

EBA recommendations on harmonisation of the covered bond frameworks in the EU

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Final report

- **Published and submitted to EU institutions on 20 Dec 2016**
 - <https://www.eba.europa.eu/-/eba-recommends-a-harmonised-eu-wide-framework-for-covered-bonds>

Mandate

- **ESRB Recommendation on funding of credit institutions (Recommendation E, ESRB/2012/2)**
- EBA requested to assess functioning of the framework for covered bonds under the EBA 2014 best practice principles and provide views on recommended further action

Previous work

- Follow up to the **EBA report and best practices on covered bonds (July 2014)**

Content

Part 1

- Analysis of **developments in national covered bond frameworks** (alignment with 2014 best practices)

Part 2

- Analysis of the **market and regulatory developments at EU level**

Part 3

- **Detailed recommendations on harmonisation of the covered bond frameworks in the EU :**
 - ‘Three-step approach’


ANALYSIS OF DEVELOPMENTS IN NATIONAL COVERED BOND FRAMEWORKS

Analysis of national covered bond frameworks


- **High diversity** of the national covered bond frameworks
- **Limited changes** to national frameworks
- High level of adherence to the **core features of the covered bonds**
- Significant differences in the rules on **special public supervision of covered bonds** across jurisdictions
- **Areas with low level of adherence:**
 - Disclosure of data by issuers on the cover assets and covered bonds
 - Liquidity buffers for the covered bond programmes
 - Composition of the cover pool
 - Stress testing on calculation of the coverage requirement

ANALYSIS OF LATEST MARKET TRENDS AND EU REGULATORY DEVELOPMENTS

Key trends



- Expansion of covered bond markets outside EU




- Special/favourable treatment of CB in EU financial regulation and ECB's monetary policy




- Innovations in the covered bond structures



- Developments in relation to rating agencies

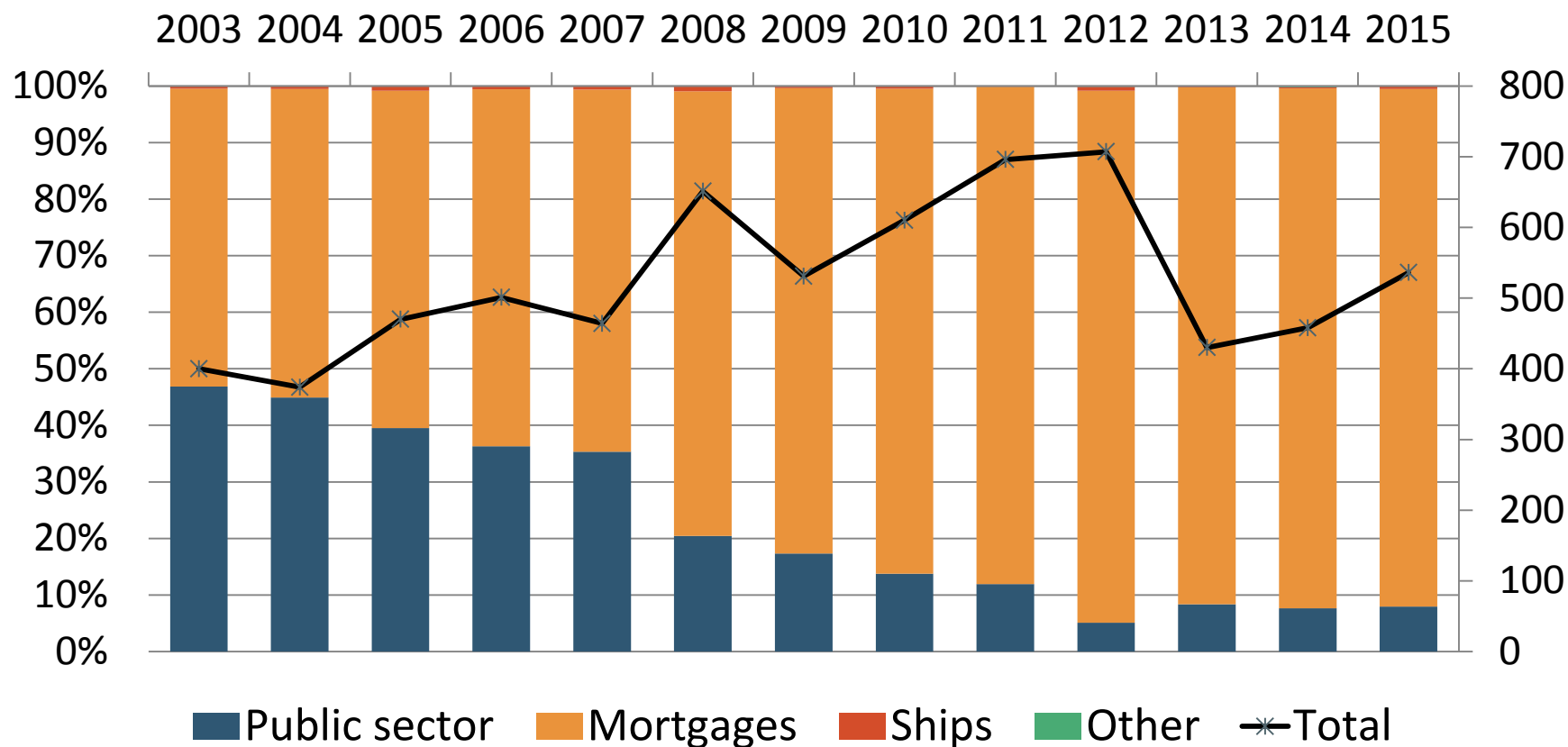


- Enhanced transparency



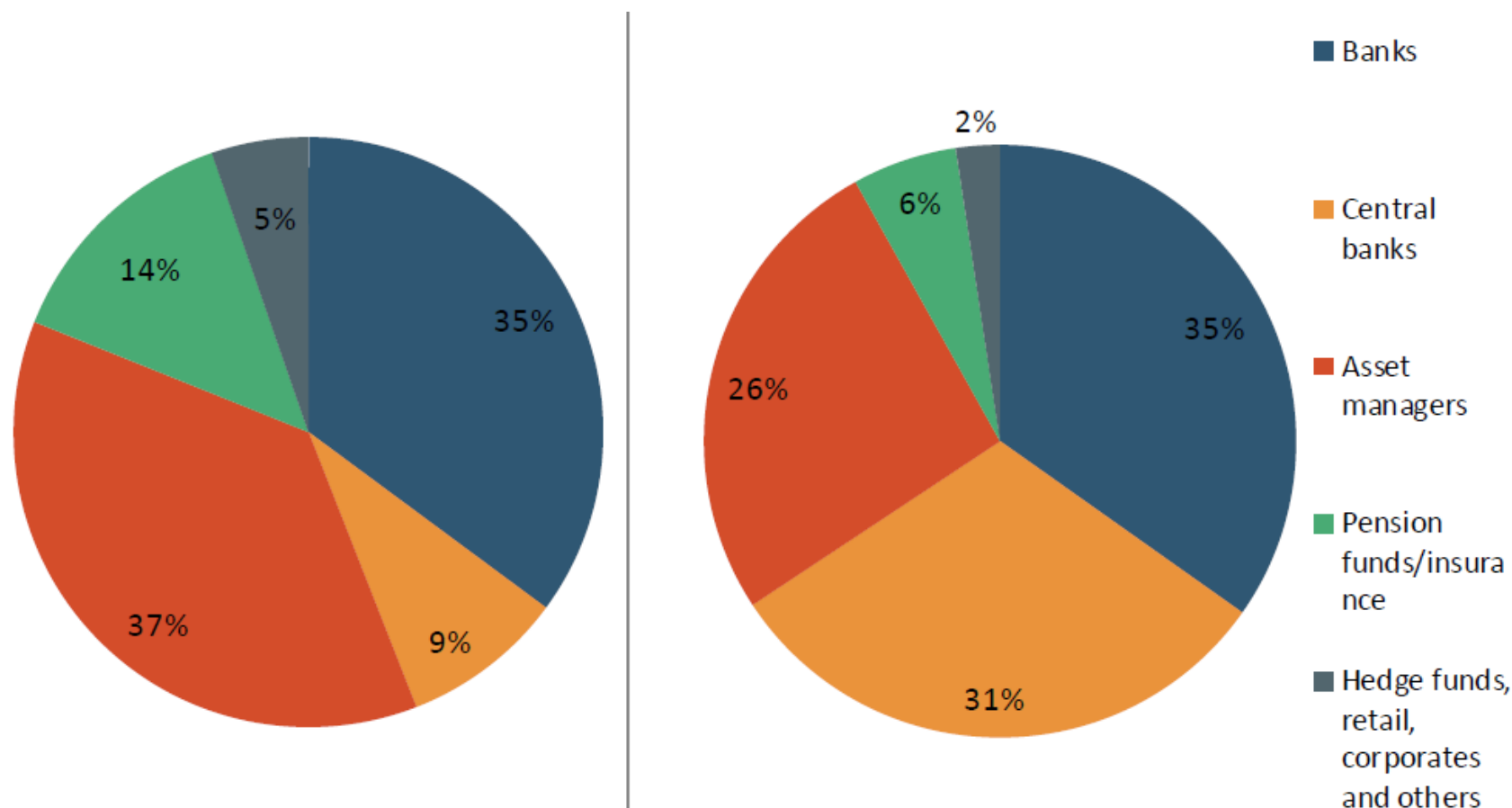
- Dynamics in issuance, composition of cover pool and investor base

Dynamics in issuance of covered bonds and composition of the cover pool



Source: EBA calculations, the ECBC


Changes in the composition of the investor base in euro benchmark covered bonds (in 2009 and 2015)



Source: EBA calculations, BALM

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

Principles behind the EBA recommendations on the harmonisation

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- Three large, downward-pointing chevrons are positioned on the left side of the slide. The top chevron is orange, the middle one is red, and the bottom one is green. Each chevron is partially enclosed by a rounded rectangular box of the same color, which contains a list of principles.
- **Taking account of conclusions of EBA analysis**
 - **i.a. covered bonds with different quality characteristics across the EU are subject to the same European regulatory rules and benefit from a privileged regulatory recognition**
 - **Better protection the 'covered bond brand'**
 - **More consistency across definition and regulatory treatment of the covered bond products in the EU**
 - **Building on the strengths and specificities of existing national frameworks**

Three-step approach to harmonisation

STEP I:

- **Covered bond framework (directive):**
- Definition of covered bond
- Replacement of UCITS provisions
- Focus on structural features
- Point of reference for prudential regulatory purposes (e.g. BRRD, LCR)
- Applicable across sectors

STEP II:

- **Amendments to CRR:**
- Enhanced conditions for preferential capital treatment of banks' investments in CBs
- Focus on credit risk related features

STEP III:

- **Voluntary convergence:**
- Non-binding instruments
- Specific areas

Step I: Covered bond directive

Structural requirements for covered bonds:	Relation to the existing rules:
Dual recourse	Amendment of the existing rule (UCITS, Art. 52(4))
Segregation of cover assets and bankruptcy remoteness: <ul style="list-style-type: none">▪ Operational plan for smooth transition to special administration phase	New rule
Coverage requirements: <ul style="list-style-type: none">• Scope of cover assets and covered liabilities	Amendment of the existing rule (UCITS, Art. 52(4))
Liquidity risk mitigation requirements: <ul style="list-style-type: none">• Liquidity buffer to cover net liquidity outflows of CB programme over next 180 days• Interactions with the LCR	New rule
Requirements on cover pool derivatives: <ul style="list-style-type: none">• Derivatives for risk hedging only	New rule

Structural requirements for covered bonds:	Relation to the existing rules:
System of special public supervision and administration: <ul style="list-style-type: none">• Cover pool monitor• Supervision of the covered bond issuer• Supervision post issuer's insolvency/resolution• Special administration of the covered bond programme post issuer's insolvency/resolution	New rule
Transparency requirements: <ul style="list-style-type: none">• Scope, format and frequency of disclosure	Amendment of the existing rule (CRR, Art. 129(7))
Additional requirements for soft bullet and CPT covered bonds: <ul style="list-style-type: none">• Triggers/conditions for maturity extension	New rule

Step II: Amendments to CRR

Conditions for preferential risk weight treatment:	Relation to the existing rules:
Requirements on the eligibility of cover assets: <ul style="list-style-type: none"> • Current scope not to be widened • Impact analysis proposed on eligibility of ship loans 	Amendment of the existing rule CRR, Art. 129(1))
Limits on the substitution assets: <ul style="list-style-type: none"> • Composition and quantitative limits 	New rule
LTV limits for mortgage cover pools: <ul style="list-style-type: none"> • Current CRR limits appropriate • Soft LTV limits 	Amendment of the existing rule (CRR, Art. 129(1))
Minimum effective overcollateralisation: of 5%	New rule

Step III: Voluntary convergence

Voluntary convergence at national level	Relation to the existing rules:
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	Amendment of the existing rule CRR – Art. 208 and Art. 229(1) via Art. 129(3))
Stress testing by the covered bond issuer on the calculation of the coverage requirement	New rule

THANK YOU FOR YOUR ATTENTION.



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