

The EBRD in

CENTRAL EUROPE, THE BALTIC STATES, AND SOUTH-EASTERN EUROPE

SUPPORTING COVERED BOND MARKET DEVELOPMENT



European Bank
for Reconstruction and Development

Impact case study

SDG contribution



Context

Though mortgage bond legal frameworks have existed in a number of countries in central Europe and the Baltic States (CEB) and south-eastern Europe (SEE), since the late 1990s or early 2000s, they have been used infrequently, as they lack important investor protection features and have failed to become established as a reliable funding instrument for banks. Consequently, credit institutions' balance sheets have shown asset-liability mismatches, while mortgage lending has been relatively subdued. For instance, in 2021, the outstanding mortgage-to-gross domestic product (GDP) ratio was less than 30 per cent in three-quarters of the European Union (EU) countries in the CEB and SEE regions, compared with the EU average of 45 per cent. Covered bonds offer credit institutions a cost-effective and long-term funding option, while providing investors with appealing risk-adjusted returns, as their dual-recourse nature makes them resilient to adverse market conditions. In addition, a well-functioning covered bond market can contribute to more affordable housing by providing banks with a stable, fixed-term funding source. This enables them to offer affordable mortgages to consumers and businesses. While covered bonds have been well established as a funding instrument for banks in mature markets for decades, accounting for more than 40 per cent of total funding for mortgage portfolios in multiple European countries, they have been underdeveloped

in some countries in CEB and SEE, while others have completely lacked the necessary legal framework. Moreover, in many countries in the CEB and SEE regions, capital markets have been characterised by low liquidity and product diversification, as well as limited domestic and cross-border investment. Against this backdrop, the European Bank for Reconstruction and Development (EBRD) has been working to expand the availability of capital market products in the CEB and SEE regions, including covered bonds.

How we work

The EBRD is committed to establishing an efficient ecosystem for local capital markets through a combination of technical assistance and policy engagement to support legal and regulatory reforms, as well as investments. The Bank has pursued a series of covered bond legal and regulatory reforms that aim to align the applicable frameworks with widely accepted standards, enhance transparency and efficiency, and eliminate obstacles that hinder the use of covered bonds as a financing tool. More recently, the legislative package for the EU-wide harmonisation of covered bond frameworks, comprising the Covered Bond Directive and the amendment to Article 129 of the Capital Requirements Regulation, has served as an anchor for local covered bond legislation in both the EU and some non-EU jurisdictions. Aside from adherence to international

standards and best practices, the growth of the covered bond market depends on achieving frequent issuance, initially to sub-benchmark and eventually to benchmark volumes. The EBRD complements policy dialogue with investments in inaugural issuance, bolstering investor confidence in new covered bond jurisdictions.

Achievements and results

The EBRD has supported the development and introduction of covered bond legal and regulatory reforms in eight countries in the CEB and SEE regions, namely Bulgaria, Croatia, Estonia, Latvia, Lithuania, Poland, Romania and the Slovak Republic.¹ The Bank has also supported the development of a pan-Baltic covered bond framework, which increases the potential size of the market and is a milestone in the creation of a pan-Baltic capital market. As a result of the Bank's policy work, a landmark covered bond transaction was executed in 2022, with Estonia-headquartered Luminor issuing the first pan-Baltic covered bond with mortgage collateral from its subsidiaries, originated in all three Baltic States. Through mid-2023, the EBRD had invested more than €800 million in covered bond issues across CEB and SEE,² including, the first-ever covered bond in Romania and the first green covered bond from Poland. In 2022, the Bank invested €65 million in a green covered bond issued by PKO Bank Hipoteczny, as part of an international €500 million issue. This was the first international green covered bond issuance by a Polish bank and the first such bond issued in an EU EBRD investee economy. The Bank's recent covered bond investments include three transactions in Estonia, where the EBRD invested €125 million in two issues by Luminor, including the pan-Baltic covered bond, and €37 million in a bond issued by LHV Pank. With the EBRD's support, Luminor's issues achieved benchmark size, attracting a large volume of new European covered bond investors. Thanks to these combined efforts, €2.1 billion worth of covered

bonds have been issued in Estonia since the Estonian Covered Bond Act was adopted in 2019.

Partnerships

The EBRD works in collaboration with national authorities and international institutions to contribute to well-functioning and deeper capital markets in the CEB and SEE regions, to open up long-term funding options for banks and to increase the level of lending to the real economy. The European Commission's Directorate General for Structural Reform Support and the EBRD's Shareholder Special Fund are among the key donors that have provided funding for EBRD covered bond technical cooperation projects in the EU. The Bank also cooperates with the European Covered Bond Council to raise awareness about covered bonds in new and emerging markets.

¹ In addition to the projects in the CEB and SEE regions, the EBRD has supported the covered bond framework in Georgia, which adopted the

covered bond law in autumn 2022, becoming the first non-EU EBRD investee economy to complete covered bond reform.

² The combined investment figure for CEB and SEE includes Greece.