



RECOMMENDATIONS ON THE HARMONISATION OF THE COVERED BOND FRAMEWORKS IN THE EU

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Mandate and previous work

Mandate

- **ESRB Recommendation on funding of credit institutions (Recommendation E, ESRB/2012/2):**
- ... *'by 30 June 2016, the EBA is requested to deliver a final report to the ESRB and to the Council containing an assessment of the functioning of the framework for covered bonds under the best practice principles and its view on recommended further action if deemed desirable.'*

• https://www.esrb.europa.eu/pub/pdf/recommendations/2012/ESRB_2012_2.en.pdf?8de3922e86b0f4863bc6e748f1f1a4c0

Previous work

- Follow up to the **EBA report on covered bonds (July 2014)**
 - Identified best practices in 8 areas to enhance robustness of the covered bond regulation across the EU

• <https://www.eba.europa.eu/-/eba-supports-capital-treatment-of-covered-bonds-but-calls-for-additional-eligibility-criteria>

ANALYSIS OF ALIGNMENT OF NATIONAL COVERED BOND FRAMEWORKS

Main conclusions of the analysis

- **Diversity of the national covered bond frameworks**
 - From legal, regulatory as well as supervisory perspective
- **High divergence in the level of alignment with the EBA best practices** across individual jurisdictions
- Best practices related to the **core features of the covered bonds** very well adhered to:
 - Dual recourse principle
 - Segregation of cover assets
 - Structural features of the bankruptcy remoteness
 - Coverage principle

Main conclusions of the analysis - cont.

- **A number of specific areas of the covered bond regulation with low level of adherence:**
 - Disclosure of data by issuers on the cover assets and covered bonds
 - Existence of liquidity buffers addressing liquidity risks in the covered bond programmes
 - Composition of the cover pool
 - Stress testing on calculation of the coverage requirement

- In addition, significant differences in the rules on **special public supervision of covered bonds** across jurisdictions:
 - Content and level of details of rules on special public supervision of covered bonds
 - Scope of duties and powers of supervisory authorities
 - Supervisory practices

ANALYSIS OF LATEST MARKET AND REGULATORY DEVELOPMENTS

Key trends observed in the past two years

- **Special/favourable treatment of covered bonds in EU financial regulation and ECB's monetary policy:**
 - Eurosystem's CBPP3
 - LCR Delegated Act: covered bonds as part of the LCR buffer
 - BRRD: exemption from bail-in
 - RTS on OTC derivatives not cleared by CCP: exemption from clearing obligations/posting margins

- **Developments in relation to rating agencies:**
 - Changes in methodologies for evaluation of covered bonds
 - Upgrades of ratings
 - New rating agencies in the market for ratings of covered bonds

- **Innovations in the covered bond structures:**
 - Move from traditional (hard bullet) amortisation structures to 'soft bullet' and 'conditional pass through (CPT)' structures

Key trends observed in the past two years – cont.

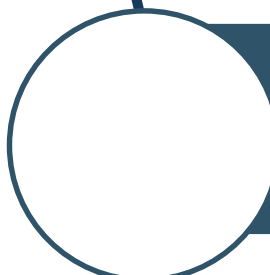
- **Dynamics in issuance and outstanding volume of covered bonds** (ref. date end 2015):
 - Trend of contraction of the market following the crisis slowing down, increasing issuance since 2013
- **Expansion of covered bond markets outside EU:**
 - Global product, first issuances in Asia in 2015
- **Changes in the composition of the investor base:**
 - Substantial expansion of the share of central banks
- **Continuing trend in the last decade as regards the composition of the cover pool:**
 - Increasing use of mortgages as cover pool collateral
 - Decreasing use of public sector loans and other asset classes
- **Enhanced transparency:**
 - Market initiatives (e.g. ECBC's HTT)

THREE-STEP APPROACH TO HARMONISATION OF COVERED BOND FRAMEWORKS IN THE EU

Principles behind the EBA recommendations on the harmonisation



Taking into account conclusions of the EBA analysis, confirming in particular existing diversity in the legal, regulatory and supervisory covered bonds frameworks across EU jurisdictions



Allowing to better protect the ‘covered bond brand’ by ensuring more consistency across definition and regulatory treatment of the covered bond products in the EU



Proposing a balanced solution towards harmonisation:

- Allowing to meet prudential objectives**
- Building on the strengths of existing national frameworks, keeping their specificities and leaving room for varying national implementation, where appropriate**

Three-step approach to harmonisation

STEP I:

- **Development of a covered bond framework:**
- Establishment of the base-line definition of the covered bond for EU financial regulation
- Replacement of covered bond-related provisions in UCITS Directive
- Focus on structural features, including soft bullet and CPT features
- Point of reference for prudential regulatory purposes (e.g. BRRD, LCR)
- Applicable across sectors
- Requirements in Step I obligatory for all covered bonds seeking regulatory recognition

STEP II:

- **Amendments to CRR, related to preferential risk weight treatment:**
- Enhanced conditions for preferential capital treatment
- Focus on credit risk related features
- Requirements in Step I as well as Step II obligatory for all covered bonds seeking preferential capital treatment

STEP III:

- **Voluntary convergence at national level:**
- Voluntary convergence at national level through non-binding instruments
- Specific areas with less material impact on the overall robustness of the covered bond frameworks

Overview of areas covered

Areas covered in the step I: Covered bond framework	Relation to the current regulatory treatment
<i>Dual recourse, segregation of cover assets and bankruptcy remoteness of the covered bonds</i>	
Dual recourse	Extension/amendment of the existing rule
Segregation of cover assets	New rule
Bankruptcy remoteness of the covered bond	New rule
<i>Requirements on coverage, liquidity risk mitigation and cover pool derivatives</i>	
Coverage requirements	Extension/amendment of the existing rule
Liquidity risk mitigation requirements	New rule
Requirements on cover pool derivatives	New rule
<i>System of special public supervision and administration</i>	
Cover pool monitor	New rule
Supervision of the covered bond issuer	New rule
Supervision in the event of issuer's insolvency/resolution	New rule
Administration of the covered bond programme post issuer's insolvency/resolution	New rule
<i>Transparency requirements</i>	
Scope, format and frequency of disclosure	Extension/amendment of the existing rule
<i>Requirements for soft bullet and CPT covered bonds</i>	New rule

Overview of areas covered

Areas covered in the step II: Amendments to CRR	Relation to the current regulatory treatment
<i>Conditions for preferential risk weight treatment</i>	
Requirements on the eligibility of cover assets	Extension/amendment of the existing rule
Requirements on the substitution assets	New rule
LTV limits	Extension/amendment of the existing rule
Minimum overcollateralisation	New rule

Overview of areas covered

Areas covered in the step III: Voluntary convergence at national level	Relation to the current regulatory treatment
Composition of the cover pools	New rule
Cover pool with underlying assets located in jurisdictions outside the EEA	New rule
LTV measurement and frequency of re-valuation	Extension/amendment of the existing rule
Stress testing by the covered bond issuer	New rule

Timeline

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Subject to approval by EBA
decision making body

Publication in December
2016 and submission to
the ESRB, the Council and
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