Cédulas de internacionalización pique foreign interest in ECA debate

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Cédulas de internacionalización came out well in a discussion of how to best use covered bonds to support export finance at the recent 19th Central European Covered Bond Conference, with at least one German issuer considering using the instrument, amid calls for clarity and a level playing field in the use of covered bonds for ECA finance.

The Central European Covered Bond Conference, in Tarragona on 22-23 October, was organised by the Housing Chair of Universitat Rovira i Virgili, Tarragona, and the Association of German Pfandbrief Banks (vdp).

Cédulas de internacionalización are envisaged as a class of Spanish covered bonds backed by guaranteed export credits under a law passed in July 2012. The framework for the instrument is yet to be finalised, and in the meantime Spain in September 2013 laid the foundations for bonos de internacionalización, which are a pass-through version backed by a specific pool of loans, comparing with cédulas de internacionalización in a similar manner to the relationship between bonos hipotecarias and cédulas hipotecarias.

Santander in February launched the first issue of bonos de internacionalización, a Eu460m deal. That was backed by 17 credits to 13 debtors totalling Eu515m and involved five export credit agencies: Belgium's Delcredere Ducroire, France's Coface, Germany's Euler Hermes, Italy's SACE, and Spain's CESCE.

Moderating the panel discussion, Sergio Nasarre Aznar, professor of civil law, Universitat Rovira i Virgili, Tarragona said that ECA guaranteed loans have increasingly been used as collateral in public sector covered bonds since the financial crisis. In German public sector Pfandbriefe, for example, more than Eu11bn of collateral is comprised of loans guaranteed by ECAs, he noted.

However, some Eu8.4bn of this is loans with German guarantees, while it does not include any Spanish exposures.

Otmar Stöcker, managing director, Association of German Pfandbrief Banks (vdp), explained that this is because of the vdp's understanding of the parts of the Capital Requirements Regulation that are relevant to determining the eligibility of export loan's public guarantees for public sector covered bonds that will achieve preferential treatment:

> **Eligible collateral** (Art. 129.1): "**exposures to or guaranteed by central governments**, ESCB central banks, public sector entities, regional governments or local authorities in the Union"
>
> **Risk mitigation** (Art. 194): "Institutions may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where the **lending institution has the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy** — or other credit event set out in the transaction documentation — of the obligor and, where applicable, of the custodian holding the collateral"

Stöcker said that given the set-up of some ECAs – including Coface and CESCE (Compañía Española de Seguros de Crédito a la Exportación), for example – the vdp is not convinced that loans they guarantee are eligible according to Art. 129 CRR. As long as the German Pfandbrief Act framework should fully comply with this CRR provision, he said, the CRR details define the eligibility.

"These criteria seem to be clear," said Stöcker. "They are not. And so far we have hesitated to ask the EBA, which is the institution to interpret the CRR. We are still at the stage where we are investigating, and we really would like to cooperate with

CESCE to learn more about your legal structure – maybe we will find out that according to a certain interpretation of the CRR rules you already qualify, and we would be happy to cooperate with you to lobby towards the EBA adopting this interpretation.

"The problem is that as long as we are not sure that we can include you consistently for the next 20 years it is difficult to base long term finance on that in a covered bond in Germany. If five years later EBA says it interprets it in a different way, then everything that is in there has to be taken out or else all covered bonds based on that – even if it is only one loan – no longer qualify according to Article 129 CRR, with a lot of consequences on other privileges, including central bank eligibility."

His view was echoed by Ralph Lerch, global head of export finance, Commerzbank, Frankfurt chair of the export credit working group, European Banking Federation (EBF), and a member of the export finance committee, International Chamber of Commerce (ICC). He described the lack of clarity in CRR as a "fundamental hiccup".

"I would also like to advocate in favour of CESCE and many other ECAs which are not qualifying at the moment under the German Pfandbrief law," he said.

However, this has not prevented issuers in other countries including loans guaranteed by such ECAs as collateral – Crédit Agricole using Coface-guaranted loans under French covered bond legislation, for example. Meanwhile, CESCE-guaranteed loans are explicitly eligible for Spain's cédulas and bonos de internacionalización.

José Manuel Marqués Sevillano, chief of the international financial markets division, Bank of Spain, Madrid, said that the creation of the Spanish instruments is one of several initiatives being undertaken by the Spanish government to promote the country's export finance.

"Up to now we don't have any issuance," he said. "They have the sense that they will use this funding when it is really necessary and now they are required to issue some instruments in order to educate or become more familiar with them.

"It is not expected that it would be the main instrument of funding exports, but is just one instrument available for that," he added. "And what the institutions tell us is that the possibility of having this way of funding export credits is already improving their situation because they can internally assign more liquidity to these credits."

Commerzbank's Lerch called for a level playing field in how covered bonds can be used in export finance.

"If a Spanish bank can make use of the Spanish legislation to issue a covered bond using CESCE transactions as underlying assets then that's quite favourable and attractive in terms of pricing," he said. "And if CESCE is not qualifying for the German covered bond platform then a German bank may not be competitive.

"We are somehow lacking some sort of consistency in this area and maybe this is something which also can be seen as a major discussion point for the future: how can we somehow make sure that when we go for such legislation on a national level we have some sort of predictability?"

In spite of the potential advantages of the upcoming Spanish instrument, Santander has worked towards establishing a French covered bond programme to finance ECA business, with Standard & Poor's having in June published a pre-sale report for a proposed deal off a Eu5bn programme – The CBR understands it has not, however, been used yet.

Lerch said it is natural for an international bank to keep alternative funding sources open and that Santander's French move should not necessarily be interpreted as having any negative implications for cédulas de internacionalización.

"If you maintain export finance for the major international exporters in a global context, from my perspective it is always wise to carefully check what long term funding alternatives are available, not to rely on one source only, and then on top to actively support what is the most appropriate way," he said.

He said that, in light of the above-mentioned questions over eligibility for Pfandbriefe and given that it is not efficient to have multiple covered bond programmes in different jurisdictions, Commerzbank is steadily considering its options and whether its public sector Pfandbrief programme will be the most appropriate going forward.

“At the moment it looks to me that the Spanish solution could be one which is quite efficient and very flexible,” he said, “and if you ultimately achieve almost the same spread on the market like with the German or French scheme – it’s not a question of whether this is maybe 10bp more expensive or not if you have more flexibility – then we may go for it – even if it looks odd for the moment that a German bank would make use of the Spanish platform.”

Jean Christophe, head of public investment finance at Deutsche Pfandbriefbank, said that his institution is also looking carefully at the Spanish initiative for similar reasons. However, he noted that Spanish instruments could trade at wider levels because of the correlation between covered bonds and their respective sovereigns.

“Therefore, a Spanish bank with significant activities in other jurisdictions may well consider also other covered bonds in order to benefit from the gap between the Spanish sovereign and other sovereign bonds such as France and Germany,” said Christophe. “This is for instance the case of Santander in France and it certainly makes sense from a medium and long term point of view.

“This is all the more the case as creating such a product from scratch is a challenge: financing demand must meet investors’ appetite and a certain level of liquidity is required to make the covered bond attractive.”

Christophe also said that removing ECA assets from the cover pools of German public sector Pfandbriefe would further shrink an already diminishing stock of assets eligible for the instrument.

“If you look back 10 years, the public sector Pfandbrief market was roughly Eu800bn, he said. “Today it’s a quarter of that. So if we are creating ECA cover pools, we will take that out of those Eu200bn, and there will be even less liquidity and less public sector bonds on the market.

“Frankly, I don’t know what kind of assets we would put in under the German bucket in our cover pool. Loans to German cities with tenors up to 30 years at 10bp margin are currently not really an alternative.”

Indeed the vdp’s Stöcker said that a key question facing the industry is whether the ECA business is financed via public sector covered bonds or a new class of covered bond.

Some slides from the discussion can be found on the vdp website.

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