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Nordic financial institutions roundtable

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Nordic financial institutions demonstrate resilience and agility amid market turbulence

Nordic financial institutions needed to navigate a series of macro risks across the year which impacted issuance plans and demanded extra agility from them in adjusting their funding mix, price expectations, and in seizing the windows of opportunity to successfully raise 2022 funding and some 2023 pre-funding. As tough market conditions persist, DZ BANK and GlobalCapital brought together some leading Nordic FIG issuers and investors to discuss how they navigated the turbulence, together with the key trends and developments shaping the FIG market as we move into 2023.

Left to right: Patrik Götzinger, DZ BANK; Ahlqvist; Eriksson; Hjelle; Ebert; Kemmish

Participants in the roundtable were:

Dag Hjelle, treasurer, SR BANK / SR Boligkreditt

Sanna Eriksson, managing director, OP / OP Mortgage Bank

Kerstin Ahlqvist, head of long-term funding, Swedbank

Henrik Stille, senior portfolio manager, Nordea Investment Management

Matthias Ebert, head FIG DCM, DZ BANK

Richard Kemmish, moderator and GlobalCapital contributing editor

GlobalCapital: It has been a very busy year for covered bonds. Why? Is that because it has been a volatile market and covered bonds are a defensive product? Because of the end of QE and cyclical factors such as that? Or is it a permanent shift towards covered bonds being a larger proportion of total funding?

Matthias Ebert, head FIG DCM, DZ BANK

Ebert: First of all, for issuers the collateral value has significantly increased, making covered bonds much more attractive as a funding instrument. That's probably the key reason. But other cyclical factors like the end of QE and the expectation for higher yields have boosted supply as well. One factor is that mortgage loan growth was stronger than expected in the first half of financial year 2023, as a number of borrowers wanted to secure the low yields. And issuers thought that they would like to replace their TLTRO funding with wholesale funding before QT starts.

Then we had other cyclical factors, like TLAC/MREL. A number of European and non-European banks progressed with their TLAC/MREL funding in 2021 and that gave more room for covered bond funding in the course of 2022. And, last but not least, some banks also had some question marks around the stickiness of deposits that came on balance sheet during the Covid crisis — and as a result we have seen more covered bond funding.

I do not believe that in future covered bond funding will have a larger share in banks' wholesale funding overall, but I do believe that next year will be a good year for covered bonds.

GlobalCapital: Issuers, have you issued more this year?

Hjelle: In SR Bank and SR Boligkreditt we have done about what we expected. For MREL funding, we didn't have any plans in euros. We did our first benchmark in 2022, and had no plans for this year. We did a little bit more covered funding than expected. We wanted to do more senior but the market was too expensive, so we opted for more covered bond funding. So, it was almost as planned, but a little skewed towards covered bonds because of the pricing.

Ahlqvist: We have also done somewhat more than expected. We saw attractive conditions in the Swedish market at the beginning of the year and took advantage of that. Otherwise, we have not issued more covered bonds than in 2021 – in fact, rather less. It has been an effect of QE and the subsequent influx of deposits – as well as MREL: in Sweden we have January 2024 to work towards. But we did the re-entry to the euro covered bond market, which was really good. We hadn't done anything since 2019; we had been focusing on local currency covered bonds because of the lower funding need generally in covered bonds for the past three years.

Eriksson: We have done two covered bonds a year. At the beginning of the year we said 'OK, it's perhaps not the easiest market', so we went a little bit shorter than we have before and we did it green — so that we put all the good things in at the same time and it was successful. But, of course, with the new law and the covered bond directive it took us time to get our programme ready.

Ahlqvist: We observe the interplay between the two covered bond markets that we are active in: domestic currency and the euro market. The Swedish domestic market is an "on-tap-market" and we are active throughout the year. The relative costs is one aspect when we decide when to issue non-domestic. In early summer there was a shift: for years the Swedish krona has been more attractive than the euro and then that suddenly reversed – euros were much more attractive, so we took advantage of that when issuing the euro covered bond in May.

GlobalCapital: Why was that?

Ahlqvist: The Swedish domestic covered bond market has historically been resilient to international volatility but this year's global rates turbulence has affected Sweden as well. Another factor adding to the domestic covered bond market volatility has been international fast money, which has been less active this year.

Ebert: Was that also because the Swedish central bank stopped its purchase programme for covered bonds?

Ahlqvist: So far the Swedish Riksbank has not stopped the purchase programme, but it has taken volumes down since the summer. The market expects the programme to discontinue from 2023.

GlobalCapital: Henrik [Stille]: Is this volume the new norm or has this year been the exception?

Stille: I think we will probably have this higher volume for a while but it will depend on what happens in the real estate market next year. You can also see a scenario where activity in the mortgage market slows down and then we will have less supply as a result. I don't think we are there yet. There are still factors like TLTRO repayments that are pushing up supply.

GlobalCapital: Clearly, this has been a very volatile year. How flexible have your issuance plans been?

Hjelle: We had to change a little bit because of the dreadful situation, the invasion of Ukraine. We did not plan to have our first transaction in euros as a covered bond; we planned for senior. Then we had to wait for a while and we saw the market was almost fully open again at the very end of March that lasted almost a month, so we did something in late March and that was a covered bond. So, the war did have an effect on our planning.

Dag Hjelle, treasurer, SR BANK / SR Boligkreditt

Ahlqvist: We have seen enormous volatility this year; the windows have been short and infrequent. When we see a good window we need to de-risk the most risky product. That has been our strategy.

All of us here are stable names. If you are a high rated issuer, you have been able to issue and markets have stayed open. But then, and Henrik you can probably fill in here, we have been more vigilant to demand for tenors, for example, and what would work at a particular time. Investor demand has been a big factor in deciding on asset class, choice of tenor and currency. We haven't seen as many three-year bonds, for example, in the past but this year we have seen quite a few of them. Otherwise, you would go as long as you can if the demand is there; it has not been the case recently and issuers have adapted. That is also about planning well — so you don't have to issue a seven year when the demand is only in the short end of the curve.

Eriksson: You have to be ready at all times. It's not like you can make these plans for the whole year and then stick to the plan. The more products and the more currencies you can issue, the more diversification and flexibility you have as an issuer.

GlobalCapital: Matthias, what are you telling issuers at the moment about next year's plans? Obviously, volatility is here to stay. What's the advice?

Ebert: I like what Sanna just said about currencies. In the past, issuers could exclusively focus on the euro market and investor demand was there from three to 15 or 20 years. Now there is an advantage if you are more flexible on currencies — maybe sterling, dollars, Swiss francs, euros and your domestic currency. We would strongly advise issuers to keep their eyes open for opportunities in different currencies.

I believe that the dollar market will present itself as an attractive alternative for more issuers as soon as the ECB's distortions fade from the euro market.

Second, investor marketing remains key. Transparency is important in how the forthcoming recession affects your balance sheet, how it affects your loan book. Issuers should look out for new investors, or old investors that have come back to the euro covered bond market. We roadshowed an Asian central bank in Germany that was keen on investing into euro Pfandbrief. These are investors that issuers should have on the radar screen. Asia is a region that some issuers neglected for some time. That region is coming back. But there are also European investors that come back from the senior preferred into the covered bond market after the increase in absolute yields.

Last but not least, timing will be key next year. You might be better off issuing the more defensive product at the start of the year. Then later on, as the European economy improves, demand might be stronger in senior as we come out of the recession.

GlobalCapital: Henrik, you have got to invest, they have got to issue. What would your advice be about planning for next year's issuance?

Stille: What is interesting for us is that over the past year we have had much more spread widening in the domestic Scandinavian currencies than in euros, so from the relative value perspective we strongly prefer to buy covered bonds in Swedish kronor, Danish kroner and Norwegian kroner at current levels — so my advice would be to issue in these currencies. The differences are quite large. If you take the short end of the Norwegian krone covered bond market, the carry, roll-down in the curve is significantly better than in the euro market. The same in the Danish market – and the Swedish market to some extent, depending on whether you buy the bonds in the long-only fund or you repo fund the purchase. But overall, euros are very expensive relative to the Scandinavian currencies.

GlobalCapital: **Kerstin mentioned duration, and shorter transactions. Do you want to see more short-dated issuance or more flexibility on duration?**

Stille: In the Scandinavian markets they are currently issuing mainly out to five years. This makes it very difficult for the euro market to compete in shorter tenors. This is what we have been saying to syndicates for some time. If we are going to buy, it is actually better for us if it's a longer tenor, because there is no competition from the Scandinavian market. So, we can argue that it's still OK to buy a covered bond in euros, but very different in the shorter tenors. In euros we prefer longer ones. I know that's not in line with most investors, many of whom don't follow the Scandinavian markets as much as we do.

GlobalCapital: **One of the issues with longer issuance is that it is more difficult to price. First, from an investor point of view, with all the volatility around new issue pricing and the difficulty of finding a fair value, is that an opportunity? Or is it a problem in between you and where you want to be as an investor?**

Henrik Stille, senior portfolio manager, Nordea Investment Management

Stille: The main problem is always to know at what level we can sell something, if we are going to buy a new bond in primary. We always get these fair values that syndicates send us and they are always 10-15bp tighter than the indicated guidance of the new bonds. But then we cannot find any bids close to those fair values. That's the difficult thing. We need to spend some time figuring out where the real bid is before we can put in an order in the primary market, especially outside the large prime issuers from the eurozone. As soon as we get into the smaller issuers, countries in eastern Europe or southeast Asia, there the screen prices are not a good fit at all to where the real bids are, so this is a bit of a challenge.

Ebert: What could be a challenge next year is investor demand. In case investor appetite stays at the short end of the curve — because people expect credit curves to steepen and yield curves to remain volatile — one could question whether bank treasuries, as the main buyers of short-dated covered bonds, will still have enough credit lines for the expected supply next year. The ECB is behind the other central banks by about six months, which means that the bid for the longer tenors could come back to in other currencies earlier than in the euro market. I'm not saying that there won't be windows of opportunity at the longer end in the euro market, but

at least in the first quarter of 2023 we will still have the sweet spot at the short end.

GlobalCapital: **What about the point about the fair values not being realistic? Secondaries are very difficult to base new issue pricing on. What is the strategy? Is it just a large new issue premium?**

Ebert: First, I hope that the signalling power of secondary markets will improve as the ECB retracts from the euro covered bond market. Most of the bonds are with the central bank and that reduces liquidity. Second, uncertainty about the fair value needs to be offset by a higher new issue concession. Otherwise, investors will not feel comfortable to buy into the long end of the curve.

GlobalCapital: **How do the issuers respond to that? What new issue premium did you put on your recent transactions and how did you arrive at that? Is there anything you can do to reduce it?**

Ahlqvist: Back in May it was 2bp-3bp, and the market was quite different then. You probably experienced the same, it was pretty stable. But the NIC is clearly constantly changing and it is also issuer-dependent.

Hejelle: We did a billion in August and I don't think we paid very much for that. I can't even remember what the new issue premium was.

GlobalCapital: **Was that just because it was nice timing?**

Hjelle: We were quite fortunate with the timing and the market backdrop was good. We were out fairly early in August. September wasn't that good. You have to choose the right timing. If you are pre-funded you can sit and wait and chose your time.

Ahlqvist: Covered bonds are the least of our worries when talking about new issue concessions. As I mentioned before, if we have a very strong window in front of us, we will choose a higher beta asset class to issue.

Eriksson: Covered bonds have shown their character, what the product is really about. It's the one product that you could go to the market with at any time, when other windows were closed. So, in that case it was very important for the banks.

Ebert: Recently, what we have seen is that the price sensitivity of investors is decreasing with tenor. Issuers that paid up a high new issue concession at the shorter end got large order books. It still worked in the five-year bucket, but going out to seven — even paying up — did not result in a large order book. That price sensitivity to a new issue concession has its limitations, so what you need for a trade at the longer end is willingness to pay up as well as a strong issuance window.

Ahlqvist: If you look at the euro swaps, you don't get compensated as an investor to go from three to seven years – you have five basis points currently.

GlobalCapital: **Because the curve is shallow?**

Ahlqvist: Exactly. It has never been as important as it is now. When you as an issuer choose a window you are aware of how this is moving and what that means for demand. Obviously, Henrik, you have another perspective, but it doesn't make sense to go to 10 years because it means compensating for the flatness of the curve by paying higher spread.

Kerstin Ahlqvist, head of long-term funding, Swedbank

Stille: And that's what we are looking for!

GlobalCapital: **Do you agree with Matthias's point about the price sensitivity being more at the short end?**

Stille: Yes. Also, when I speak to other investors, they are much more towards the short end of the curve. That's why there is the sensitivity there.

GlobalCapital: **Can we look at next year's funding needs and potential drivers of supply. Let's start with deposits. Clearly there has been a lot of volatility. We saw a lot of Covid deposits but now we have 'catch up spending' and inflation reversing that. What are you seeing**?

Eriksson: We don't see the decrease yet. If you compare third-quarter figures with the year before, it's a 1% increase but there is a lot of discussion. We will have to see. I don't have the answer. Historically, smaller banks in Finland especially have started to offer term deposits when interest rates rise. We have started to see the first signs of this phenomenon.

Hjelle: We are growing at 7%-8% year-on-year. But we can expect the volumes of deposits to trickle back. But we also had almost 10% growth in lending, so lending was more than deposits. Probably it will go a little bit down but we are not seeing it yet.

GlobalCapital: **Kerstin, are you also seeing strong deposits but stronger loan growth?**

Ahlqvist: Yes, we do. The deposit growth has been strong over the last 10-12 years but has accelerated over the last two years because of QE. The loan to deposit ratio was 212% in 2012 and we are now at 137%. It has now stabilised from the extreme acceleration, and we expect it will be a gradual decrease. Even though we have some outflow of deposits, it doesn't mean that we need to fill it up with wholesale funding per se.

GlobalCapital: **Matthias, are you hearing from any issuers about pressure on deposits or on regulatory or rating treatment of deposits?**

Ebert: Deposits are quite a hot potato. Some regulators have more questions about the stickiness of deposits, in particular for those deposits that were rolling on to the balance sheet during Covid. That can be for good reasons, particularly in the light of high inflation, high energy costs and higher interest rates on mortgages in Europe.

But one always has to look under the surface. How much of the deposits are sight and term deposits and what is the share between retail and corporate deposits. Corporate deposits have low stickiness and are price sensitive; retail deposits are not. One could argue that for the whole financial system in a country it's just a question of how the deposits are shifted around from one client to another. However, we need to take into consideration that there are more attractive options for retail clients, as bonds are positive yielding again. And some countries, such as Germany, are net importers of energy. The environment has changed overall and this needs to be taken into consideration. It's really hard to judge on the impact on deposits for a banking system, as clients are affected very differently in each country.

If mortgages are 95% variable, rate hikes have a much larger impact on savings than, for example, in Germany, where most retail clients took mortgage loans with a fixed rate of 10 to 15 years.

Ahlqvist: I think we see it more like a closed system. If retail deposits are going into funds instead, they come back to us at some point anyway. What will really have an impact is QT and Riksbank taking out money from the system. That will shrink the volume and that is what we will be looking at more, to be vigilant on the potential affects from QT.

GlobalCapital: **Sanna, I'll let you respond to the point about floating rate mortgages. Obviously in Finland they are almost exclusively floating rate.**

Eriksson: We stress test our mortgages with a 6% interest rate for 25 years to maturity and our average maturity of a new loan is 21 years. We want to be careful. What they can also do is have an interest rate cap: 32% of our mortgages are secured with a cap, so the customers are doing pretty well, even though the interest rates are higher and the bank is enjoying it. All in all, the situation is not worrying. But everyone is asking about it because in Finland the market is so different from most other countries.

GlobalCapital: **Can I move on to another driver of covered bond supply, MREL. In the past, two or three years ago, a lot of covered bond issuance was held back by the necessity of MREL build-up. Are we there yet? Have we built up our MREL buffers? Is that going to be a constraint?**

Ahlqvist: We have until January 2024, so we are still in the build-up phase. If we look to January 2025 and onwards, the steady state outstanding volume will be quite a bit higher than what we had before the MREL build-up. So, by default, that means that the covered bond volume outstanding can be lower.

Eriksson: In our case, we have to issue more of everything. It doesn't affect that much on the covered bond side what we are doing on the co-operative side or our senior bonds, and so on. So, it's different issuers and different characters in that sense.

Hjelle: We are building up also towards January 1 2024. We need to follow a linear path and I think we are spot on. Next year, if the market allows, we will do one more senior non-preferred in the euro market benchmark format — and, of course, if we didn't have to use this expensive instrument, we would go for a cheaper one!

Ebert: The overall MREL shortfall is €21.2bn against the final 2024 targets for all European banks, as of the first quarter of 2022. In fact, €21bn doesn't seem a lot. However, 58% of that shortfall is with non-Pillar 1 banks, 38% is with top tier banks where the balance sheet is larger than €100bn, 3% is with other Pillar 1 banks and 0.3% is with GSIBs. So the bigger banks are fine; the shortfall is more of a problem for the smaller banks. Maybe it is more difficult for them to access the market in more volatile times or maybe they are more price sensitive.

With the recession that is kicking in, we will see RWAs go up. I do believe that we will also see buffers go up, which will create some additional MREL needs. However, loan growth will probably suffer, so RWA migration needs to be compared with lower levels of loan growth. I don't know what the net number will be but we will have to keep the MREL needs of the smaller banks on the radar screen.

GlobalCapital: **How much pressure are you getting for higher duration funding, long-dated mortgages, more focus on short-dated funding. Are you under any pressure to put on funding duration?**

Hjelle: No. We have a healthy maturity profile, and also a healthy duration. If this continues, if we only issue three year paper — we will end up with average 1.5 year funding and that would be too short. But I think the market will open up again. I don't know when.

GlobalCapital: **But at the moment there are constraints from rating agencies saying there is a duration gap? Or regulators?**

Ahlqvist: No. Not for us.

Eriksson: There were so many years when we did mostly seven or 10 year issuances and built up the outstanding secondary curve. Our funding profile is therefore stable and strong. Even if the demand is now in shorter tenors, we don't see it as a problem. Our funding limits are conservative and they make sure that our maturity profile will stay stable. Of course, always when we issue something we take into account the market sentiment, price and demand.

GlobalCapital: **Henrik, you mentioned wanting long-dated issuance in euros. But in general?**

Stille: That's more to avoid the competition from the Scandinavian currencies. We would hedge the duration of the longer-dated issues; we wouldn't add the duration. It's spread that we are adding.

Ebert: Are you of the opinion that the credit curve will stay reasonably flat? You can hedge the interest rate risk but you can't hedge the credit risk.

Stille: The spread curve should steepen. Everyone expects that when we are in this phase but what happens is that there is no supply in the long end, so then you don't get the steepening. When the supply comes back in the long end it is usually because the demand is also back. So we might have a little steepening of the credit curve but I don't think we will have a significant steepening.

Ahlqvist: The tenor is not what is driving the funding. We will adapt to demand. We have several metrics that we need to conform with — such as NSFR and Survival Horizon. All these metrics which are steering us mean that we can be flexible on the tenor.

If we issue more three year bonds, then of course it will roll off sooner — which will increase the funding need earlier, but it is nothing that is hindering us and it will never be the reason to go to 10 years and pay up massively. Funding planning is key. If it is prudent enough, then hopefully you don't need to be forced to issue a certain tenor.

GlobalCapital: **Can we talk about alternative currencies? We have already spoken about the Scandinavian markets and your shift, Kerstin, from kronor and kroner being more attractive to euros being more attractive. In general terms, do you look at other currencies? There has been a lot of dollar issuance this year – not particularly from this region, but could it make sense? is it diversification in a volatile market?**

Hjelle: 2017 was a favourable year for swaps. After that it has been too expensive, or the euro market has been so cheap. When the credit spreads are increasing, the dollar market could be interesting again. We are agnostic to currencies but we don't have that much to issue. We could do some dollars because we have some natural needs but so far the [sterling] market has not been an alternative for us. It has been Norwegian kroner. We could do something in Swedish kronor but I don't think so. The euro is our main motor — and then potentially dollars, if that came cheap enough.

GlobalCapital: Swiss franc ever?

Hjelle: We have done in the past, although not covered bonds. We could — that is such a small size that it wouldn't jeopardise our euro market presence.

Eriksson: On the senior side we are open to the currencies but in covered bonds we just stick with euros.

GlobalCapital: Why is that?

Eriksson: Well, I had never really thought of it! I think the euro market has worked fine for us, so there has not been a need — but that doesn't mean that it couldn't be that in the future.

Sanna Eriksson, managing director, OP / OP Mortgage Bank

Ahlqvist: For the last two years we have issued half of the covered bonds we used to issue, so we have focused on the Swedish kronor market. It's our bread and butter and it has proved to be a very stable market over time. We want to stay present there and so the smaller volume we need has been focused on staying present in the market and providing market liquidity. It has meant we have funded rather more covered bonds than needed from a pure funding need perspective.

But then we also did a euro this year as the pricing dynamics changed versus Swedish kronor. Also [we wanted] to not be out of the market too long, as we see that market as a very complementary. Swedish domestic markets and euros complement each other and we are vigilant about how the pricing changes over time.

We issued in the dollar market once — but currently, with lower funding needs, we focus on Swedish kronor and euros.

When we talk about attractiveness, it is more of a hypothetical relative play as we don't need to swap back from euros to Swedish kronor immediately when we do a transaction. We have a risk mandate that means we can sit with the risk and swap back when we want to. Nevertheless, it makes sense to evaluate it like this.

GlobalCapital: Henrik, presumably you can buy any currency — but then you just do a straight 'swapped back' comparison. Or is it more complicated than that?

Stille: It's more complicated. We can do what we want but the only thing we cannot have is the FX risk outright. So, either we can just do a complete basis swap back to euros or we can just do rolling FX forwards and keep the non-euro rates. So, if we buy Swedish kronor or Norwegian kroner we can basis swap them but we can also just do the FX hedge. For example, in Swedish kronor at the moment it is expensive to do the FX hedge, so there we prefer to do the complete basis swap and also to repo-fund the purchases to get rid of the FX risk that way.

When it comes to the non-Scandinavian, non-euro currencies – for example, the US dollar —we have not been buying anything this year, but that might be something that we will start to look at again next year. That will depend a lot on our general views on the US economy versus the euro economy — because if we buy covered bonds in US dollars we typically do it when we like to have the US dollar rates risk. For example, at the beginning of 2020 we bought quite a lot of US dollar covered bonds where we didn't hedge the rates risk to have better protection against the pandemic uncertainty — where you have much more protection in US dollar rates. In general, depending on how severe the recession will be here, that can also be something to look at — even though, right now, the economic outlook looks poorer in Europe than in the US. But, of course, that's not the ultimate situation. It's something we will monitor next year.

Ebert: I believe in a revival of the US dollar covered bond market, but it will be an interesting process. Ten years ago, we had issuers from France, the Nordics, Australia — and most recently Japan, Canada and Korea — playing in the 144A/Reg S dollar market. As the ECB has distorted the market and has made euro covered bond funding so much more attractive than US dollar covered bond funding, some of the issuers who were natural dollar funders have moved into the euro market. The Koreans are a good example.

If you look at the order book split, you see that even on 144A/Reg S dollar trades roughly 45%-50% of the demand is coming from European and Asian accounts, so issuers looking at Reg S dollars will find a reasonably well-established investor base. However, that market only works for €500m trades. If you look for larger trades, like the Canadians or Australians do — a billion or above — you need the US buyers as well and I think that market is not very well developed simply because there was not much supply over the past few years. The investor base is always a chicken and egg game: there is no supply, there are no investors. Once the supply comes back, the investors come back as well. I think that for issuers that want to go into the US dollar market for the first time, it will be harder in 144A/Reg S, at the beginning at least, to find a sufficiently large, granular investor base than for those that look at Reg S dollars.

On the other hand, for Reg S dollars you often pay up. Just look at the German issuers that have natural US dollar exposure. When they came to the dollar covered bond market, they were willing to pay up a few basis points because they save credit lines on the cross currency swap and the currency match pleased rating agencies. So there was a tendency in the Reg S market to pay up versus euros on a currency adjusted basis. Some of the investors are used to that — so, if you take everything into account, I think the most promising option for smaller issuers is the US dollar Reg S market, and for larger issuers it will be a journey to develop the US QIB investor base.

One last point: it depends also on the investors. If large investors can look at a Reg S only covered bond trade, then it will be easier for issuers to return to that market. Are you a buyer of Reg S paper only? Or does it have to be a 144A/Reg S format to get you on board?

Stille: We can buy only Reg S securities.

Ebert: Would it be a precondition for you that it is a dual tranche 144A/Reg S to have a higher level of liquidity on the bond, or are you fine if it is just a Reg S?

Stille: As long as you can do a $500m issue with only a Reg S, this is fine for us.

GlobalCapital: Let's move on to the ESG market. With the expense, the amount of data mining you have to do, is it actually worth it in terms of basis points saved?

Eriksson: If you look at just one issuance, of course not. The greenium for us was 1bp or less. What we did was to build up the system. Now we have already done two, and hopefully [we will do] some more in the future. What we hear from investors is that the houses that are able to issue green or sustainable or social is that their regular products are of more interest. When you build up your sustainable products, you also widen the investor base for your other products as well. For green finance, I think it is really important that we are all there. Of course, we are all in different places on the path: you need the pioneers and you need the rest to follow.

GlobalCapital: One basis point or less than a basis point. What do you think the greenium is now for all covered bond issues? Can you even come up with a single number and is that going to widen or narrow?

Ebert: One basis point on average is probably right. With higher credit spreads and higher yields, there is a likelihood that we will see a larger greenium.

Moreover, the ECB purchasing programmes diluted differences between green and brown as well. Issuers got a 40% order from the ECB on both types of bonds. There was no differentiation. When this distortion goes out of the market, then the greenium might increase. However, I do not believe that the greeniums will become large in the covered bond market. The average 1bp greenium was not achieved by comparing apples with apples. Often the green trade was a €500m "will not grow" transaction that people compared with an outstanding brown curve of €1bn trades. So, I am not sure whether the greenium you saw in some of the trades was actually a result of the capped size on the trade or the green collateral behind it.

But I hope — and I think — that the greenium will increase over time with a decreasing bid from the ECB and higher yields and spreads.

GlobalCapital: Henrik, what do you think? Are there good reasons to accept different yields — such as the new reporting standards that you have got?

Stille: For us it's still very much a data issue. It's difficult to get hold of the data that we need, especially on the cover pools. This is what our clients are asking about. They want to have this data but they are probably not prepared to pay much for it — by paying, I mean that they are not prepared to say you can buy these covered bonds significantly tighter than other issuers.

This is very much now driven by our clients because we are trying to just deliver what the clients are asking us to deliver. We cannot deliver the data ourselves but we need to tell the issuers that we want to have this data. In the end, I expect that it will be pretty much the same type of data from all issuers but we are not there yet and it will probably take some time. It feels like the regulation is probably two years ahead of the data availability.

GlobalCapital: When you talk about data there, you mean specific to the cover pool or more holistic about the issuer?

Stille: I mean specifically on the cover pool — for example, the energy efficiency on the mortgages. I don't only mean the green bonds that are issued. I think the whole cover pool. They will probably get them on the cover pool then the next step will be on the whole lending book. But the cover pool will be a good starting point. That would satisfy most clients.

Eriksson: Then when issuing not just green covereds but also green bonds we find out that investors like their questions. We start off from the green side and they ask, for example, about the cyber risk, and so on. Then we go to the regular products and their questions are still the same — so, I truly think the same that Henrik thinks.

Stille: That's also what our clients are asking us. They want to know the whole cover. They don't focus so much on the individual issues, they want the data on the whole cover pool. So, that's why [we have] the same questions on the green bonds as on the non-green bonds.

Eriksson: Whether you are a green issuer or not, we have to be prepared. It's really important that we have these discussions so that we can learn, like Henrik said, they don't have the data — and neither do we — so have to ask the clients to give us the data. Then we have some reporting to do. It's not something that any of us can do alone; we need the whole thing aligning.

Stille: The best way would probably be if you could incorporate it into the ECBC label, to have some kind of database of this data.

Eriksson: That's exactly what they are doing.

Ahlqvist: We have been very active in green bonds and have outstanding bonds in all major currencies, plus Swedish kronor, and have a total of five bonds in green format outstanding. As the first major Nordic bank, we have just updated and built out our green bond framework to a Sustainable Funding Framework which also includes social categories. The reason we work so actively with this is that we see bonds as a tool to facilitate the lending business and to actually increase it that way. So what we have implemented from the start in 2017 is that every basis point of greenium – if we achieve one — is transferred back to the business areas to incentivise them. That we will also apply on the social side, so that is one very large incentive.

Beyond the importance of greenium, because of the funds transfer price mechanism that we have there are two other important reasons we focus so much on sustainable funding. Adding the green label to a transaction normally takes down the execution risk. That is why we chose to issue green in non-preferred or preferred senior format, instead of covered bonds.

Normally we get higher demand, which is great in times of turbulence, as we are experiencing now. And the third point is that green bonds trade better, if you look at trading data and research and at outstanding curves. So by issuing green, for example in a senior non-preferred, we help the outstanding curve and provide a better reference point for future issuance of conventional bonds.

However, we primarily look at ESG from a broader and holistic basis. Only 5% of our outstanding senior bonds are green, meaning 95% are non-green, and so it is on that majority that we are focusing our efforts to ensuring future funding for. We believe that the success of achieving access to funding and capital is linked to our internal efforts on ESG. It is one of the reasons we as a bank work intensively with the ESG agenda: what KPIs and targets do we have in place at the top of the bank to transform our overall balance sheet? How do keep up to speed on ESG reporting and disclosures? How do we ensure a strong ESG rating? If Swedbank can be best in class in all aspects of ESG, we can ensure good and stable funding, outperform versus peers, and even affect our bottom line by reducing funding cost and raising ROE.

Hjelle: We take what we have in green lending, put it in a pool and then issue senior non-preferred and covered out of that pool — and we will probably continue to do so. In covered we don't see much greenium. But to your point, when we do senior non-preferred we see that we find funds that are more interested in the green. I'm not sure whether we can put it down to a number of basis points, but you actually have bigger orders or more orders. We were very early in this. I think the reporting from the investors will be tougher and that will come back to the banks. What we have today in green lending is going to evolve rapidly over the next few years. It's not what we have in assets that are green, it's the footprint, the transition for the bank and our clients — but then we need the data. How are going to get that? It's a big job.

GlobalCapital: Henrik, with all of the concerns about house price declines and affordability, as a rates investor are you starting to have concerns about credit anywhere? Or in the Nordic region specifically?

Stille: I can have concerns about the credit but I don't think it's a covered bond credit issue. For example, if you look at Sweden it would be more of these smaller real estate developers and not so much the major banks. If this becomes a large topic next year it is further down in the capital structure that we would be worried. Not for covered bonds.

Countries with their own currencies have a bit of an advantage because for the central bank in Sweden or Norway, for example, it is not difficult to see if you have more variable rate mortgages — in which case, you cannot hide as much as you can if you have more fixed rate mortgages. So, all else being equal, I think its fair to assume that you will have less hiking in those countries that have an independent central bank and more variable rate mortgages. That is a factor that central banks in these countries take into account.

Ebert: One question. Does that not also make the currency a bit weaker, because you always have the risk that with lower interest rates you still have imported inflation?

Stille: Yes, definitely. It will have an impact on the currency. Over the last 50 years, the Swedish central bank has always chosen this path. If they have to chose between inflation or killing the housing market, they will always choose inflation.

GlobalCapital: In one sentence or less, what is going to be the biggest factor in the covered bond market next year?

Ahlqvist: Central banks.

Eriksson: Demand.

Hjelle: The end of the purchasing programmes — so, central banks.

Ahlqvist: That incorporates QT, rate hikes and TLTRO.

Ebert: Balance sheet dynamics.

Stille: Central banks will continue to dominate the agenda. GC