Funding of Dutch mortgages :
The importance of capital market funding for the Dutch housing market

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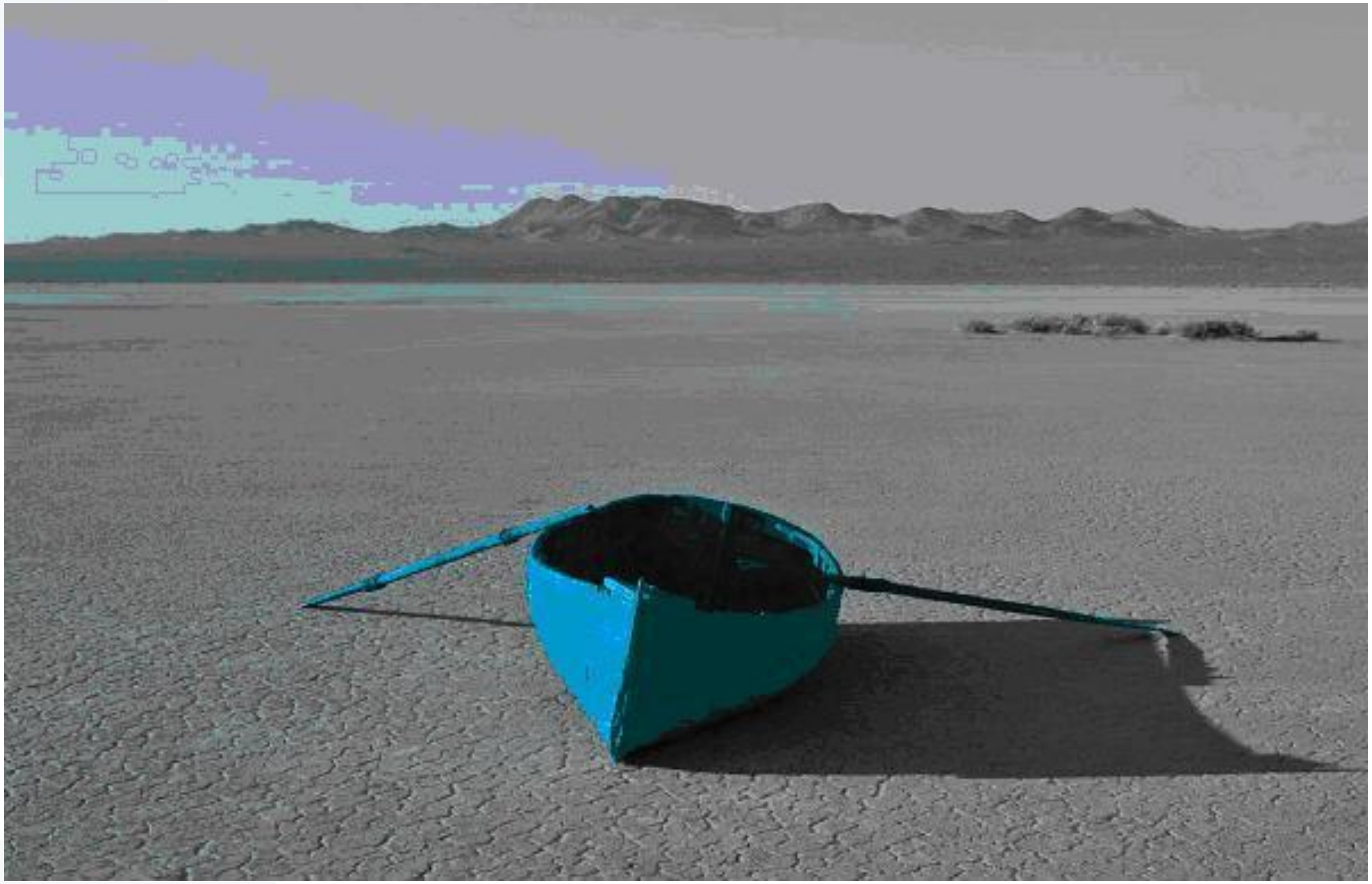
The funding gap of Dutch mortgage originators

- **Mortgage portfolio** **€ 645 billion**
- **Savings (banks)** **<u>€ 375 billion</u>**

Funding gap ***€ 275 billion***

Conclusion: search for liquidity



The funding mix of Dutch mortgage originators

The funding gap must be bridged on the international capital market :

- **Senior Unsecured loans**
- **Securitisation (Residential Mortgage Backed Securities, RMBS)**
- **Covered Bonds**
- **Other debt titles**

Possible new alternatives to bridge the funding gap :

- **Danish mortgage funding model?** ***No***
- **Tax facilitated saving ("Bouwsparen")?** ***Not any time soon***
- **Tap liquidity of Dutch pension funds through Dutch Mortgage Bond (Nederlandse Hypotheek Obligatie, NHO) (Committee Van Dijkhuizen)?** ***Promising***

A pile of new regulation as a result of the crisis: intended to create more resilience and stability of banks

- Basel 3 (in Europe translated into CRD IV) for Banks
  * Liquidity Coverage Ratio (LCR)
  * Net Stable Funding Ratio (NSFR)

- Solvency 2 for insurers and pension funds
  Comparable demands / measures

The new regulation however does also impose serious limitations to securitisation (unintended and intended) (1)

- Under Basel 3 securitisations are only partially eligible for the LCR (while Covered Bonds are treated substantially more beneficial)

- That would make it practically impossible for banks to invest in securitisations

- Banks form 50 - 60 % of the investor base of Dutch RMBS

The new regulation however does also impose serious limitations to securitisation (unintended and intended) (2)

- Under Solvency 2 the capital charge for securitisation is 10 x (!) as high as the capital charge for covered bonds
- That would make it practically impossible for insurers and pension funds to invest in securitisations
- Insurers and pension funds (including asset management for third parties) form 20 - 30 % of the investor base of Dutch RMBS

The new regulations however do also impose serious limitations to securitisation (unintended and intended) (3)

- These limitations are partly unintended but also partly well intended to limit securitisation

- Because securitisations are viewed by many politicians, policymakers and regulators as bad and irresponsible financial instruments

This mistrust is unjustified

- Securitisations are generally associated or even identified by many people with the US sub prime mortgage transactions that started the financial crises in 2008 and that gave this financial instrument its bad reputation
- As such that is totally understandable
- What is not right is that this is not only true for the general public but also for people who (should) know the facts and therefore should have a more nuanced view
- Fact is that financial institutions have responded too late to negative new regulation end have explained too late why there is a need to differentiate
- Fortunately, there is a shift happening in the way policymakers and regulators are viewing securitisation
- There are more and more people that know and understand the real facts and have the courage to express this in public :

  some **politicians, journalists, scholars/scientists/experts, Ministries of Finance,**

  Central Banks

Not all securitisations are the same

- NO, securitisation did NOT create the credit crisis of 2008.
  The root causes of the credit crisis (relevant in this context) were:
  - the practically unregulated mortgage origination in the US
  - the housing bubble in the US
  - the goal of US sub prime securitisations (transfer of credit risk)
  - the few and weak structural enhancements of US sub prime securitisations

- YES, US securitisations were badly structured and had attached to them unduly granted AAA ratings
  Therefore this instrument did indeed lead to substantial losses by investors and has contributed to the development and the growth of the credit crisis.
  Some US banks have been sued an convicted to large fines for their role in this respect (and rightfully so)

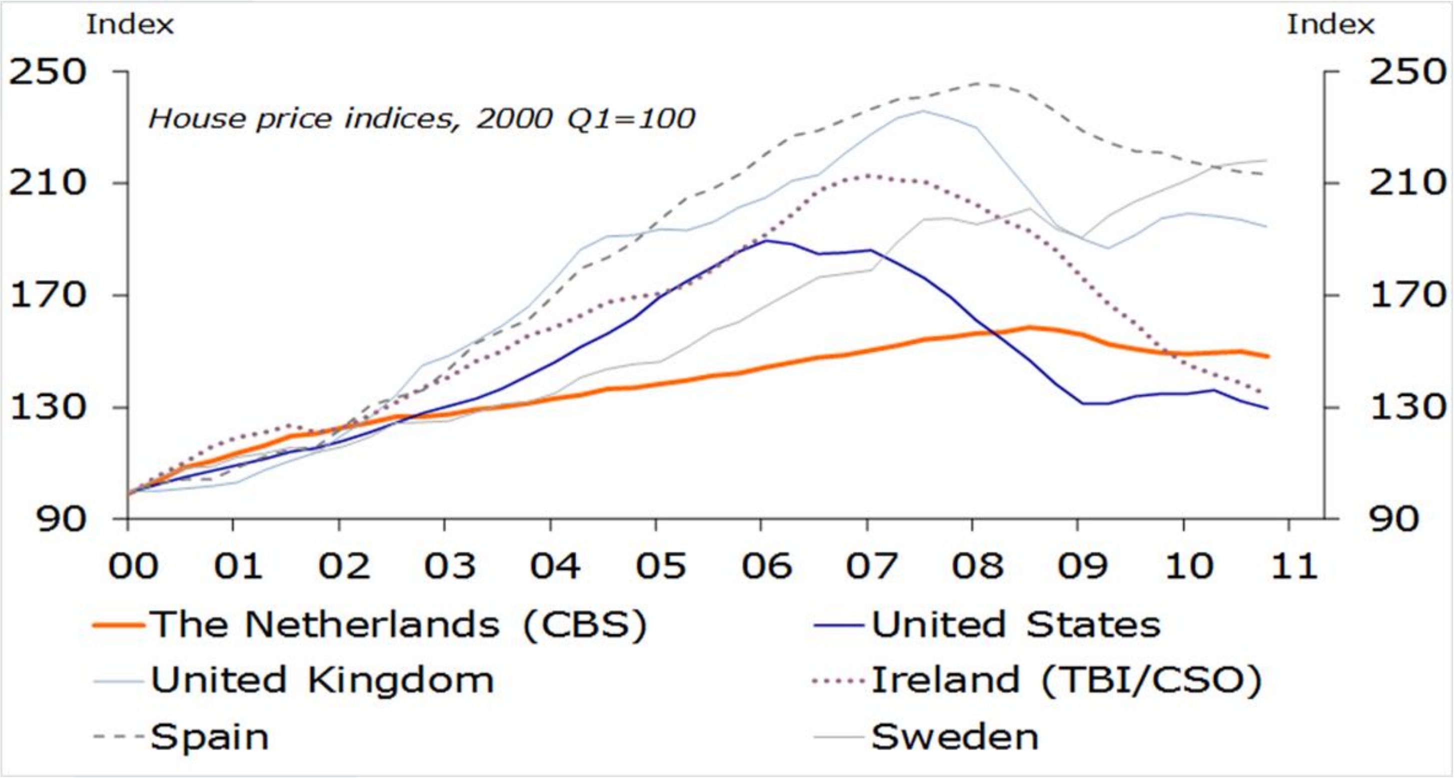
- NO, Dutch RMBS is absolutely incomparable with a US sub prime securitisation

- YES, Dutch RMBS is a highly responsible and safe financial instrument

Key differences between the housing and mortgage markets in the US and in the Netherlands

	USA	The Netherlands
Affordability of houses	Under pressure	Under pressure
Development of house prices (from 2000)	Strong and swift increase & strong and swift decline	Moderate and gradual increase & moderate and gradual decline
Speculation / buy to let	Substantial in the past	Negligible
Mortgage lending restrictions	Limited in the past	Code of Conduct
Subprime market	Large in the past	Negligible
Forced sales	Sharp increase	Moderate increase
Supply of houses	Grew strongly	Continuous shortage
Labour market	Increased unemployment	Moderate unemployment
Personal liability for mortgage debt	Walkaway.com	Until the day you die

Housing price development



Bron: Reuters-Ecowin

Key differences between US RMBS and Dutch RMBS

	USA	The Netherlands
Primary goal of securitisation	Transfer of credit risk	Funding
Transfer of credit risk	Substantial	Virtually not
Structural support	Present	Extremely strong
Reliance on issuer	Present	Very remote

Robustness of Dutch RMBS illustrated : Performance of the STORM programme

- Continued extremely low level of arrears & losses for all seventeen outstanding transactions, totalling some € 27 bln.
  - Arrears > 90 days are currently 0.3%
  - Currently only 448 foreclosures out of 166,546 securitised loans or 0.3%
  - **Cumulative** losses EUR 17.4 mln. on a securitised portfolio of circa EUR 32.9 bn.
  - **Cumulative** losses as of the initial mortgage balance at 5.3 bps over the last 9 years
  - Over the last 9 years on average < 1 bp per annum
  - All losses are easily covered by the Excess Margin of 50 bps per annum, the Reserve Account of 130 bps and a Credit Enhancement of 6 %
  - No drawing has ever occurred on any Reserve Account for any transaction or on any cash advance facility
  - Excellent performance with arrears & losses well below the Dutch average

Consequences of funding limitations as a result of new regulations (1)

- <u>For investors</u>

  (banks, insurers, pension funds, asset managers)

  * no longer access to very good investments (extremely low credit risk, good
    return and good liquidity, even during the crisis)
  * concentration risk and systemic risk regarding covered bonds increases by
    definition

Consequences of funding limitations as a result of new regulations (2)

- <u>For mortgage originators</u>

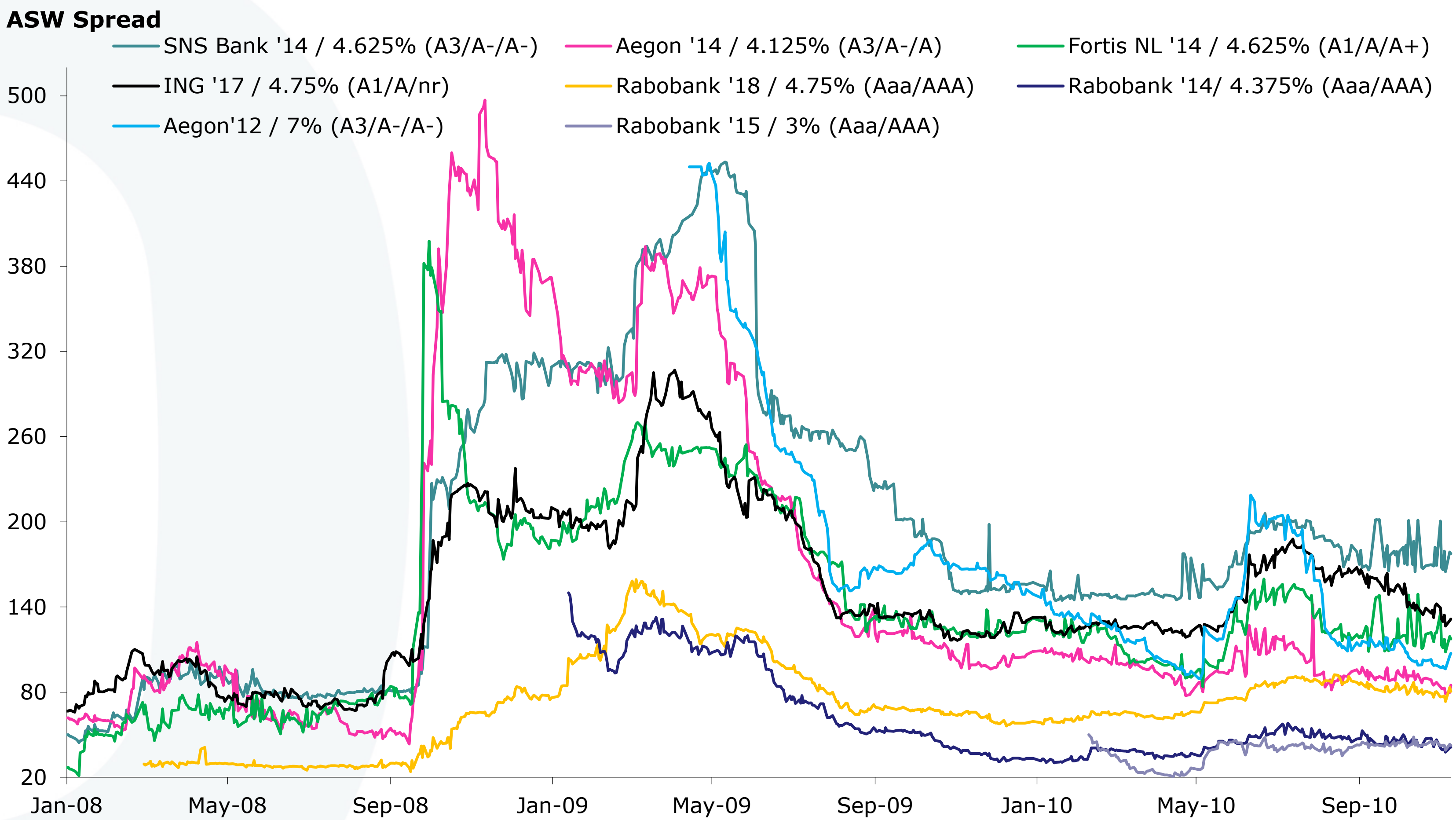
  * less liquidity available
  * higher cost of liquidity

Consequences of funding limitations as a result of new regulations (3)

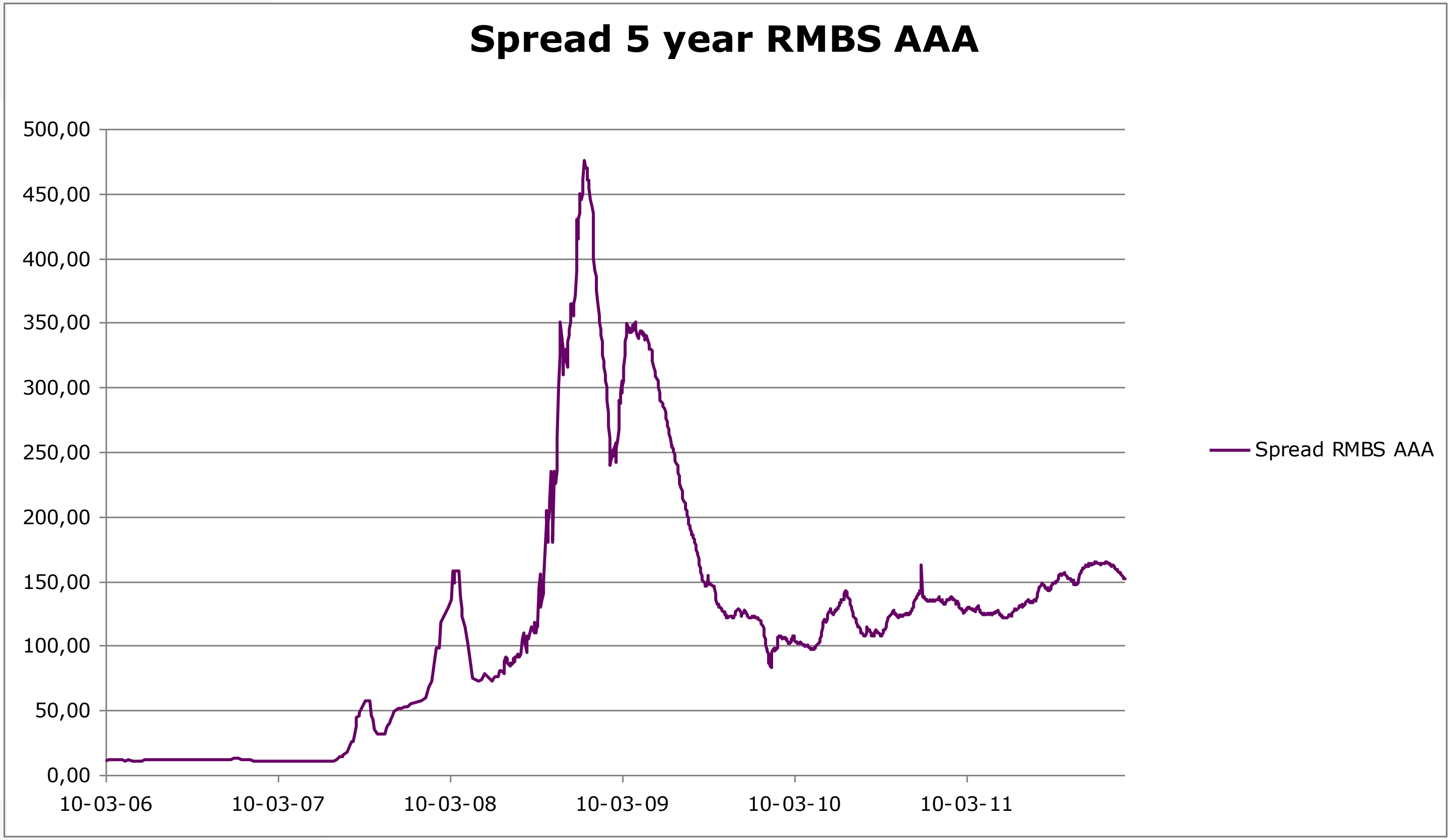
- <u>For consumers</u>

  * higher funding cost translates directly into higher mortgage rates
  * fewer lenders

The cost of funding has increased substantially (1)



The cost of funding has increased substantially (2)



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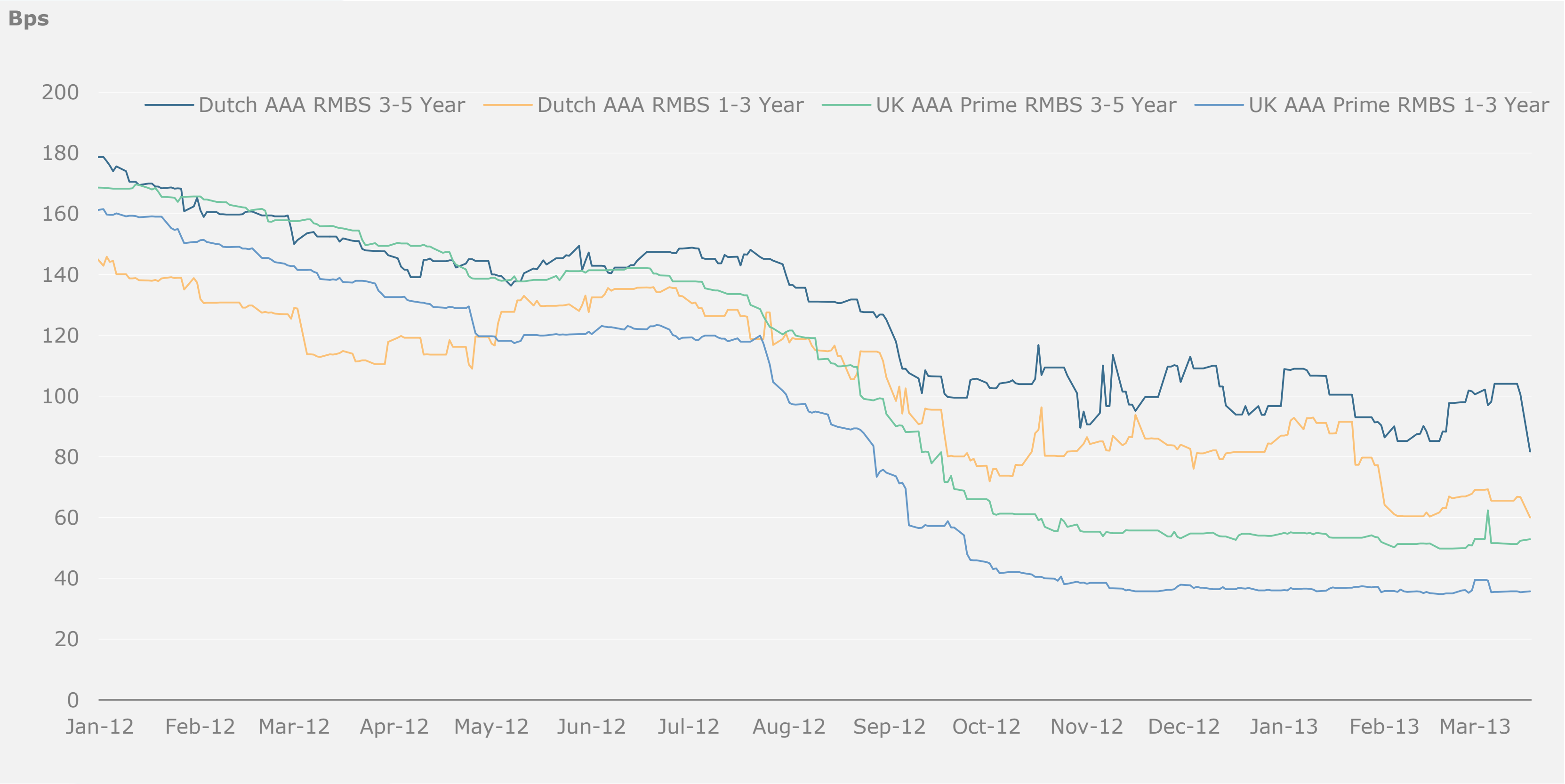

Are Dutch banks making much higher margins on mortgages ?

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YES

Are Dutch mortgages rates unduly high ?

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NO

Are Dutch banks making unduly high profits on mortgages ?

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Then, what are the reasons for the higher margins ? (1)

Then, what are the reasons for the higher margins ? (2)

- **Funding cost**

Then, what are the reasons for the higher margins ? (3)

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What action are the Dutch mortgage originators taking ? (1)

- **Intensive dialogue with involved bodies** (DNB, Ministry of Finance, European Parliament, ECB, EBA, etc.)

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- Providing extensive information (a.o. ECB loan level data,)
- **Quality Labeling and Standardisation** (PCS, DSA)

What is de current situation and what is to be expected ?

Current situation :

- The market for Dutch RMBS is recovering but is still jittery and relatively expensive
- The market for Covered Bonds is certainly not in better shape
- The cost of funding has decreased since 2008 but remains high

To be expected :

- Further gradual recovery of the market for RMBS
- Strong recovery is only possible if new regulation is adapted in such a way that securitisation remains an attractive investment for banks, insurers, pension funds and asset managers
- Dutch Mortgage Bonds (Nederlandse Hypotheek Obligaties) (Committee Van Dijkhuizen) looks promising, however there are issues to resolve and that will take some time

Questions ?

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