India Securitization Summit

November 18th 2021

Covered Bonds

WORLD BANK GROUP
Finance, Competitiveness & Innovation

Loic Chiquier, Senior Advisor

Key Features

- Global brand name: long established, top quality/security, large bond markets (Euro 2.5 Trillion)
- Funding about ¼ of overall EU residential mortgage markets (with variations across countries)

- Growing interest by non-EU issuers (now 16% of overall issuance): Australia, Canada, UK, Turkey, Singapore, Brazil, Chile (more to come: Japan, Morocco, Georgia) + cases of existing unused laws (West Africa, Azerbaijan, Uruguay, etc.)

- Rather used by large banks to diversify their long-term funding (also to comply with Basel III)
- Permits flexible ALM notably for lenders expanding their affordable long-term fixed-rate mortgage lending
- Stability feature: resilient access to funding even under stressed market conditions
- Possible contribution to develop corporate bond markets
- Usually appreciated by risk adverse institutional investors (pension funds, life insurance, provident funds)

- Complementary funding tool to deposit transformation and securitization

  -> not all lenders want to securitize their best assets when not looking for capital relief,

  -> possible cheaper cost of funds (due to 4-5 possible rating notches vs. unsecured paper)

Key Trends

- Global investors tend to prefer now a clear legal and regulatory framework (so less of structured CBs)
  -> Cover pool limited to low-risk mortgage real estate and sub-sovereign loans
  -> Authorized issuers limited to regulated financial institutions
- Several variants but common features: double recourse, legal privilege over bankruptcy/ no bail-in, cover pool administrator, public supervision, what happens in case of default, matching, minimum OC, derivatives, LTV limits
- Favorable regulatory package for investors (repo, RW, LCR, reserve requirements) to reflect risk/liquidity
- Devil in the details of country laws & bylaws: many countries race to keep improving their framework
- The 2019 EU Directive has de factor become a world standard (as a minimum denominator)
- In "new" countries asset encumbrance issue for deposit-taking credit institutions -> issuance limits (8%-10%)

WORLD BANK GROUP
Finance, Competitiveness & Innovation

Specific Questions Relevant to India

- As pioneered in India, other countries interested to use similar principles used for other assets/unregulated issuers
  - Different ESN branding in Europe: different financial/legal risks (e.g. auto loans, sme loans)
  - Better avoid the confusion for global investors
  - Turkey remains an exception among EMDEs (SME portfolio can also be an eligible cover)

- Equivalence assessment of covered bonds by EU authorities in July 2024 for non-EU countries (to access Euro investors under a favorable regulatory treatment) -> important deadline for India

- Recommended introduction in India at least for housing finance: for HFCs and banks diversify their long-term funding, and to boost corporate bond markets (given over-reliance of HFC on DA, to access longer term funding from NBFIs)

- Also recommended development of a multi-originator RMBS platform

- Policy makers /regulators to clarify the preferred direction on CBs: if to mobilize global investors, legislative path? regulatory bifurcation between covered bonds and secured notes?