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COMMISSION STAFF WORKING DOCUMENT
EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

Proposal for a Directive of the European Parliament and the Council on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU

Proposal for a Regulation of the European Parliament and the Council on amending Regulation(EU) No 575/2013 as regards exposures in the form of covered bonds

{COM(2018) 94 final} - {COM(2018) 93 final} - {SWD(2018) 50 final}

Executive Summary Sheet
Impact assessment on a proposal for Initiative on an integrated covered bond framework
A. Need for action
Why? What is the problem being addressed?
Investment and job creation are key objectives of the EU. As part of the Capital Markets Union (CMU), the EU has launched several initiatives to unlock funding of Europe's growth and stimulate market financing. Covered bonds are an important source of cheap and long-term funding for banks. They facilitate the financing of mortgage loans and public sector loans, thereby supporting lending more broadly. However, covered bond markets are unevenly developed across the Single Market. They are very large in some Member States, less so in others. Whereas covered bonds benefit from a preferential prudential treatment in light of their lower risks, what constitutes a covered bond is only partially defined in EU law.
What is this initiative expected to achieve?
The initiative will firstly aim at leveraging the capacity of financial actors to invest in the wider economy by facilitating the use of covered bonds by credit institutions. It will seek to foster covered bond markets in Member States where they do not currently exist or are under-developed as a means to help financing the real economy in line with the objectives of the CMU. It will also seek to diversify the investor base (today most covered bonds are purchased by banks); further stimulate investments within the EU; and, attract more investors from third countries. Secondly, it will address prudential concerns deriving from the current lack of a sufficiently complete definition in EU law of the key features of what constitute a covered bond. An increased level of harmonisation of those features should ensure that the preferential treatment contained in several pieces of EU law is granted to covered bonds sharing a minimum amount of common key characteristics ensuring prudential soundness and a high level of investor protection. The initiative will also include targeted amendments to the requirements under which preferential capital treatment is granted to credit institutions investing in covered bonds under the Capital Requirement Regulation.
What is the value added of action at the EU level?
Concerning the CMU potential, the EU level is the most effective to address significant differences in national regulatory frameworks, diverging practices in the market and at regulatory level by Member States, fragmentation in the Single Market and lack of harmonization that hamper cross-border investments. Second, as regards prudential concerns, these stem from the fact that what constitutes a covered bond is not comprehensively addressed in EU law. EU action further defining what is a covered bond is necessary to ensure that the current preferential treatment granted by existing EU law is prudentially sound. Such action should nevertheless preserve well-functioning existing markets and limit itself to what is strictly necessary to produce a common definition of the key characteristics of a covered bond.

B. Solutions
What legislative and non-legislative policy options have been considered? Is there a preferred choice or not? Why?
The Commission has considered a number of policy options that achieve the above objectives to a different extent. The baseline scenario consists of the current status quo (i.e. no action). There are also a range of options that differ in terms of intensity of harmonisation, spanning from a non-regulatory option to options involving full harmonisation. More specifically: • Baseline: do nothing; • Option 1: Non-regulatory option; • Option 2: Minimum harmonisation based on national regimes; • Option 3: Full harmonisation replacing national regimes; or • Option 4: 29th regime operating in parallel to national regimes.

The preferred option is minimum harmonisation based on national regimes. Option 2 achieves most of the objectives of the initiative at reasonable costs. It furthermore appropriately balances the degree of flexibility necessary to accommodate Member States features with the uniformity that is necessary for achieving coherence at EU level. It is likely to be the most effective in achieving the objectives, while at the same time being efficient, minimising disruption and transition costs. Of the options considered, it is also, among the most ambitious options in regulatory terms, while at the same being the course of action that enjoys the highest support by stakeholders.
Who supports which option? Stakeholders mostly support Option 2. That includes institutional investors, supervisors, Member States and covered bonds industry representatives. The EBA (report 2016), the ECB, the European Parliament (July 2017 Report), national and European supervisors have advocated for initiatives of a largely similar nature and content. A majority of Member States also favour this option, including those representing all largest markets. The European Covered Bond Council representing the industry is also in favour of this option.
C. Impacts of the preferred option
What are the benefits of the preferred option? Implementing this option would stimulate the development of covered bond markets where they do not exist or are underdeveloped, increasing issuance between 50% and 75% of the benchmark of EUR342 billion. It would also lower costs of funding for issuers. At aggregate level funding cost savings of between 50% and 75% of the benchmark of EUR2.2-2.7 billion per year would be achieved. It would contribute to diversify investor base (60% of investors other than banks), to facilitate cross-border investments and to attract investors from third countries (16.5% of investments from third countries for additional EUR 80 billion per year from outside the EU). Overall it would help achieving savings in borrowing costs for the real economy of between 50% and 75% of the benchmark of EUR1.5-1.9 billion per year. This option would address prudential concerns, also in relation to market innovation, and achieve the prudential benefit of aligning the structural characteristics of the product with the preferential prudential treatment at EU level. Finally, it would also strengthen investor protection and reduce due diligence costs for investors.
What are the costs of the preferred option? The preferred option achieves most of the objectives of the initiative at reasonable costs by combining enough flexibility to accommodate Member States features with the objective of achieving coherence at EU level for covered bonds. The direct administrative costs both one-off and recurrent under the preferred option are expected to increase for issuers in low-cost jurisdictions. Costs would also increase for supervisors and in particular for light-touch jurisdictions which are expected to converge towards the benchmark represented by high-cost jurisdictions. On the contrary costs will not increase for investors. The credit enhancing features of rules foreseen would lower due diligence costs for investors.
How will businesses, SMEs and micro-enterprises be affected? The policy option chosen would have some direct and indirect positive effects on SMEs financing. However, the most significant benefit on SMEs would come from the initiative on European Secured Note (ESN) which, as explained at the forefront of this impact assessment, is a parallel separate initiative.
Will there be significant impacts on national budgets and administrations? No
Will there be other significant impacts? No
D. Follow up
When will the policy be reviewed? A first review of the new framework could be undertaken 2-3 years after its entry into force.