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Covered Bonds

Dutch CPT covered bonds

A discussion of the similarities and differences

The Dutch conditional pass-through covered bond (CPTCB) market today counts five Dutch issuers and has a €6.75bn size. The conditional pass-through covered bond programmes share a lot of structural similarities, including their 32 years extendable maturity if the bonds are not repaid in full on the intended due for payment date. However, there are also various structural differences. In our view, unlike issuer credit risk characteristics, these structural differences are not always reflected as a selection criterion in the spread levels of the covered bonds.

The Dutch conditional pass-through covered bond market has seen a further expansion this year, with two more issuers establishing a covered bond programme in conditional pass-through format. **Five out of the nine registered Dutch covered bond issuers have conditional pass-through programmes in place**. These are all smaller size banks without domestic systemic importance, of which three are bank subsidiaries of larger Dutch insurance companies. Hence, in comparison to the Dutch (soft) bullet covered bond market, which is dominated by the four Dutch D-SIBs, the Dutch CPTCB market remains relatively small in size with €6.75bn in € benchmark covered bonds outstanding.

Conditional pass-through covered bonds differ from standard hard and soft bullet covered bonds via their **extendable redemption structure**. The Dutch regulator defines conditional pass-through covered bonds as bonds with an extendable maturity **of more than 24 months**. Extendable redemption structures up to 24 months are soft bullet. Conditional pass-through covered bonds can never be issued from the same programme as standard bullet covered bonds. The pass-through redemption structure reduces the refinancing risks related to the covered bonds due to the fact that a fire sale of assets can be avoided if the issuer fails to meet its redemption obligations on the bonds.

Dutch CPTCB structures have a lot of similarities, but also multiple differences. In this document we discuss some of the key **structural features of Dutch conditional pass-through programmes**. Differences in the issuer credit ratings, systemic importance or size of the investor base explain the persistent pickup of Dutch CPTCB versus bullet covered bonds. However, further insights in structural differences, cover pool features or rating agency treatment could support performance considerations in the CPTCB space.

Key differences: Dutch conditional pass-through covered bond programmes

	Achmea Bank	Aegon Bank	Van Lanschot	NIBC Bank	NN Bank
1. Asset segregation	Transfer	Transfer	Transfer & sale	Transfer & sale	Transfer
2. Collection foundation	Yes	No	No	Yes	No
3. Contractual OC	-	10%	15%	15%	10%
committed AP under ACT	93.5%	93%	90%	95%	93%
4. Minimum mortgage rate	-	1.00%	1.50%	3.00%	1.00%
collateral if reset lower	-	No	Yes	Yes	Yes
5. Coupon during extension for a fixed coupon bond	Fixed (or floating)	Fixed	Fixed	Fixed	Fixed
6. Attempt to sell assets	6 months	6 months	6 months	6 months	6 months
in final extension year	Monthly	Monthly	6 months	6 months	Monthly
7. Ratings deposit set-off					
S&P (st/lt)		A-1 / A	A-1 / A	A-1 / A	A-2 / BBB
Fitch (st/Lt)	F1 / A	F1 / A	F1 / A	F1 / A	
Adjustment for DGS	Yes	Yes	Yes	No	Yes
8. Max. bond maturity	30yr	15yr	15yr	15yr	15yr

Source: Programme documentation, ING

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Dutch CPT covered bonds

Conditional pass-through covered bonds differ from standard hard and soft bullet covered bonds due to the (long) extendable redemption structure of the covered bonds. The pass-through redemption mechanism in the event that the covered bonds are not repaid in full on their intended due for payment date transfers the refinancing risks related to the bonds to the investor. The Dutch central bank (DNB) therefore requires that issuing entities provide detailed information on at least the following aspects.

- The events that could trigger the pass-through mechanism or extension of payment obligations;
- The payment obligations that are subject to the pass-through mechanism or extension;
- The rights of the covered bondholders in the event of an extension of payments, in particular regarding the bondholders rights to receive coupon payments during the extension period on the redemption amounts that have not been repaid yet.

In this document we discuss the most important **structural features of Dutch conditional pass-through programmes**, and touch upon the major similarities and differences between the Dutch conditional pass-through programmes.

The conditional pass-through features

When do the bonds become pass-through?

Maturity extension is not subject to issuer discretion

Dutch conditional pass-through covered bonds do not allow for any issuer discretion to extend the maturity of a covered bond. Dutch covered bonds are only **extendable for a period up to 32 years** if one of the following situations occurs:

- If an issuer event of default has occurred and a notice to pay has been served on the Covered Bond Company, and the latter has **not repaid the covered bond in full** on its maturity date, this covered bond becomes a pass-through covered bond.

- If an issuer even of default has occurred and a notice to pay and **a breach of the amortisation test** have been served, *all* covered bonds become pass-through covered bonds.

A failure by the CBC to (fully) repay a covered bond on the intended due for payment date or a breach of the amortisation test both do not constitute a CBC event of default and consequently will not result in an acceleration of payments. Such a failure to pay by the CBC on the intended due for payment date therefore does not expose the covered bonds to recovery risks associated with a fire sale of assets. A CBC event of default does occur however if the bond has not been repaid in full on the extended maturity date.

Coupon payments during the extension period

Dutch CPTCB continue to pay a fixed coupon on unpaid amounts post extension

During the extension period, the Covered Bond Company will continue to pay interest over the unpaid redemption amount. Whereas in the case of Dutch soft bullet covered bonds the fixed coupon on the bond generally changes into a floating rate coupon, the Dutch conditional pass-through covered bonds will **continue to pay a fixed coupon during the extension period**.

Achmea Bank is the only Dutch issuer that has an optionality under its programme documentation to pay a fixed or a floating rate on its covered bonds during the extension period if so specified in the final terms of the covered bonds. Under the first series of covered bonds issued by the bank, the coupon remains fixed during the extension period. Aegon Bank, NIBC Bank and NN Bank would even switch to fixed coupon payments on floating rate covered bonds if they were to issue these. In the case of Van Lanschot, a fixed coupon bond would remain fixed coupon and a floating coupon bond continues to pay a floating coupon during the extension period.

Given the fixed interest rate nature of the assets in Dutch cover pools this therefore preserves a more or less natural match with the fixed coupon covered bonds during the extension period. Furthermore, keeping a stable fixed coupon reduces the coupon uncertainties on the covered bonds during the extension period, particular in a declining or negative yield environment.

On the other hand the refinancing risks on the bonds in the event of a maturity extension become more eminent for investors in a rising yield environment where reinvestments of redemption proceeds would potentially generate higher yields than the fixed coupon paid during the extension phase. At the same time, prepayments may decline in a rising yield environment, while the market value of assets to be sold could fall. This may prolong the extension period in a situation of rising yields.

Attempt to sell assets at least on a six month basis

After an issuer event of default and service of a notice to pay on the CBC, the CBC will use its best efforts to sell or refinance assets as soon as possible if:

- Amounts remain unpaid on the maturity date of a covered bond;
- A covered bond falls due within the next six months;
- A breach of amortisation test notice is served.

Assets will be offered for sale every six months during the extension phase

If the sales proceeds are insufficient to redeem the covered bonds in full, the CBC will repeat its attempt to sell or refinance the assets **every six months** until the covered bond is redeemed in full. Mortgage assets will be sold for the best terms available considering market circumstances, but in any event not for less than the required redemption amount (i.e. assets will not be sold at fire-sale prices).

Some programmes will try to sell assets on a monthly basis in the final extension year

Achmea Bank, Aegon Bank and NN Bank, will step up their sale and refinancing efforts to once a month if, on the refinance date immediately preceding the extended due for payment date, the covered bond has not been repaid in full. Hence, **in the last year prior to the extended due for payment date** on the covered bond, the CBC will attempt to sell and refinance assets **on a monthly basis** upon the best terms reasonably available (subject to consent of the security trustee), even if the amount received is less than the amount required to fully redeem the covered bond.

Mitigation of time subordination risks in the event of asset sales

The sale of assets is subject to certain restrictions to reduce time subordination risks

The sale of assets is subject to several restrictions that mitigate **time subordination** risks for later maturing covered bonds:

- **Random selection of assets**. The assets to be sold have to be selected randomly. This assures that the issuer will not sell the best assets in the pool first in order to repay the first maturing covered bond.
- **A proportional sale of assets**. The issuer is not allowed to sell a more assets from the pool than comparable with the ratio of the redemption amount on the maturing covered bond versus the total redemption obligations on all the covered bonds outstanding. This protects the collateral levels available to later maturing bonds.
- **No deterioration of the amortisation test**. The sale of assets and subsequent redemption of the covered bond may not result in a deterioration of the amortisation test**,** i.e. the quotient of the amortisation test aggregated asset amount versus the principal amount outstanding on all covered bonds outstanding cannot decline.

A higher share of amortising loans mitigates the potential extension risks

Pools with a higher share of amortising loans are likely to facilitate a more rapid repayment of the covered bonds than pools with a lower share of amortising loans. Since 2013 only new amortising loans that are repaid in 30 years qualify for tax deductibility. Less seasoned cover pools consequently tend to have higher shares of amortising loans. Aegon Bank and NN Bank have the highest shares of amortising loans in their pool and the lowest shares of interest only loans (Figure 5).

Furthermore, under the 2017 coalition agreement, the maximum tax rate at which mortgage interest payments can be deducted will be more rapidly reduced by 3ppts per year to 37% in 2023. This is an additional incentive to amortise loans, including the more seasoned interest only loans, at a more rapid pace to assure the total costs involved with a mortgage loan will remain relatively stable.

Transfer of the assets

Assignment or sale and assignment

Under all Dutch covered bond programmes the eligible assets for covered bond issuance are transferred to a separate **Covered Bond Company (CBC)** by means of a *guarantee support agreement*. Under this agreement, the mortgage originator passes on eligible receivables to the Covered Bond Company via an *undisclosed* or *silent assignment*. The legal ownership of the mortgage loans is in that case transferred to the Covered Bond Company via a *deed of assignment* with the tax authorities, without notifying the debtors of the receivables.

Van Lanschot and NIBC Bank transfer assets to the CBC via sale and assignment

Only in the case of the conditional pass-through covered bond programmes of NIBC Bank and Van Lanschot the transfer of assets takes place via a *deed of sale and assignmen*t with the tax authorities. As there is an actual *sale* of the mortgage receivables to the Covered Bond Company, the Covered Bond Company is entitled to receive the proceeds on the transferred assets as of the first day of the month preceding the date of transfer and purchase. Under these two conditional pass-through programmes a **subordinated loan provider** grants a subordinated loan to the Covered Bond Company to finance the purchase of mortgage loans and substitution assets.

Addressing commingling risks

The collection foundation account

Achmea Bank and NIBC Bank address commingling risk via a collection foundation

Under the covered bond programmes of Achmea Bank and NIBC Bank, *commingling risk* is addressed via a passive bankruptcy remote entity, the **collection foundation**, that maintains a separate bank account (***collection foundation account***) with a **foundation account provider**. All payments made on the mortgage receivables are paid into the collection foundation account, to be distributed to the Covered Bond Company. The amounts received will only be distributed to the Covered Bond Company after an assignment notification event or a notice to pay is served. In the event of a bankruptcy of the transferor of the mortgage loans to the CBC, any amounts standing to the credit of the collection foundation account relating to these mortgage receivables will not form part of the bankruptcy estate of this transferor.

Asset coverage tests

Dutch conditional pass-through covered bond programmes have to meet a) two **regulatory** coverage requirements, b) **programme specific** coverage test(s).

Regulatory coverage requirements

The **regulatory coverage requirements** are the same for all Dutch covered bond programmes:

- The ***first regulatory coverage requirement*** assures that the nominal value of the mortgage receivables (excluding defaulted loans) and the market value of the substitution assets cover at least 105% of the covered bonds outstanding.
- The ***second regulatory coverage requirement*** makes sure that the covered bonds are for 100% covered by the mortgage receivables (excluding defaulted loans) and substitution assets (valued at market value) under the condition that residential

mortgage receivables are only recognized as eligible assets up to 80% of the indexed valuation relating to the mortgage loan.

Programme specific coverage requirements

The **programme specific asset cover test requirements** may differ from programme to programme:

- Under the first programme specific asset cover test, the **adjusted aggregate asset amount** has to be at least equal to the amount of covered bonds outstanding. The adjusted aggregate asset amount is defined as the aggregate of A (the adjusted current balance of the mortgage receivables) + B (cash on the transaction accounts) + C (substitution assets) – Z (the interest reserve required amount).

  This test makes sure that sufficient assets are pledged to at least meet the minimum nominal committed overcollateralization levels, for instance for rating agency purposes. This coverage requirement is also subject to the restriction that the covered bonds should always at least be a 100% covered if the mortgage assets are recognized up to an indexed LTV of 80% at most.

  Primarily with reference to the determination of the **adjusted current balance of mortgage receivables (A)** there are programme specific differences. These differences include the committed asset percentages (i.e. overcollateralization levels), or the additional coverage requirements to adjust for set-off risks or to assure the minimum mortgage interest rate commitments are met. Loans in arrears for more than three months are not recognized as eligible assets under none of the Dutch conditionals pass-through programmes.

Achmea Bank does not commit to a minimum OC of 10% or 15%

- Dutch conditional pass-through covered bond programmes generally also have **a programme commitment** to maintain **a minimum nominal overcollateralization level** of at least 10% (Aegon Bank and NN Bank) or 15% (Van Lanschot and NIBC Bank). Only Achmea Bank does not have such a programme commitment.

Adjustments for set of risks

NN Bank's rating trigger for deposit set-of risk reservations differs three notches from others

All Dutch conditional pass-through covered bond programmes account for ***deposit set-off risks*** under A. If the issuer's rating falls below A-1 (short-term) or A (long-term) at S&P, or F1 (short-term) or A (long-term) at Fitch, an additional amount for possible set-off risk will be deducted, equal to a) the amount deposited with the issuer for mortgage loans issued by the issuer adjusted for amounts guaranteed under the Deposit Guarantee Scheme (DGS)(only NIBC Bank does not make such a DGS adjustment), or b) a lower amount if this will not adversely affect the covered bond ratings. NN Bank applies somewhat less strict minimum rating criteria to adjust for potential deposit set-off risks. This particular bank pledged additional collateral if the issuer's rating falls below A-2 (short-term) or BBB (long-term) at S&P.

A breach of the asset cover test - no issuer event of default

A breach of the ACT does not trigger the pass-through mechanism

A breach of the asset coverage test does not constitute an issuer event of default in the case of the Dutch covered bond programmes. It would also not trigger the pass-through mechanism for any of the covered bonds outstanding. A breach of the asset cover test merely prevents Dutch issuers from issuing any further covered bonds until the breach is remedied. If the breach of the asset cover test is not repaired, the CBC is allowed to retain the proceeds on the transferred assets until the breach is remedied. The CBC is in this case not allowed to make payments to the issuer (and, in the case of Van Lanschot and NIBC Bank, the subordinated loan provider). Furthermore, following a breach of the asset cover test, the CBC is not obliged to make payments under the guarantee until an issuer event of default has occurred and an issuer acceleration notice and a notice to pay have been served.

Amortisation test

Coverage requirements post issuer event of default

The **amortisation test** has to be performed following a notice to pay. A notice to pay can only be served if an issuer event of default occurs and results in the service by the security trustee in an issuer acceleration notice on the issuer. An issuer event of default occurs for instance if the issuer defaults for a period of seven calendar days or more on the redemption payment when due, or for a period of fourteen days or more on the payment of interest on any series of covered bonds when due. Other issuer events of defaults are the passing of a resolution for the dissolution or winding up of the issuer, a liquidation of the issuer or all its assets or if the issuer is found bankrupt.

Achmea Bank does not commit to a minimum OC level under the amortisation test

Achmea Bank's covered bond programme no longer applies the committed asset percentage under the amortisation test, but only ensure 100% coverage after recognizing loans only up until the 80% LTV cut-off. The other Dutch conditional pass-through covered bond programmes, on the other hand, also have to meet the minimum overcollateralization commitment under the amortisation test. These Dutch conditional pass-through programmes separately test that the outstanding principal amount of the cover assets is at least 110% or 115% of the covered bonds outstanding if the amortisation test is performed. Notice that all Dutch covered bond programmes always at least have to meet the regulatory (105% and 100%) collateralization requirements, also after an issuer event of default.

The commitment to a minimum overcollateralization level under the amortisation test strengthens the issuers' assurance that mortgage loans will not be sold at distressed market prices if doing so would damage the overcollateralization levels available under the programme. Post issuer default, this preserves accruals on the pool in excess of the amounts due on the covered bonds and facilitates the gradual increase in the overcollateralization levels once covered bonds under the programme mature over time.

All covered bonds will become pass-through after a breach of the amortisation test

A **breach of the amortisation test** does not constitute a CBC event of default. However, all covered bonds will become pass-through covered bonds after such a breach. The full programme extension feature in the case of an issuer event of default *and* a breach of the amortisation test serves as a time subordination assurance for holders of the longer maturity bonds post issuer default. Proceeds on the pool will be *pro-rated* to *all* covered bonds, and not just to the first instrument redeeming. This also means that earlier maturing bonds may be repaid at a later date than their intended maturity date, while later maturing bonds may be redeemed ahead of their intended maturity date.

Other refinancing risks mitigants

Minimum interest rate commitment but no use of swaps

Dutch conditional pass-through covered bond programmes do allow for the use of derivatives to hedge risks related to interest rate mismatches between assets and liabilities, but in practice do not use swaps.

Minimum interest rate commitments on the cover assets differ

Most conditional pass-through programmes do commit however to a minimum interest rate of 3% (NIBC Bank), 1.5% (Van Lanschot) and 1% (Aegon Bank and NN Bank) on the mortgage loans securing their covered bonds, to maintain sufficient margin versus the coupon payments to be made on the covered bonds. Achmea Bank is the only issuer that does not have such a minimum interest rate commitment, although the bank does assume that interest rates are reset at 1% for interest reserve requirement purposes under Z of the asset cover test and amortisation test (see below).

If the mortgage interest rate is reset below the committed levels, all Dutch conditional pass-through issuers, with the exception of Aegon Bank, will provide for additional collateral under the asset cover test if the interest rate on a mortgage loan is reset at a level below the minimum interest rate commitment.

Interest reserve requirement to cover for potential negative carry

Interest reserve requirements cover for negative carry

Dutch conditional pass-through covered bond programmes make an interest reservation under Z of the asset cover test and the amortisation test for the event that the interest expenses on the covered bonds exceed the expected interest income on the cover assets up until the intended maturity date of the bond and during the extension period. For the purpose of determining the interest income on the assets, Aegon Bank and NN Bank assume a mortgage interest rate equal to the expected mortgage interest rate to be offered by the servicer on loans with an interest rate reset, without further specification of the expected interest rate level. The servicer will inform the CBC and the rating agencies regarding this interest rate. Achmea Bank assumes that the mortgage interest rates are reset at 1% on the reset date. This interest rate level may be amended from time to time by the CBC and the issuer, subject to prior written consent of the security trustee and notification to the rating agencies. NIBC Bank makes the assumption that the mortgage interest rates are reset at the minimum mortgage interest rate of 3%. Van Lanschot assumes interest rates are reset at the mortgage interest rate. The minimum mortgage interest rate under this programme is 1.5%.

Reserve account requirements

Reserve account requirements cover interest payments due over the next three months

The interest rate reserve requirements to cover for potential negative carry under the asset coverage test or the amortisation test, differs from the reserve account requirements applicable to the Dutch conditional pass-through programmes. For the latter purpose, the Covered Bond Company is required to open a **reserve account** with the account bank. The reserve account represents the higher of a) the *reserve account required amount* or b) the *liquidity reserve required amount* that covers for 180 days of interest rate expenses required under the Dutch covered bond legislation.

In the case of NIBC Bank and Van Lanschot the reserve account will be credited by the Covered Bond Company from the proceeds of the subordinated loan. For these two programmes, the **reserve account required amount** covers the interest payments due on the covered bonds over the next three months, or if higher the accrued interest since the last interest payment date of each bond, plus 0.03% of the principal amount outstanding of the covered bonds plus a fixed amount of €62,500. Achmea Bank on the other hand adds 0.03% of the principal amount plus a fixed amount of €30,000 to the three months (or accrued) interest coverage requirements, NN Bank 0.04% plus €30,000 and Aegon Bank 0.045% plus a fixed amount of €30,000.

If the interest receipts and the principal receipts on the cover assets are insufficient to meet the payments due related to the covered bond programme, all amounts credited to the reserve account will be available to meet the interest payments on the covered bonds and third party expenses due. If during an interest period, a notice to pay is served on the Covered Bond Company, the amount of scheduled interest due on the covered bonds in this period will be paid directly from the reserve account.

Rating agencies' treatment

Ratings are not always fully delinked from the issuer's rating

S&P is the only rating agency that fully delinks the CPTCB rating from the issuer rating

The three largest rating agencies, Moody's, S&P and Fitch, all three rate (some of) the Dutch conditional pass-through covered bond programmes. The **only rating agency that truly delinks the rating of the covered bonds from the rating of the issuer is S&P.** This rating agency assigns an unlimited collateral based uplift to the conditional pass-through covered bond programmes as the 32 maturity extension feature has removed the asset-liability mismatch risk for these programmes. The ratings of the Dutch conditional pass-through covered bond programmes are therefore only fully shielded from any potential volatility in the issuers' credit ratings at this rating agency.

The rating agency treatment of the conditional pass-through covered bonds is also more favourable than for bullet programmes at Fitch and Moody's due to the mitigated refinancing risks as a consequence of the conditional pass-through mechanism. In the case of **Fitch** the conditional pass-through programmes receive the **maximum achievable payment continuity uplift (PCU) of eight notches**. As Dutch covered bonds are exempt from bail-in in a resolution scenario they are eligible for an issuer default rating (IDR) uplift. Van Lanschot and NIBC Bank have a two-notch IDR uplift reflecting that the banks' IDR is driven by their viability rating. Achmea Bank, Aegon Bank and NN Bank have a one-notch IDR uplift reflecting the support-driven nature of the banks' IDR. All latter three banks are 100% owned subsidiaries of insurance companies. The uplift on a stressed recovery basis is currently one notch, which is supported by a lower overcollateralization than a rating based upon a two-notch uplift for recoveries. However, as a two-notch uplift is in principle achievable for these programmes, the AAA rating of the covered bonds would only be vulnerable to a downgrade of the issuer default rating of at least four notches (NIBC Bank) to seven notches (Achmea Bank).

Achmea Bank has a TPI of "Very High" at Moody's but an unpublished TPI Leeway

Achmea Bank is the only Dutch conditional pass-through covered bond programme rated by **Moody's**. The **Timely Payment Indicator (TPI)** for this programme is **"Very High"**, while Dutch (soft) bullet covered bonds have a TPI of "Probable". The TPI Leeway is not published for this programme as the issuer's CR Assessment (CRA) is also not published. Unlike in the case of the Australian conditional pass-through covered bonds of Bank of Queensland, Moody's has not delinked the covered bond ratings from the issuer rating. We understand that the rating agency still applies the TPI framework due to the fact that the issuer's discretion is insufficiently mitigated. Achmea Bank can for example still alter the nature and the risk profile of the bank by adding riskier assets. In the case of Bank of Queensland the bank can only issue further bonds and include further assets in the pool if there is no impact on the existing covered bond ratings.

We consider an unpublished issuer rating, CRA and TPI Leeway a disadvantage. At a TPI of "Very High" the covered bond rating would only face downgrade risks if the issuer's CRA were to drop to a sub-investment grade level of Ba1(cr) or lower. It is not clear however, how many notches the bank's CRA is removed from this level. Furthermore, there are no relevant rating triggers related to Moody's ratings where the bank itself is a party to the programme. A notification event, for instance, would take place if the issuer's credit rating falls below BBB by S&P, while this rating agency does not even rate the covered bonds. Notification with reference to Moody's would only take place if the issuer's long-term unsecured credit rating is rated at Moody's (which is not the case) and falls below Baa1. The servicer rating triggers make a similar reference to S&P and Moody's. Deposit set-off risks reservations under the asset cover test are only made if Fitch's rating triggers are breached. Fitch does rate the covered bonds.

Relative value considerations

Dutch CPTCB tend to trade at a pickup versus bullet comparables

Dutch conditional pass-through covered bonds tend to trade at **wider trading levels than standard bullet covered bonds**. Within the 7yr area of the curve, the spread between soft bullet covered bonds of the three largest Dutch banks and conditional pass-through covered bond comparables is at least 10bp.

Differences in issuer ratings and systemic importance largely explain the wider CPTCB spreads

The different trading levels primarily reflect **a)** differences in the **underlying issuer credit ratings** and **b)** differences in the (domestic) **systemic importance** of the issuing entities. All bullet covered bond issuers are domestic systemically important banks, while none of the conditional pass-through covered bond issuers have systemic importance. That said, three out of five conditional pass-through entities are subsidiaries of larger Dutch insurance groups, of which one (i.e. Aegon) is a global systemically important insurer (G-SII). **c)** The **investor base** for conditional pass-through covered bonds also remains

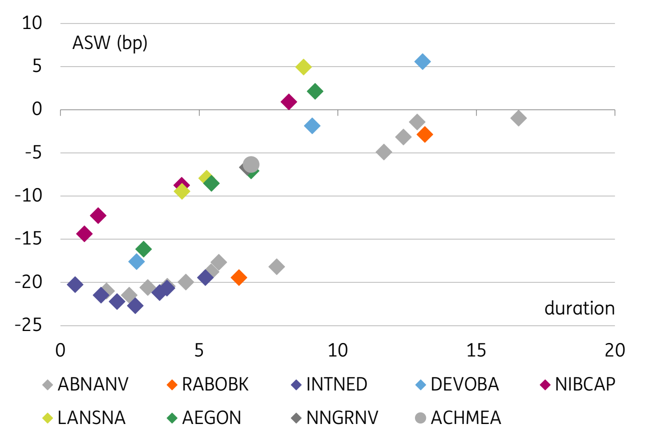
somewhat smaller than for standard bullet covered bonds as some investors would not invest in covered bonds with extendable redemption structures that stretch beyond the more common 12 months soft bullet extension periods.

Structural differences or collateral pool specifics hardly seem to be of relevance to explain spread differences within the Dutch conditional pass-through space. NIBC Bank, for instance, has supportive structural features. The bank transfers assets to the CBC via a deed of sale and assignment, uses a collection foundation account to address commingling risks, pledges a minimum overcollateralization level of at least 15% and commits to a minimum interest rate on its assets of 3%. Yet this issuer's conditional pass-through covered bonds tend to trade a tad wider than other Dutch conditional pass-through covered bonds throughout most of the curve (Figure 1). This reflects the issuer's somewhat lower credit ratings and smaller rating cushion at Fitch.

Achmea Bank's recent 7yr bond, on the other hand, trades closely aligned with recent comparables from NN Bank and Aegon Bank. Yet this particular issuer has not committed to a 10% minimum overcollateralization level under the asset cover test and amortization test and also does not commit to a minimum mortgage interest rate of at least 1%. Achmea Bank uses a collection foundation account and has the most favourable rating cushion at Fitch, albeit no published TPI Leeway at Moody's (Figure 4).

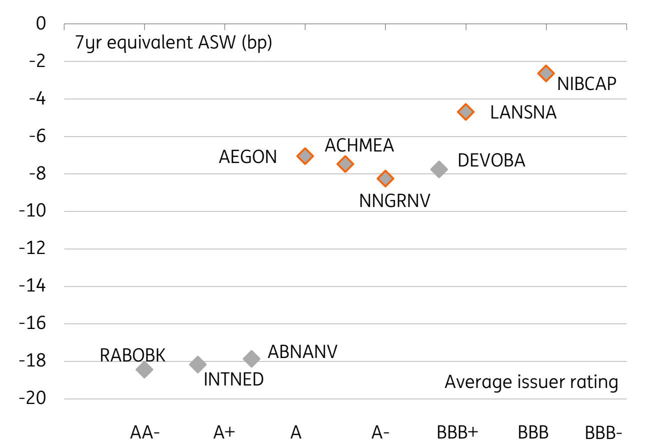
From an issuer credit risk perspective Aegon Bank's curve, in our view, has better performance potential in the 6yr area and beyond. The bank has the highest share of amortising loans and NHG loans in its pool, but has less exposure to the strongest performing housing region, i.e. Noord Holland. (See Figure 5 to Figure 11 for an overview of the collateral pool differences). Van Lanschot looks most interesting in the 10yr area of the curve at a pickup of 3bp to 5bp versus CPTCB comparables.

Fig 1 Dutch covered bond curves



Source: Markit iBoxx, ING

Fig 2 7yr CPTCB curves versus bullet comparables



Source: Markit iBoxx, ING

Fig 3 Programme overview Dutch conditional pass-through covered bonds

	Achmea Bank	Aegon Bank	Van Lanschot	NIBC Bank	NN Bank
Type	Dutch Registered CPT	Dutch Registered CPT	Dutch Registered CPT	Dutch registered CPT	Dutch Registered CPT
Programme size	€5bn	€5bn	€5bn	€5bn	€5bn
Amt issued	€0.5bn	€2.25bn	€1.5bn	€2.0bn	€0.5bn
Covered bond rating					
Moody's	Aaa				
S&P		AAA	AAA	AAA	AAA
Fitch	AAA	AAA	AAA	AAA	AAA
Issuer rating					
Moody's	-	-	-	Baa1	-
S&P	A-	A+	BBB+	BBB	A-
Fitch	A	A-	BBB+	BBB-	-
Short-term issuer rating					
Moody's				P-2	
S&P	A-1	A-1+	A-2	A-2	A-1
Fitch	F1	F2	F2	F3	
Asset segregation	Transfer	Transfer	Transfer and sale	Transfer and sale	Transfer
Guarantor	Achmea CPT Covered Bond Company	Aegon CPT Covered Bond Company	Van Lanschot CPT Covered Bond Company	NIBC CPT Covered Bond Company	NN CPT Covered Bond Company
Subordinated loan provider			Van Lanschot	NIBC Mortgage Backed Assets	
Collection foundation account	Yes			Yes	
Collateral	Dutch residential mortgages	Dutch residential mortgages	Dutch residential mortgages	Dutch residential mortgages	Dutch residential mortgages
Non-Dutch eligible assets allowed	No	No	No	No	No
Maximum maturity mortgage loan	30yr	30yr (except long-term mortgage loans)	30yr	30yr	30yr (except long-term mortgage loans)
Regulatory coverage requirement					
Nominal	105%	105%	105%	105%	105%
Recognizing LTMV cut-off	100%	100%	100%	100%	100%
Asset percentage (ACT)	Committed 93.5%	Committed 93%	Committed 90%	Committed 95%	Committed 93%
Contractual nominal overcollateralization	-	10%	15%	15%	10%
Max LTFV*	125%	130%	125%	125% (130% if 5% ins .)	130%
Max LTMV**	4% (ex. transfer tax)	4% (ex. transfer tax)	4% (ex. transfer tax)	4% (ex. transfer tax)	4% (ex. transfer tax)
Foreclosure value versus market value	90%	90%	83.70%	85%	90%
LTMV cut-off	80%	80%	80%	80%	80%
Market value	Original market value	Original market value	Original market value	Original market value	Original market value
Indexed value	Automated Valuation Adj.	Land Registry house price index	Land Registry house price index	Land Registry house price index	Land Registry house price index
Indexation	90% increase, 100% decrease	90% increase, 100% decrease	90% increase, 100% decrease	90% increase, 100% decrease	90% increase, 100% decrease
Derivatives	No (but possible)	No (but possible)	No (but possible)	No (but possible)	No (but possible)
Minimum mortgage loan interest rate	-	1.00%	1.50%	3%	1.00%
Substitute collateral	Yes	Yes	Yes	Yes	Yes
Maturity	*CPT*	*CPT*	*CPT*	*CPT*	*CPT*
Conditional pass-through (CPT)	Extendable maturity (32 years)	Extendable maturity (32 years)	Extendable maturity (32 years)	Extendable maturity (32 years)	Extendable maturity (32 years)
Maximum maturity covered bond	30yr (62yr extended)	15yr (47yr extended)	15yr (47yr extended)	15yr (47yr extended)	15yr (47yr extended)
Attempt to sell assets	Each six months	Each six months	Each six months	Each six months	Each six months
Year prior to extended payment date	Once a month	Once a month			Once a month
Sale of assets possible if AT deteriorates	No	No	No	No	No
Coupon during extension period					
Fixed coupon bond	Fixed or floating	Fixed	Fixed	Fixed	Fixed
Floating coupon bond	Fixed or floating	Fixed	Floating	Fixed	Fixed
Covered Bond Label Compliant	Yes	Yes	Yes	Yes	Yes
ECB eligible	Yes	Yes	Yes	Yes	Yes
UCITS 52(4) Compliant	Yes	Yes	Yes	Yes	Yes
LCR Treatment	Level 1	Level 1	Level 1	Level 1	Level 1
Solvency II Compliant	Yes	Yes	Yes	Yes	Yes
CRR Compliant	Yes	Yes	Yes	Yes	Yes
Risk weight CRR Standardised	10%	10%	10%	10%	10%

Source: Programme documentation, ING

Rating agency overview

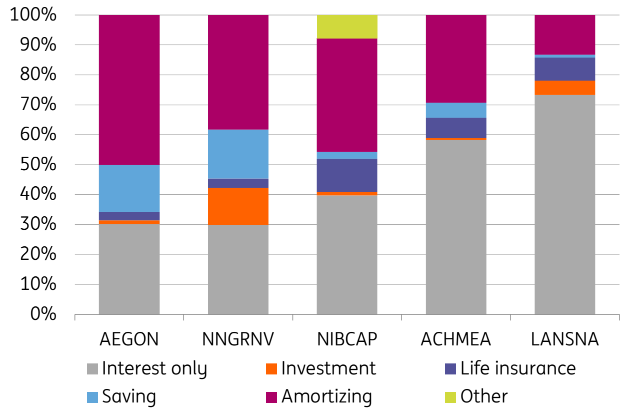
Fig 4 Rating agency assessment of Dutch conditional pass-through covered bonds

	Achmea Bank	Aegon Bank	F. Van Lanschot	NIBC Bank	NN Bank
	CPT	**CPT**	**CPT**	**CPT**	**CPT**
Moody's	**Aaa**				
Senior unsecured rating	-				
Bank deposit rating	-				
Adjusted BCA	-				
CR Assessment	Unpublished				
CB Anchor	CRA+1 notch				
TPI	Very High				
TPI Leeway	**Unpublished**				
Cover pool losses	11.0%				
Market risk	7.6%				
Collateral risk	3.4%				
Collateral score	5.0%				
Collateral score (excl. Systemic risk)	4.7%				
Committed OC	5.0%				
Required Overcollateralization	6.5%				
Fitch	**AAA**	**AAA**	**AAA**	**AAA**	
Long term IDR	A	A-	BBB+	BBB-	
Uplift from IDR	1 notch	1 notch	2 notches	2 notches	
PCU uplift	8 notches	8 notches	8 notches	8 notches	
Uplift on a stressed recovery basis	1 notch	1 notch	1 notch	1 notch	
Cushion to IDR downgrade	**6 notches**	**5 notches**	**5 notches**	**3 notches**	
Stressed expected loss	6.6%	2.5%	4.4%	6.1%	
Credit losss	3.3%	2.2%	4.0%	5.7%	
Cash-flow valuation	-4.8%	-7.8%	-1.7%	-6.6%	
Asset disposal loss	2.5%	1.3%	2.9%	0.4%	
Break-even Asset Percentage	93.5%	95.0%	95.0%	95.0%	
Break-even overcollateralization	7.0%	5.3%	5.3%	5.3%	
S&P		**AAA**	**AAA**	**AAA**	**AAA**
Long term ICR		A+	BBB+	BBB-	A-
Adjusted ICR		-	bbb+	bbb-	-
Reference rating level (RRL)		a+	a	bbb+	a-
Jurisdiction supported rating level (JRL)		aa	aa-	a	a+
Jurisdictional support assessment		Strong	Strong	Strong	Strong
Legal framework		Very Strong	Very Strong	Very Strong	Very Strong
Systemic importance		Strong	Strong	Strong	Strong
Sovereign credit capacity		Very Strong	Very Strong	Very Strong	Very Strong
Achievable collateral based uplift		**Unlimited**	**Unlimited**	**Unlimited**	**Unlimited**
Unused notches of uplift		Delinked	Delinked	Delinked	Delinked
WAFF*WALS		2.70%	8.46%	5.85%	8.74%
Actual OC level for current rating		2.50%	5.86%	2.50%	23.84%
Target credit enhancement		-	-	-	7.00%

Source: Moody's, Fitch, S&P, ING

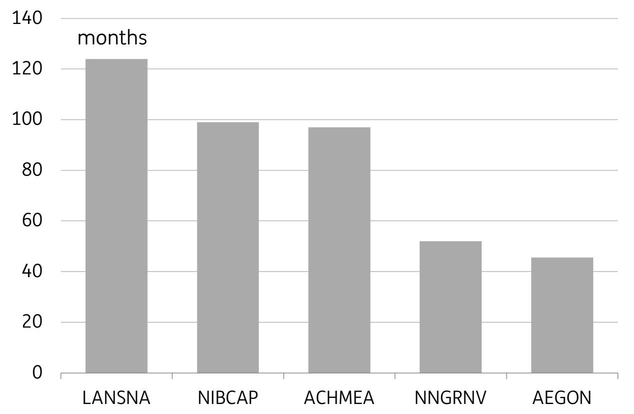
Collateral pool comparison

Fig 5 A lower share of interest only loans…



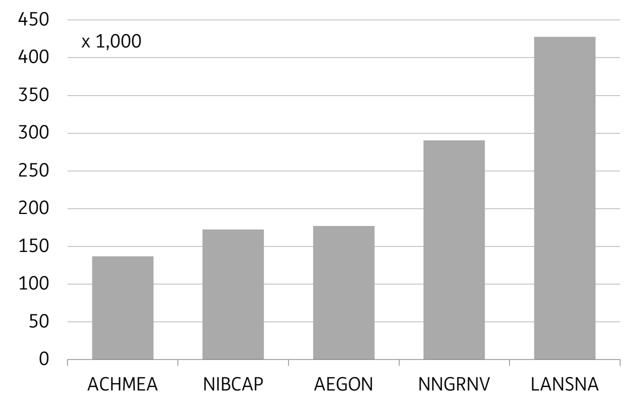
Source: Issuer investor reports, ING

Fig 6 …in less seasoned pools



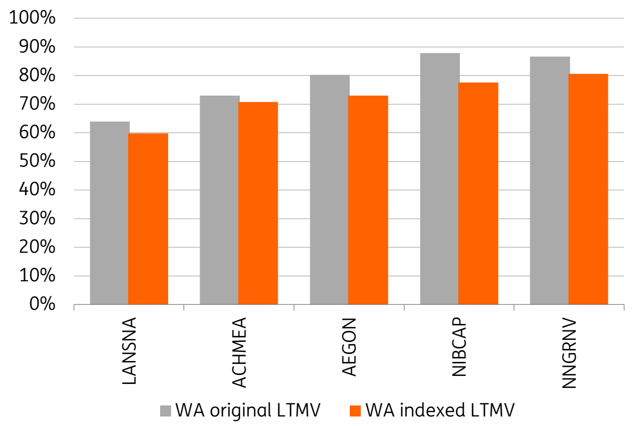
Source: Issuer investor reports, ING

Fig 7 For seasoned pools, higher average loan sizes…



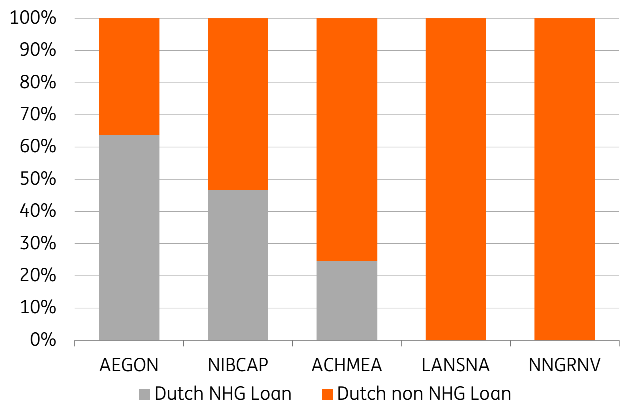
Source: Issuer investor reports, ING

Fig 8 …do not coincide with higher average LTV ratios



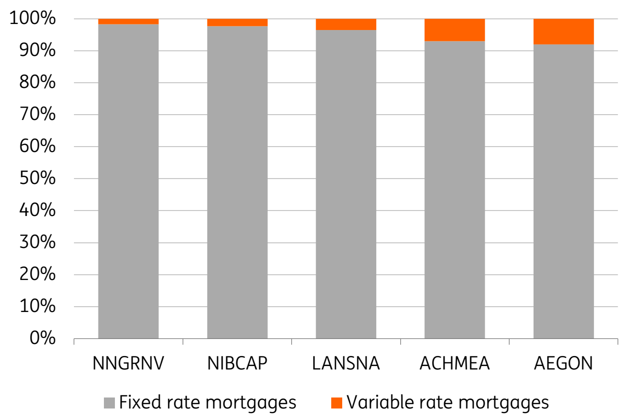
Source: Issuer investor reports, ING

Fig 9 Guaranteed (NHG) loans not present in all pools



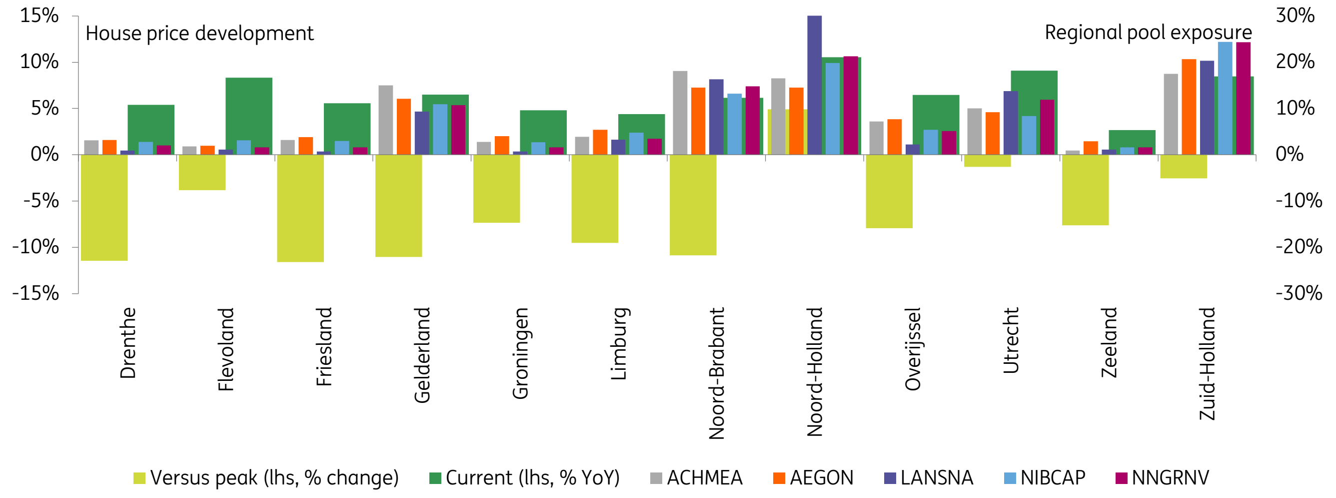
Source: Issuer investor reports, ING

Fig 10 Most loans are fixed rate mortgage loans



Source: Issuer investor reports, ING

Fig 11 Dutch CPTCB cover pools have more exposure to the strongest performing housing regions



Source: Issuer investor reports, Kadaster, ING

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