

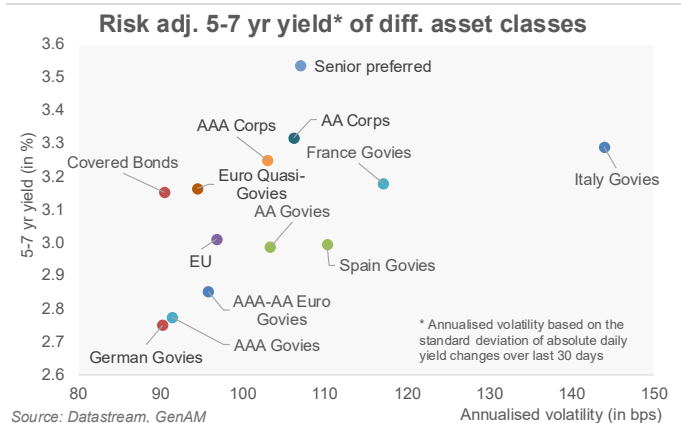
Core Matters

Covered Bonds: A safe haven in turbulent times

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Our Core Matters series provides thematic research on macro, investment, and insurance topics

- Covered bonds have once again proven their high quality during recent bouts of market turbulence. Even when geopolitical headlines disrupted risk sentiment, the segment remained comparatively resilient and continued to be viewed as a safe-haven product.
- Covered bonds stand out for their safe-asset features: they are exempt from EU's BRRD bail-in rules (unlike bail-in-eligible bank liabilities) and offer investors dual recourse, combining a direct claim on the issuer with a preferential claim on a dedicated, ring-fenced cover pool. This strong structural protection, reinforced by ongoing cover pool monitoring and disclosure, underpins the asset class's unrivalled track record, with no defaults recorded over more than 250 years.



- Euro-denominated IG issuance has already topped €150 bn year-to-date, but it has been absorbed smoothly. Even as the ECB gradually retreats, strong private demand for safety and liquidity is expected to continue to comfortably digest new supply. ESG covered bond issuance still represents only a small share of total supply, constrained by limited eligible assets and high reporting requirements.
- Our fair value model for covered bond spreads is driven by bank credit quality, housing dynamics, financial conditions, bond market factors, and fiscal variables. Conditional on geopolitical easing, the model suggests a moderate spread tightening, as lower volatility and stronger financial conditions could outweigh still-elevated yields, pointing to limited but positive compression potential.
- This is even more valid as the regulatory backdrop is turning incrementally more supportive. Recent policy and supervisory discussions point to a potentially more favourable prudential and collateral treatment environment for covered bonds, which – if carried through – would reinforce their structural appeal for core investor bases and provide a modest technical tailwind for the asset class.
- Overall, covered bonds offer an attractive proposition for investors with a lower risk appetite, combining relatively high yields with stable performance and strong credit quality.

| | |
|---|----------|
| 1. Covered bonds back in focus | 2 |
| 2. Covered bonds offer safety and low volatility | 3 |
| 3. Issuance reaccelerates on resilient demand | 4 |
| 4. Fundamentals support spread tightening | 5 |
| 5. Regulatory tailwinds for covered bonds | 7 |
| 6. Conclusion | 7 |

When safe assets are disappearing, covered bonds stand out – high quality and attractive yield level

1. Covered bonds back in focus

For many investors, finding assets that combine attractive yields with high credit quality and low volatility has become increasingly difficult. Bond market volatility has risen sharply in the wake of the Iran war, while the investable universe of highly rated issuers has continued to shrink. Elevated public debt levels, mounting refinancing needs, and weaker fiscal outlooks have led to a growing number of sovereign downgrades, limiting the availability of traditionally “safe” yield-bearing assets.

Against this backdrop, covered bonds have moved back into the spotlight. Although they represent one of the oldest segments of the euro area fixed income market, their structural characteristics make them particularly appealing to investors with a lower risk appetite. Covered bonds are bank-issued securities secured by a ring-fenced pool of high-quality assets and offer dual recourse to investors – first to the issuing institution and, in the event of default, to the dedicated cover pool – under well-established covered bond legislation. For the purposes of this paper, we use the universe defined by the [ICE BofA Euro Covered Bond Index](#). We focus on euro-denominated covered bonds as the product remains uncommon in markets such as the US and is not anchored in a single statutory framework comparable to Europe’s.

Despite their favourable risk characteristics, covered bonds are not a rapidly expanding asset class. Since 2000, total market value has increased only modestly, from approximately €795 bn to around €950 bn today. This growth lags far behind other fixed income segments: over the same period, the market value of the ICE BofA Euro Government Bond Index expanded from around €2.2 tr to more than €8 tr.

A defining feature of this universe is its exceptionally high rating quality: around 93% of outstanding bonds are rated AAA (up from less than 75% in 2020), with a further 6% rated AA. Issuance is dominated by euro area banks, with France accounting for over 30% of the market, followed by the Netherlands and Germany at roughly 15% each; Spain and Austria each represent close to 5%.

Covered bonds also stand out for their shorter duration, with an average maturity of around 4.3 years, well below that of high-rated quasi-government bonds (around 8 years) and AAA-rated corporate bonds (nearly 10 years). In spread terms, covered bonds currently trade at about 36 bps over Bunds, placing them between AAA

corporates (48 bps) and AAA/AA-rated quasi-government bonds (27 bps) – highlighting their balanced risk-return profile.

Covered Bonds: Size of the market

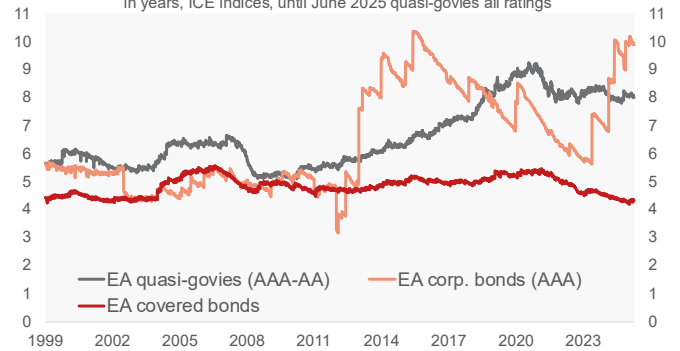
in bn EUR, EUR denominated, outstanding amount > EUR 100m, IG rating, fixed coupon, remaining maturity > 1 year



Source: Bloomberg, GenAM calculations

Bond Markets: Maturity high-rated bonds

in years, ICE indices, until June 2025 quasi-govies all ratings



Source: Datastream, GenAM

2. Covered bonds offer safety and low volatility

Covered bonds have repeatedly proven their high quality during episodes of market turbulence. Even when geopolitical shocks impaired risk sentiment and pushed volatility higher across fixed income assets, the segment remained comparatively resilient – consistent with its role as a safe-haven allocation.

The core reason is structural. Covered bonds are not bail-in instruments under the EU Bank Recovery and Resolution Directive. Bail-in is a resolution tool that allows authorities to write down or convert a failing bank’s liabilities so that creditors and shareholders absorb losses rather than taxpayers. Covered bonds are excluded from bail-in because they are secured liabilities backed by a protected cover pool – unlike senior preferred bank bonds. This legal treatment materially strengthens investor protection in a stress scenario.

Protection is further enhanced by dual recourse: investors have (1) a direct claim on the issuer and (2) a preferential claim on a ring-fenced cover pool. Even if the bank fails, bondholders remain protected by the cover pool – unlike holders of senior unsecured debt or securitisations, where investors depend primarily on collateral performance (for example, in the case of Hypo Alpe Adria, where unsecured creditors incurred losses and were ultimately not fully protected in the resolution).

Continuous structural safeguards reinforce this framework. The Asset Coverage Test (ACT), conducted by the trust manager or the issuer, ensures that the cover pool remains sufficiently large and valuable to meet obligations (an ongoing solvency test). The Amortisation Test focuses on post-default resilience, ensuring that cover-pool cash flows can safely amortise the bonds following a trigger event. Some programmes also incorporate soft-bullet features: if repayment is not possible at scheduled maturity, maturity extends automatically to a predefined date under transparent criteria, allowing repayment from asset-pool cash flows before a default is triggered.

This structural strength helps explain the asset class’s long-standing reputation – often illustrated by a 250+ year history with no defaults – and, crucially, its low realised volatility. E.g., in the 5-7 year segment, volatility-adjusted comparisons typically place

Built to withstand stress: covered bonds combine legal protection, proven resilience and exceptionally low volatility

covered bonds among the least volatile assets (often close to German government bonds), while offering higher yields than core government bonds and a more attractive yield/volatility trade-off than senior preferred and several quasi-government alternatives (see front-page chart).

3. Issuance reaccelerates on resilient demand

Covered bond issuance is expected to rise moderately in 2026, supported by gradually improving bank lending and exceptionally high redemption volumes. Focusing on fixed-coupon, euro-denominated, investment-grade covered bonds with an original maturity above one year, we expect gross issuance at around €320 bn, up from €230 bn in 2025 (partly reflecting the exceptionally large redemptions due in 2027). At the same time, redemptions in 2026 are projected to reach a record €275 bn (2025: €200 bn). As a result, net issuance is expected to amount to around €50 bn (up from € 30bn in 2025, but well below the 2023 level of more than €160 bn), while the ECB's net reduction of covered bond holdings via Quantitative Tightening is estimated at roughly €45 bn (slightly higher than in 2025), implying net-net supply of about €95 bn to be absorbed by the market.

Against this backdrop, issuance activity has been stronger than initially expected. Year to date, gross issuance has already exceeded €150 bn, despite very tight spread differentials between senior preferred and covered bonds at the turn of the year, which should have discouraged covered bond issuance at the margin. Issuance temporarily slowed during periods of heightened geopolitical uncertainty but has since recovered, with covered bond primary markets functioning well despite volatile conditions. Order books remain well covered: while bid-to-cover ratios have come down from the very elevated levels seen at the start of the year (with large issuers often achieving books of around 6x), demand remains solid, with books still around 3x and transactions frequently well through initial guidance, in some cases even flat to or inside secondary curves. From a maturity perspective, investor reluctance to extend duration persists. The share of long-dated issuance (10 years and above) has fallen below 10%, compared with close to 20% in earlier years, while the 5-10 year segment continues to dominate supply.

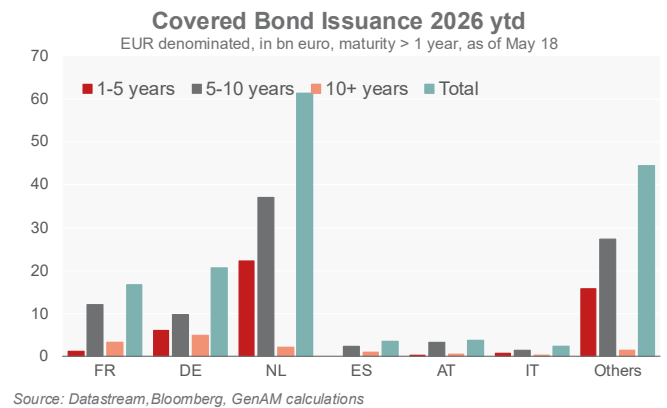
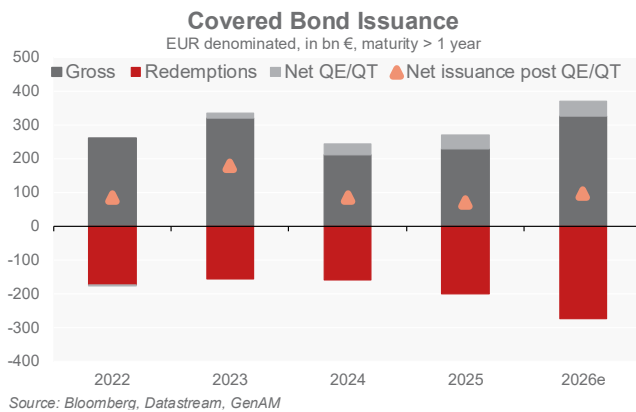
Issuance activity in 2026 is shaped by a broader funding trade-off. Banks can choose between covered bonds and senior unsecured instruments, with funding decisions influenced not only by relative pricing, but increasingly by regulatory requirements and balance sheet constraints. In particular, competition from senior unsecured issuance has intensified, as banks prioritise bail-in-eligible instruments to meet rising MREL/TLAC buffers and to strengthen their loss-absorbing capacity. At the same time, retained covered bonds continue to play a central role in liquidity and collateral optimisation. Amid declining excess liquidity, banks have increasingly used retained covered bonds since 2023 to build buffers of ECB-eligible collateral and to generate short-term funding via the repo market. These considerations, alongside [upcoming changes to ECB haircut frameworks](#), remain an important determinant of effective market supply.

We expect demand for covered bonds to remain sufficient to absorb the moderately higher net-net supply, even as central bank support has faded. Traditionally, banks are the most important structural buyers, while insurance companies and pension funds act as core long-term holders attracted by high credit quality. Asset managers primarily use

Strong supply meets resilient demand – covered bonds absorb higher issuance with ease and remain a safe-haven in volatile markets

covered bonds as low-beta investments and liquidity buffers. While the ECB is no longer a source of demand due to Quantitative Tightening, banks have emerged as the key stabilising force in 2026, complemented by renewed interest from insurers and pension funds amid higher yield levels and still reasonable valuations. In periods of geopolitical uncertainty, covered bonds continue to benefit from safe-haven flows.

ESG-labelled covered bonds remain a small but established segment of the euro-denominated market in 2026. Their share of total issuance has not increased materially and remains well below 10%, and even below 5% on a year-to-date basis, clearly lagging ESG penetration in other bank bond formats. While investor demand is generally supportive, supply-side constraints dominate, notably limited availability of eligible green assets in cover pools and higher reporting requirements. As a result, ESG covered bonds remain strategically important for issuer positioning, but they are not a volume driver of the market in 2026.



4. Fundamentals support spread tightening

In the following, we develop a fair value framework to assess the fundamental level of euro-denominated covered bond spreads. Despite structural differences across jurisdictions and issuers, spread dynamics are driven by a consistent set of underlying factors.

Our model identifies nine key drivers. First, bank credit quality – proxied by return on equity – is a core determinant, as stronger profitability enhances investor confidence in an issuer’s ability to meet its obligations. While covered bond investors benefit from dual recourse to both the issuer and the cover pool, issuer solvency remains a relevant pricing factor.

Housing market fundamentals also play a central role. Developments in euro area residential house prices directly affect the value of the underlying collateral, while construction activity captures both housing market momentum and broader real economy conditions. Notably, construction activity is more informative than broader indicators such as GDP or PMIs, as it directly reflects the housing and mortgage cycle.

In addition, broader financial conditions and market-based factors matter. The euro area financial conditions index serves as a proxy for overall market stress, with improving conditions pointing to easier credit availability and lower risk premia. Bond market

volatility captures changes in risk aversion and investors' willingness to allocate to spread products, while liquidity influences spreads via a liquidity premium: in periods of scarce liquidity, investors demand additional compensation for trading frictions and exit uncertainty. As a result, changes in liquidity often drive short-term spread movements independently of fundamentals. Rising government bond yields also tend to widen spreads, as they increase required returns, tighten financial conditions and reduce the relative attractiveness of spread products.

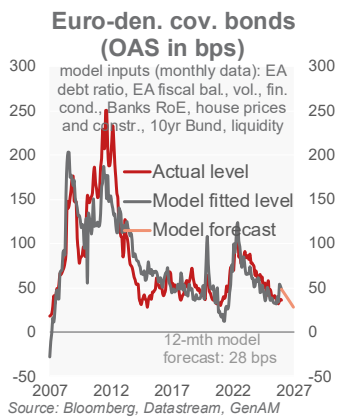
Finally, fiscal dynamics exert an important influence. Higher sovereign debt and fiscal deficits increase government bond supply, weaken sovereign credit quality and compress the convenience yield of government bonds, thereby supporting tighter covered bond spreads in relative terms.

The model exhibits a solid fit over the past 19 years (adjusted R^2 of 0.73), with all variables statistically significant and displaying the expected signs. At present, however, it implies a fair value spread of 48 bps compared to an observed level of 36 bps. This gap is primarily driven by the sharp rise in yields since the onset of the Iran war and, even more importantly, by the surge in bond market volatility, while liquidity effects have remained limited. The more moderate spread widening observed in the market points to strong underlying demand and underscores the increasing safe-haven characteristics of covered bonds in a more turbulent environment. Consistently, relative value analysis versus senior preferred bank debt and quasi-government bonds does not indicate any material mispricing, with spreads broadly in line with their 2026 averages across segments.

Looking ahead, and conditional on a gradual easing in geopolitical tensions, we see scope for further spread compression. Even if 10-year Bund yields remain above 3%, a decline in bond market volatility, an improvement in financial conditions and a continued increase in sovereign debt ratios should support tighter spreads. For example, a normalization in the euro area financial conditions index to its late-February level would imply around 5 bps of tightening, while each one percentage point increase in the euro area government debt ratio lowers fair value by more than 3 bps.

On a 12-month horizon, the model points to a fair value of around 28 bps. While such projections should be interpreted with caution, they nevertheless highlight that meaningful potential for further spread compression remains.

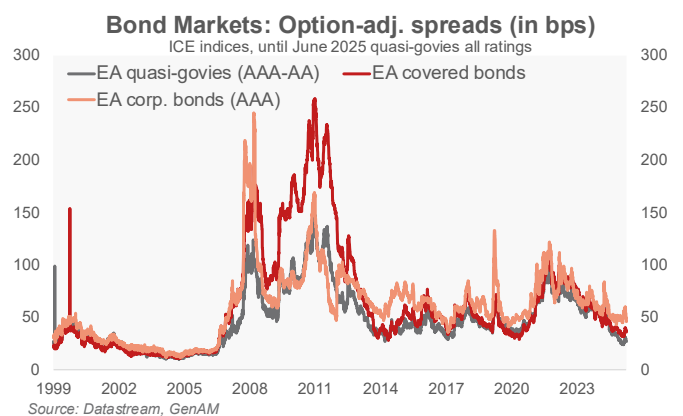
Valuations point to upside – fundamentals still allow for covered bond spread tightening once markets normalise



Regression (2007-2026)

| Parameter | Coefficients |
|--------------------|--------------|
| Intercept | 741.82 |
| 10-yr Bund | 15.04 |
| Banks RoE | -10.78 |
| Fin. conditions | -9.73 |
| House construction | -3.21 |
| House prices | -0.47 |
| EA debt ratio | -3.27 |
| EA fiscal balance | 1.39 |
| Bond volatility | 0.36 |
| Bond illiquidity | 0.06 |
| R-square | 0.73 |

Source: Datastream, Bloomberg, GenAM



5. Regulatory tailwinds for covered bonds

Beside the fundamental factors pointing to some spread tightening potential, we see upcoming regulatory changes as an additional supportive factor for covered bonds. The euro area covered bond market continues to benefit from a regulatory framework that not only recognises the asset class's structural robustness but is increasingly shaping a supportive backdrop for valuation and demand. The [European Banking Authority's review of the EU covered bond framework](#) confirms that the existing regime is broadly fit for purpose, while explicitly advocating further regulatory refinements aimed at strengthening harmonisation, improving legal clarity and expanding the market's reach. Importantly, this assessment reinforces the perception of covered bonds as a core low-risk funding and investment instrument within the euro area financial system.

Expectations around regulatory support for the covered bond market, however, have recently been recalibrated. Earlier proposals to reduce the standardised risk weight for high-quality European covered bonds (CQS1) from 10% to 5% were not retained in the ECON committee's May 2026 vote on the securitisation package. While this outcome removes the prospect of an immediate improvement in capital treatment, it stopped short of closing the door entirely. Importantly, the compromise text includes a formal review clause under which the European Commission will reassess the prudential treatment of covered bonds five years after entry into force, supported by an earlier EBA market impact assessment. This keeps the debate on more risk-sensitive capital treatment alive and underlines policymakers' continued recognition of the low-risk nature of the asset class.

At the same time, the discussion on a potential third-country equivalence regime adds another layer of longer-term support. By establishing clear criteria under which non-EU covered bond frameworks could be recognised as equivalent, such a regime would facilitate cross-border issuance and investment, thereby deepening market integration and enhancing liquidity. It would also allow EU issuers to access a broader international investor base, while giving global investors greater regulatory certainty when allocating to European programmes. In this context, equivalence would not only expand the market's reach but also reinforce the role of the EU framework as the global benchmark for covered bond regulation. Absent equivalence, the proposed risk-weight reduction would further differentiate EU covered bonds from non-EU issuance, reinforcing relative demand for euro area covered bonds.

Taken together, these regulatory developments point to a clear conclusion: rather than acting as a constraint, regulation is likely to represent a medium-term tailwind for covered bond performance. By underpinning demand, supporting relative valuations and enhancing the asset class's defensive characteristics, the evolving regulatory environment should help covered bonds remain resilient and well supported across market cycles.

6. Conclusion

In an environment marked by elevated macro uncertainty, persistent geopolitical risks and a shrinking pool of genuinely safe yield-bearing assets, covered bonds continue to stand out as a compelling fixed income allocation. Their combination of robust legal protection, exceptionally high credit quality and proven liquidity ensures that they

Regulation turns into a tailwind – strengthening demand, supporting valuations and reinforcing covered bonds' defensive appeal

remain a core safe-haven instrument for a broad range of investors. Repeated stress episodes have confirmed their low volatility and strong defensive characteristics, particularly relative to senior unsecured bank debt and several quasi-sovereign alternatives.

As set out in this Core Matter, covered bonds have recently demonstrated compelling safe-haven characteristics during periods of sustained market turbulence, showing notable resilience even as broader risk sentiment deteriorated. At the same time, they are not merely a defensive hold: fundamentally supportive supply-demand dynamics and a strong investor base continue to provide a favourable backdrop. Importantly, both valuation metrics and model-based fair value estimates suggest that current spreads are broadly aligned with fundamentals, while still leaving room for moderate spread tightening once market conditions improve and key drivers – such as volatility and financial conditions – evolve more favourably.

Taken together, covered bonds should remain a highly liquid and very safe fixed income asset class, with the prospect of modest spread compression adding to their appeal as financial markets gradually normalise.

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