Helaba

Focus on: Covered Bonds
23 April 2026

Retained Covered Bonds – Swiss Army Knife or Boomerang?



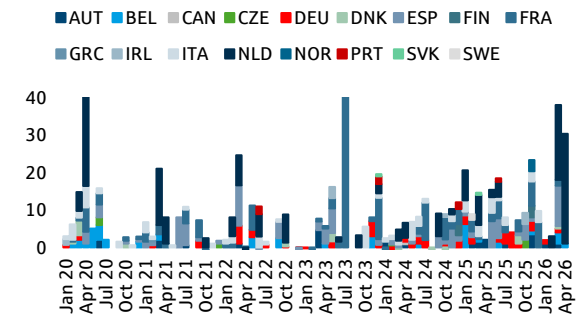
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Already last year, retained covered bonds developed into an important segment of the covered bond market and at the same time established themselves as a central instrument in banks' liquidity management. These are covered bonds that are structured by banks but instead of being placed with investors are held entirely in the company's own banking book. They do not fulfil a direct refinancing function but nevertheless are characterised by a high degree of versatility resulting from the combination of balance sheet neutrality, regulatory recognition and operational flexibility.

In the following sections, we analyse the economic and regulatory underpinnings of retained covered bonds. We show that this instrument opens up a wide range of liquidity management opportunities for issuers. At the same time, we identify risks of overuse and conclude that a balance between retained and placed emissions is the most sensible strategy.

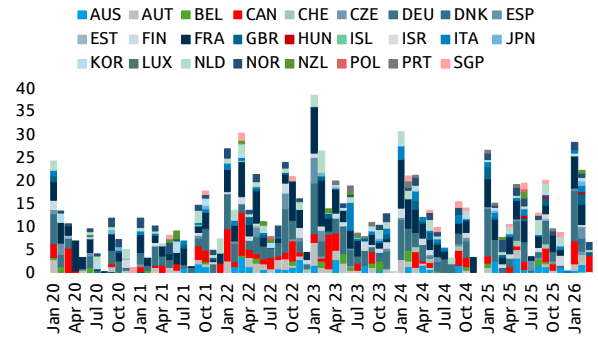
First of all, it should be noted that in the following, for reasons of readability, we will speak of "issued" retained covered bonds, even if they are not placed with external investors.

Retained Covered Bonds: monthly issuance data



Sources: Bloomberg, Helaba Research

Regular Covered Bonds: monthly issuance data



Sources: Bloomberg, Helaba Research

As can be seen from the chart on the left, the market breadth for retained covered bonds is still significantly smaller than for classically placed issues, although an increasing trend can be seen. In contrast, regularly placed covered bonds show a rather stable issuance trend. It is striking that in the period from the beginning of the year until the outbreak of the Iran war (about eight weeks), around EUR 14bn of retained covered bonds were issued, while the issuance volume jumped to around EUR 71bn in weeks since the outbreak.

1 Accounting, economic and regulatory classification 2
2 Structural mechanics and calculation example 3
3 Use as a liquidity instrument 3
3.1 Unused liquidity option in the company's own portfolio 3
3.2 Typical use: central bank refinancing 3
3.3 Private sector use: Interbank repo 4
3.4 Cooperative use: Collateral Transformation Trade by Exchange 4
3.5 Plain-vanilla use: Sale 5
3.6 Rolling Refinancing via Main Refinancing Operation 5
4 Essence: Retained Covered Bonds as a Swiss Army Knife 5
5 Risks arising from extensive use 5
5.1 Asset Encumbrance 5
5.2 High dependence on the central bank 6
5.3 Interest rate risk 6
5.4 Increasing Connectivity 6
6 Conclusion: Balanced use is crucial 6
7 Appendix 7

1 Accounting, economic and regulatory classification

From a balance sheet perspective, the starting point is clear: since retained covered bonds remain entirely in the issuer's banking book, neither capitalizable receivables nor liabilities to third parties come into existence. Receivables against oneself are not accountable, nor are liabilities to oneself. Accordingly, there is no balance sheet expansion under IFRS 9.

From a regulatory point of view, however, the picture is different. The first step is an increase in asset encumbrance by inclusion of qualifying assets in the cover pool and the simultaneous technical issuance of retained covered bonds: the cover assets are no longer part of a possible insolvency estate but are – as with all other covered bonds – bankruptcy remote. In a second step, a covered bond is created, which has no immediate financing function, but can still be used as a flexible means of refinancing. This creates a liquidity option that can be activated at any time. Through this process, the bank transforms illiquid assets (e.g. mortgage loans) into a standardised, high-quality security without changing the balance sheet total.

Retained covered bonds are embedded in several regulatory frameworks. Of particular relevance are liquidity regulation (LCR, NSFR), capital requirements (RWA), asset encumbrance,[1] and disclosure and reporting obligations. The decisive factor here is the distinction between the mere existence of a retained covered bond in the company's own portfolio and its actual use. The full regulatory impact materializes only upon their use, in particular in repo transactions with the European Central Bank or within the interbank market.

By and large, four forms of state can be identified: (i) retained covered bond in the issuer's banking book without particular use, (ii) utilization via central bank open market operations, (iii) interbank repo for cash and (iv) interbank collateral swap. For the sake of completeness, the possibility of selling a retained covered bond (either partially or fully) should be mentioned. Differentiation according to form of use is central, as it generates completely different regulatory effects. We will explain the respective modes of action in more detail in the following chapters.

[1] In the broadest sense, "asset encumbrance" refers to the recording of all encumbered assets that are no longer fully available to the institution in the event of insolvency, for example because they are pledgedor collateralize other transactions.

2 Structural mechanics and calculation example

The structural logic of a retained covered bond is closely linked to regulatory requirements. To demonstrate the economic effectiveness of retained covered bonds in practice, we begin a series of calculations in this paragraph, which we then continue in subsequent paragraphs. We examine the model case of a fixed cover pool and its associated retained covered bond.

Based on a cover pool of EUR 1bn and an overcollateralisation ratio of 10%, the maximum bond nominal volume issuable is around EUR 909mn.

In our example, the overcollateralization assumption consists of a combination of statutory, contractual, and "accidental" overcollateralization.

3 Use as a liquidity instrument

3.1 Unused liquidity option in the company's own portfolio

A retained covered bond is typically a legally recognised asset held in the issuer's banking book. As previously mentioned, this fact itself has no balance sheet or regulatory effect: own issues are generally not eligible for high-quality liquid assets (HQLA) and are therefore not considered in the liquidity buffer. Consequently, neither the HQLA stock increases nor short-term outflows are reduced. The underlying assets (e.g. mortgage loans or municipal loans) are often not HQLA-eligible anyway, so there is no indirect improvement or deterioration.

From a net stable funding ratio perspective, the mere presence of a retained covered bond in the investment portfolio has no impact. As there is no external financing, there is no 'Available Stable Funding' (ASF), only internal structuring. The underlying assets will retain their previous required stable funding (RSF) requirements. In this state, the retained covered bond has no regulatory effect.

3.2 Typical use: central bank refinancing

The most common association with retained covered bonds is probably their use as collateral for open market operations with the central bank. Self-issued covered bonds are eligible for use with the European central bank thanks to an exemption in Article 138 of the **Guideline** on the implementation of the Eurosystem's monetary policy framework. While Article 138 does stipulate that a counterparty may not submit or use an asset as collateral if it has been issued, owed or guaranteed by itself or any entity with which it has close ties, even if the asset is eligible, this does not apply to self-issued covered bonds. However, covered bonds are explicitly excluded from this regulation.

By delivering the covered bond, the commercial bank receives central bank liquidity net of a risk-adjusted haircut. The haircut, which is regulated in the **Guideline** on the Implementation of the Eurosystem's Monetary Policy Framework, depends primarily on the credit quality step (step 1 & 2 vs. step 3) of the paper. Furthermore, the remaining maturity of the covered bond tendered in the open market business is relevant before an additional haircut premium is applied to self-issued covered bonds. The valuation discount is 8% of the market value of the debt securities for credit ratings 1 and 2, and 12% for credit quality level 3.

For a covered bond with a high credit rating (CQS 1), a fixed interest rate, and a medium maturity period of three to five years, the base haircut is 2.5%. If the bond is used by the issuing bank itself, an additional own-use haircut of 8% is applied. In our example, where the nominal value is EUR 909mn and we assume the bond is structured so that it is quoted close to par, this reduces the mobilisable liquidity to around EUR 813.5mn.

Delivering the retained covered bond to the ECB fundamentally changes the regulatory situation: the cover assets and the retained covered bond itself are considered encumbered and can no longer be considered freely disposable assets. However, in return, the bank receives central bank liquidity, typically included in the HQLA portfolio as a Level 1 asset alongside cash and central bank deposits.

The regulatory effect thus consists of a transformation:

Non-HQLA-eligible asset → non-HQLA-eligible retained covered bond → HQLA Level 1 (cash)

However, it should be noted that short-term collateralised transactions in the LCR regime are partially neutralised by so-called 'unwind' mechanisms. This prevents institutions from artificially inflating their LCR through short-term transactions. Nevertheless, using the ECB is still the most efficient way to generate regulatory-eligible liquidity from retained covered bonds.

From the NSFR's perspective, the following occurs: If the bond is used by the ECB, short-term refinancing is created. However, this only contributes to a limited extent to the ASF, since short-term funds are given low weighting in the NSFR regime. At the same time, the encumbrance of the underlying assets can lead to a higher NSFR, especially if the peg is long-term. This often results in a small or even negative effect on the NSFR.

3.3 Private sector use: Interbank repo

As an alternative to the central bank, retained covered bonds can also be used in the interbank market. This is also based on a special rule for covered bonds in the CRR: commercial banks can generally recognise covered bonds issued by the counterparty themselves in the context of (reverse) repo transactions to reduce credit risk (**EU Regulation 575/2013 – CRR Article 207 (2) 2nd paragraph**). Another prerequisite for this is usually the application of a haircut logic – also similar to the ECB – which, however, arises from the internal risk models of the liquidity provider.

An interbank repo also leads to an inflow of cash, which can generally be counted as HQLA. In contrast to the ECB, however, there is a risk that the counterparty will lose economic interest in continuing the business and terminate the transaction. As a consequence, these types of transactions are also subject to the LCR-specific Unwind rules.

The effect on the LCR is therefore less clear. Although liquidity is created, regulatory adjustments in the numerator or denominator can weaken the improvement. In practice, the effect depends heavily on the specific structure and duration of the transaction.

From an NSFR perspective, the interbank repo shows a similar structure to that used by the ECB, but with additional market dependency, as counterparties in the interbank market are less reliable than the central bank.

3.4 Cooperative use: Collateral Transformation Trade by Exchange

Of course, the repo or lending model above works not only for the trading of bonds against cash, but also for the trading of bonds against bonds. This results in Bank A's retained covered bond being exchanged for Bank B's retained covered bond. If banks hold third-party covered bonds after such an exchange, the additional own-use haircut in the event of a second use by the central bank is omitted.

In the example shown, this increases mobilisable liquidity from around EUR 813.5mn to around EUR 886.3mn. The liquidity gain thus amounts to more than EUR 72mn. However, this effect creates the additional risk that the regulatory benefit depends on the continued existence of the underlying transaction (back-to-back repo): if one of the parties loses economic interest, the other party loses part of the regulatory advantage.

Exchanging retained covered bonds does not initially result in an inflow of liquidity. However, the LCR ratio of the parties involved improves when they exchange their own non-HQLA-eligible covered bond for a third-party covered bond with HQLA eligibility. Depositing the foreign paper with the central bank increases the HQLA effect even further.

In terms of the NSFR, a pure collateral swap generates neither liquidity nor funding. Accordingly, there is no ASF, although there can potentially be encumbrance effects. In terms of NSFR regulation, the effect is usually neutral to slightly negative. While the exchange improves the usability of collateral, it does not improve the stability of the refinancing structure.

3.5 Plain-vanilla use: Sale

For the sake of completeness and to illustrate the flexibility of retained covered bonds, we want to include the simple sale of a retained covered bond in our considerations. Issuers have the option to hold or lend retained covered bonds, or to sell them – in whole or in part – directly to investors at any time. At the other extreme, they can also remove them from stock entirely, causing the bond to cease to exist.

3.6 Rolling Refinancing via Main Refinancing Operation

The Main Refinancing Operations (MRO) of the European Central Bank are a key utilisation option. These one-week trades can be rolled an unlimited number of times under the current fixed-rate, full allotment regime.

In theory, this creates an unlimited refinancing period, provided sufficient collateral is available. Retained covered bonds therefore enable the establishment of a quasi-permanent liquidity line that can be activated regardless of market conditions.

The cost of liquidity generated by the central bank is equivalent to the monetary policy interest rate, which is currently around 2.15%. Liquidity of EUR 813.5mn for retained covered bonds mobilised in the example would result in annual financing costs of around EUR 17.5mn. If a collateral transformation were to occur – i.e. if the own-use surcharge were to be avoided – the EUR 886.3mn would generate financing costs of EUR 19mn.

The exchange mechanism increases the absolute amount of liquidity, and thus the absolute interest costs, too. However, the additional liquidity of around €72mn will only incur moderate additional costs. Therefore, it is not the level of interest rates that is decisive, but rather the ability to make liquidity available in the first place.

4 Essence: Retained Covered Bonds as a Swiss Army Knife

In summary, the particular strength of retained covered bonds is their versatility. They perform several functions in the banking process simultaneously. They can be transformed into central bank money at any time, acting as a liquidity reserve. They facilitate collateral transformation, converting illiquid loans into standardised collateral.

They also provide stable access to central bank funding and offer a high degree of flexibility in managing short-term liquidity needs. This combination of properties justifies their characterisation as a 'Swiss Army knife': an instrument that can be used in a wide variety of situations and fulfils several functions simultaneously.

5 Risks arising from extensive use

5.1 Asset Encumbrance

A major risk is the increasing encumbrance of assets. As soon as retained covered bonds are used, the assets contributed to the cover pool are generally no longer available to other creditors. Although the use of retained covered bonds increases financial flexibility and stabilises the respective issuer (in regulatory terms, the probability of default decreases), the default rate increases in the event of actual insolvency. Additionally, it should be noted that more than one 'unit recovery rate' is lost for each 'unit of stabilisation' due to the over-collateralisation requirement. We also fundamentally believe that stabilising the institution is more important than stabilising the Supervisory Authority. However, legislators, supervisory bodies and rating agencies may not share this view. Currently, there are only disclosure obligations regarding the encumbrance rate, and there are no hard limits that must be observed. Even rating agencies have not yet viewed the extensive use of retained covered bond programmes negatively. Nevertheless, the substantial and one-sided use of these programmes may attract the attention of supervisory bodies, with an uncertain outcome as is so often the case.

5.2 High dependence on the central bank

Using MRO transactions on a rolling basis can lead to a structural dependence on the central bank. Changes to the monetary policy regime — particularly moving away from the full allotment procedure — could significantly reduce refinancing capacity. Given the current geopolitical and economic situation, it is difficult to envisage a departure from this policy. Even if a fundamental decision were to be made in this direction, it would probably be phased out over a long period of time and after much consideration. Issuers that have become heavily dependent on the central bank through their retained covered bond issuance behaviour would probably have enough time to prepare their investors accordingly.

However, the latter should not be underestimated in the covered bond market, where many investors adopt a long-term perspective when making investment decisions. Small and medium-sized capital collectors in particular make a very conscious selection of which countries and names to invest in, depending on effort and return. In this case, effort means building an understanding of the issuer and their products, and having credit lines ready if necessary. Yield means having the opportunity to use this understanding and these lines. Issuers that can provide investors with investable material regularly are often favoured over more opportunistic ones. The investor work required to place securities on the market again after years of exclusive use of covered bonds in retained form could be quite lengthy and thus more costly than expected.

5.3 Interest rate risk

The exclusive use of covered bonds as retained instruments probably poses a more realistic danger in terms of interest rate risk than in terms of a change in the ECB's full allotment policy. When issuing covered bonds, issuers select the issue's duration depending on the desired maturity profile and the current market situation. The result is long-term fixed funding costs. In the case of retained covered bonds and their use in the money market (via the central bank or third-party banks), refinancing costs depend directly on the key interest rate. Therefore, interest rate hikes have a direct impact on the cost structure. This can lead to considerable burdens, especially in the case of permanent high utilisation.

5.4 Increasing Connectivity

The fact that something is permitted by regulation does not mean that it is risk-free. For example, using retained covered bonds as collateral in the interbank repo, or exchanging them with third-party banks, strengthens the networking between the participating institutions. Despite regulatory independence, additional counterparty risks arise, making the financial system more complex and potentially vulnerable, especially in the case of idiosyncratic risks. For example: In the event of systemic risks, both the securities involved would be affected by price reductions in an exchange transaction. The institutions involved would then offset their margin claims against each other, which would have little effect on the overall transaction. However, if only one of the institutions involved experiences difficulties, the transaction itself could collapse. The difficulties at the affected bank would thus be exacerbated.

6 Conclusion: Balanced use is crucial

As they raise capital from external investors, market-based covered bonds represent a real source of funding. They contribute to the diversification of financing structures and reduce dependence on monetary policy conditions. Retained covered bonds, on the other hand, offer maximum flexibility and immediate availability, but do not generate any real external financing. Their use is more dependent on regulatory and monetary policy conditions and regulations.

Retained covered bonds are undoubtedly a highly efficient and versatile instrument in modern bank liquidity management. They enable liquidity to be generated from existing assets in the short term, offering flexibility and an important stability function, especially in times of stress. Their "Swiss army knife" characteristics result from the combination of liquidity reserve, collateral transformation, and access to central bank refinancing. In the current

uncertain times, banks would be wise to take advantage of this flexibility by issuing retained covered bonds. In this respect, the sharp increase in retained transactions last year, particularly since the outbreak of war in Ukraine, is understandable.

However, the associated risks should not be underestimated. Overuse can lead to increased asset encumbrance, central bank dependency and systemic interconnectedness. Changes in regulatory frameworks and sudden idiosyncratic risks can create a "boomerang".

Therefore, balanced use is crucial in the long term. Retained covered bonds are a powerful instrument, but they can only deliver sustainable benefits in conjunction with a diversified refinancing strategy.

7 Appendix

This publication devoted a lot of space to the topic of refinancing existing assets via open market operations of central banks. Our focus was primarily on the policy of the ECB, which, as mentioned above, favours covered bonds in general and retained covered bonds in particular. Central banks in other economic areas, on the other hand, use their own regulations, which are sometimes more restrictive, with regard to covered bonds. The annual 'ECBC: European Covered Bond Factbook' contains detailed articles on this topic. Additionally, an updated table summarises the current policies of selected central banks in a standardised manner.

Central Bank	Operation	CB eligiblity	CB Type	Currency	Minimum Rating	Rating Treatment	Minimum Size	Retained
ECB	Main and and Long term refinancing operations)	Yes	EEA and non-EEA G10 countries	EUR, USD, GBP, JPY	BBB-	Best	No	Yes
Bank of England	Level B Collateral (ILTR, DWF, CTRF and FLS)	Yes	UK, French, German regulated Covered Bonds		Broadly equivalent to AAA	Rating references are indicative	GBP 500mn or equiv.	No
	Level C Collateral (ILTR, DWF, CTRF and FLS)	Yes	UK, US & EEA		Broadly equivalent to A-/A3		No	Yes
SNB	Repo operations, Standing Facilities	Yes	Technically any legislative covered bond, but not issued by a Swiss bank	CHF	Security and issuer's country: AA-/A	Second-best	CHF 100mn	No
			Technically any legislative covered bond	EUR, USD, GBP, DKK, SEK, NOK	Security: AA-/Aa3 with various exceptions Issuer's country: AA-/Aa3		EUR 1 bn USD 1 bn u.a.	
Norges Bank	Repo Operations	Yes	Technically any legislative covered bond	NOK, SEK, DKK, EUR, USD, GBP, JPY, AUD, NZD, CHF, CAD	Domestic currency: None but BBB- for favourable liquidity category (II not III)	Second best	Domestic currency: NOK 300 m	Yes
					Foreign Bonds: A/A2		EUR 100mn or euiv.	
Reserve Bank of Australia	Repo Operations	Yes	Technically any legislative covered bond	AUD	AAA or BBBfor domestic covered bonds >1Y	Lowest rating (of at least two ratings)	None	No
Reserve Bank of New Zealand	Overnight Repo Operations, Bond Lending Facilities	Yes	Technically any legislative covered bond	NZD	AAA from at least two rating agencies and no rating is below AA+		None	No
Bank of Canada	Standing Liquidity Facility	Yes	Canadian Covered Bonds	CAD and USD	AAA (sufficiently high quality)		None	No
Danmark Nationalbank	Credit facilities	Yes	Danish Covered Bonds	DKK, EUR	n/a		EUR 1bn or equivalent	n/a
Riksbank	Repo operations, Standing Facilities	Yes	EEA (based on the location of the underlying assets)	SEK USD, GBP, DKK, EUR, JPY, NOK	AA-	Lowest rating	SEK 100 mn or the equivalent	No
Singapore	MAS SGD Term Facility	Yes	Singapore Covered Bonds	SGD, G10 Countries currencies	BBB-	Lowest rating	SGD 50mn or equivalent	No

Sources: Helaba Research, ECBC Covered Bond Factbook, Central Banks



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