was a lengthy process, and for the legal frameworks in the Nordics, it broadly ended up being in line with our expectations. Unlike some jurisdictions, such as Spain, where we saw bigger shifts, in the Nordics the changes have been much more minor.

I would highlight two things. In Norway, we have seen something of a shift from contractual arrangements to law-based arrangements. If you take the soft bullet structure, for example, previously its mechanics were in the contract, while now it's law-based.

And perhaps more importantly, the way soft bullets work in Sweden is rather unique: the purpose of extending soft bullets is purely to avoid the insolvency of the issuer, whereas in other jurisdictions an extension is possible pre and also post issuer insolvency, which gives you more flexibility to extend when it provides the greatest benefit.

So overall the impact has been mildly credit positive, but without a shift in ratings when it comes to the Nordics.

Kunze, NORD/LB: I agree with the points Alexander has made, and would note that although we are talking about harmonisation, this still leaves room for interpretation, for example, in how the maturity extension works and how liquidity buffers are calculated. Because of these small differences, it makes sense to think of harmonisation as having established minimum standards where you can differ in one direction or another. From an investor perspective, it's easier to compared different covered bonds because key features and reporting standards are quite similar, even if there are some differences.

While it's good to have this framework for a bloc like the European covered bond market, one of the most important achievements is its global impact — we can already see that its influence spreading across the world, for example, in the reporting standards under Article 14 being relevant for non-EU issuers if they want to retain their LCR status. Many are already adapting to this, which is somewhat comparable to how, during the lengthy harmonisation process, a lot of issuers front-ran the expected changes by using the harmonised transparency template in order to be ready ahead of the deadline.

Jensen, Danske Bank AM: Harmonisation is always good, because it makes it easier to follow the different covered bonds. However, it's not something that we have needed to spend a lot of time on. As Anders mentioned, in Denmark there is not a big difference to how things were before.

Day, The CBR: Our final topic is ESG. Christian, towards the start you mentioned your recent green debut in euros, and shortly before that you launched a Swedish debut to complete green issuance from all four Nordic jurisdictions. What's the big picture behind Nordea's activity?

Peschel, Nordea: We are proud to be the first bank to have issued green covered bond benchmarks in all these four currencies. Everyone knows ESG is the talk of the town — you can't get around that, and we just try to embrace it. We see all the positives that it brings to us, to society. And for now, it also helps in execution.

We have a green funding framework that we update annually and this year we published our green presentation for euro covered bonds. The framework describes Nordea's approach to green bonds and a lot of work has gone into it. So far, the feedback we've gotten from investors, specifically from ESG investors, has been that they very much like this framework, because it very clearly shows what their money is used for. Going forward, the key challenge will be to continue the growth in green lending, in order to continue to be able to issue in green format, especially in the long run. For the near term, we do have more assets, but that will be one of our main challenges.

Day, The CBR: Anders, looking back, you were the first bank to report under the Energy Efficient Mortgages harmonised disclosure template. How does this fit with your issuance?

Hansen, Jyske Realkredit: It's true, we were the last bank to join, but the first one to report under the EEM initiative. That's also because for the last couple of years we've really been working comprehensively on collecting data in Denmark — in general, but also asset information linked to our cover pool. In Denmark, we have extremely good access to public data, so we now have EPC scores for all properties in Denmark — not only the ones in our cover pool, but all properties. So what we've done is, rather than just issue green bonds and show the 10% best green properties, we have shown the entire cover pool out of a point of transparency. So you can see all the EPC scores within our cover pool, and the transition within the cover pool over time.

Last week we launched an extra initiative: having all the EPCs scores, we are now able to calculate carbon emissions on an ISIN code level — for each and every bond in our cover pool, you can go in and look up the exact carbon emission of the bond, even if it's not a green bond. Which mortgages has it actually funded? What are the emissions from it? I still think this is the way to go. It takes an approach to transparency just like you would with credit: I would never just do a credit update with Frank and just show him the 10% best credits; I think he'd like to see the entire portfolio and its credit risk if he were to invest in me — I know that Frank looks at the tail risk of the credit portfolio before he invests. So as long as the green bonds are pari passu with all other issuance out of the same cover pool, it's hard to justify issuing green bonds significantly. If it's done from a separate cover pool, I see a way forward. But right now, we're pushing complete transparency within the cover pool. I know we're treading a path that not a lot of other issuers are treading, and maybe we're going in the wrong direction. But we like to show carbon emissions on all our ISINs and that's our latest initiative.

Day, The CBR: Dag, what's your activity on this front?

Hjelle, SR-Bank: I'm as much of a fundamentalist as Anders, but we lack the data.

We pool our green assets from the bank and the covered bond entity, and we then issue out of this green pool. We've done one covered, one senior non-preferred, and two seniors out of this pool, and have now issued close to €2bn off that. There's €2bn left in the pool, and we are adding to it, so hopefully we can also help in the green transition with the small steps that we are taking.

Day, The CBR: Frederick, how do you view the overall development of this market?

Kunze, NORD/LB: Not only green, but also social and sustainability-linked issuance is growing, so we are seeing a lot of positive developments. And these are most welcome, because it's a good thing to be channel financing power in the direction of, for example, alternative energy sources.

Reine, Norway
Credit: *Tampatra1/Dreamstime.com*

But there is a lot of heterogeneity within the ESG universe, which makes things more complex. It's sometimes difficult to compare different bonds and there's so much to analyse — even more so when you consider the overall footprint of an issuer and not just its green bond, which we understand an increasing number of investors are doing. Some kind of harmonisation is necessary and in this respect the EU Taxonomy is the elephant in the room — many issuers are finding it tough to comply with that, and there is a question whether the EU Green Bond Standard is really needed by investors. So overall it is very demanding for both issuers and investors to see through all these different developments to find what is the single point of truth.

Day, The CBR: Frank, to what extent are you focused on these bonds and the ESG qualities of issuers? And what is your view on how these affect execution?

Jensen, Danske Bank AM: It definitely seems easier to get your book filled up if you issue a green bond compared to doing a conventional bond.

We are somewhat focused on green bonds, but we're not totally there yet. Because of the new regulations, a minimum amount in our portfolios has to be green bonds. But all the green bonds in Danish kroner are floating rate bonds, which are only a small part of the market, so it's difficult for us to put them in many portfolios. It's easier in the euro market where you can get green bonds across the curve.

At the moment we only look at the label of the bond, and not so much at the issuer, but we will be focusing more on that in the coming year.

Day, The CBR: Alexander, how does ESG come into your work?

Zeidler, Moody's: For us, there are two aspects at play. One is the second party opinion part — how green a bond really is, if you like.

The other aspect is that we try to contribute to the fundamental question, how does ESG impact credit risk? That's important, but it's not that well covered yet in the market. Our contribution is a so-called "credit impact score". That looks at ESG separately at the issuer level: how much exposure does the bank have to such risks? And ultimately, what's the impact of these exposures on the credit risks of the bonds? Is it neutral, or maybe negative, or even potentially positive? By having this score, investors can then differentiate across issuers.

We do this for almost all the banks we rate and a large portion of the scores are in neutral territory, meaning they don't constrain the rating. The reason for that is that over the years we have already baked ESG considerations into the rating — it's not that these weren't considered before; we're just being more transparent about the underlying ESG drivers now.

Kunze, NORD/LB: Regarding the credit impact of ESG, because of the geopolitical and energy crises we are facing, we have right now a real life stress test relating to the energy efficiency of buildings — which is very relevant for covered bonds. If your home is very energy efficient, you don't have to pay such high bills, which can reduce the credit risk from the homeowner. Speaking to friends and neighbours, it is clear that those with energy efficient homes are happy these days, and those without are facing a burden — I'm not really happy about it, because my home is just too old! This is something we discussed in the past in a more theoretical way, but we can see that these discussions are not so far-fetched. ■